

Practical Considerations for Handling Shareholder and LLC Member Disputes

BY RANDALL M. PAULIKENS, CPA, WITHUMSMITH+BROWN

It's not uncommon for marriages to end these days. In fact, various studies suggest that nearly one out of every two marriages in New Jersey will end in divorce. Fortunately, this article is not about divorce – at least not about divorce in a family law setting. Instead, we will discuss corporate divorce, the basic economics of corporate divorce, as well as practical strategies about where to look for the typical abuses found in shareholder oppression suits. We will also review settlement ideas that reduce the acrimony that costs your clients much more in terms of lost opportunity. The suggestions indicated below will also help conserve your client's assets, which should make getting paid easier. And who doesn't like being paid promptly?

How the Fuse Gets Lit

Unfortunately, the story is all too familiar: Partners (the term is used generically for corporate shareholders, members of LLCs and true members of partnerships) who once started out on a journey together now find themselves at each other's throats. Various New Jersey business statutes and customs indicate that partners have a fiduciary responsibility to their other partners. This is true, but the fact that there is a disagreement suggests that the fiduciary duty has been violated, or there is the appearance that it has. While there are emotional aspects to any dispute, and recognition of these aspects is important, it is, after all, just business, not personal.

The typical scenario arises where one partner or group of partners takes advantage of or is perceived to take advantage of the other partner(s), either through un-agreed compensation and/or perks, un-agreed-upon work

effort, or misappropriation of assets or opportunities. The most successful partnerships have mechanisms to monitor and police the business relationship, the unsuccessful ones don't. A practice point for your clients is to periodically review these mechanisms with them to avoid ruinous fights later.

Start with Expenses

The first area that a forensic accountant should look at is the typical areas where personal and non-business expenses are paid, including travel and entertainment, automobile (is a car really necessary?), country club dues, advertising and others.

Next, examine if the salaries have been paid as agreed and, alternatively, if the owners' salaries have been paid at an arm's-length amount. By arm's length, we mean what would be paid to a non-owner, unrelated party for the same services. In the most basic case there should be no damage from a compensation perspective if salaries have been paid equally. However, from a valuation perspective, measuring the arm's-length value of the services may have a significant effect on the adjusted net income and thus the resulting valuation.

Have other expenses, such as rent paid to a related party, been properly accounted for and thus factored into the compensation and valuation metrics? Rent is merely one example, as any related-party expense can be troublesome.

In Everyone's Best Interest

When defending an alleged wrongdoer, don't make the mistake of believing and advising the client that hiding information makes sense. Hiding



information is rarely successful and actually creates more problems for the defense. Remember, it's not the crime but the cover-up that takes you down. It's better to negotiate settlement terms, such as discounts for certainty of result and collection. A settlement also saves the costs of trial, along with its inherent uncertainty, which can reduce, sometimes dramatically, the net outflow of funds and leave the parties less damaged in the long run. Furthermore, the business itself and the buyout of the outgoing partner will likely do better if the operating partners can focus on the business and not litigation.

As is in matrimonial matters where the costs of the divorce can ruin the economic health of a family, the potential damage from a corporate divorce can be just as traumatic. Professionals in the matrimonial field usually understand this; if business divorce professionals recognize this, then the dispute can be resolved with minimal damage to the entity and former partners. ❏

Randall M. Paulikens, CPA, ABV, CFF, CITP, is a partner at WithumSmith+Brown and the director of its Litigation/Lawfirm/Valuation Services Group. He is a member of the New Jersey Society of CPAs Litigation Support & Forensic Accounting, Matrimonial Accounting and Valuation Services interest groups. Contact Paulikens at 732-759-6822.

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