

DEADLOCK DOESN'T HAVE TO MEAN

GOOD-BYE

All too often individuals form a business with the highest hopes and then they see those hopes dashed. They may suffer the death of a "key man"; they may realize less-than-rosy income; they may mire themselves in disagreements about the firm's management; they may be betrayed by people in key positions. Whatever the cause the result is always the same: deadlock.

Since an all-too-common resolution of deadlock consists of a de facto bankruptcy filing, and since a bankruptcy filing consumes time and capital and resources, not to mention the personal and emotional tolls it takes, said individuals may wish there was another option.

There is. It's called a Receivership. It's a legal process and while not appropriate for each and every case, it often does provide deadlockees with at least some measure of relief.

The Problem: Deadlock Defined

Corporate deadlock means no single person or group of persons has legal control of the business. No clear-cut majority of ownership agrees on a single course of action. The business can't make a decision.

This often occurs in a two-person partnership whose ownership has been split down the middle. It also occurs when ownership factions become so polarized that no majority can agree on what to do next. The practical result is that, to the detriment of the firm, operational control remains unchanged. The firm lurches ahead, rudderless. Often those in control prevent those not in control from gaining access to information, compensation, or profits are held hostage.

Origins of Disputes (Continued)

Disputes also occur when a majority owner of a firm engages in activity that disadvantages or even defrauds the interests of a minority owner. Under California law, the owner of 33% or more of the voting stock of a corporation may petition the courts to force removal of a person in control or to force court-supervised dissolution and wind-up of the corporation. For partnerships, the withdrawal, death, self-dealing, or fraud of a partner will result in the dissolution of the partnership, unless the partnership agreement provides otherwise. Under these circumstances a partner may petition the courts to force the dissolution and wind-up of the partnership, also under the court's supervision.

What it Costs

What are the available options? The pre-litigation option is usually the liquidation of the assets, a costly and time-consuming process. Often the business subject to the dispute becomes valueless to the individual owners due to the high cost of litigation and/or the continued employment of people who perpetrate fraud or malfeasance in the first place. Additionally, in

circumstances of fraud or self-dealing by those in control, assets are dissipated and secreted away before the litigation ends.

The Solution: Receiverships Defined

There is another option, less obvious because it is less well known. Much of the costs, delays and risks caused by litigation due to deadlock might be avoided through a court-implemented Receivership. A Receiver is an independent individual who preserves the business' value for the benefit of parties affected by the conflict. The Receiver, as an independent and neutral third party, takes possession of all assets and assumes control of the business and its operations.

Depending on the situation, a Receiver may also use limited special powers to investigate fraud and mismanagement and then report these findings to the court. The Receiver may also undertake investigations to determine and recommend to the court fair allocations of the value of the business among its owners. A Receiver, under appropriate circumstances, can also obtain a stay (a halting) of creditors' actions until a resolution of the disputes is achieved. Finally, a Receiver investigates the business involved in the dispute. The Receiver will ordinarily meet with all of the ownership interests, collectively or individually or both, to discuss the claims and positions of each owner. Often this enables the deadlock to be resolved through a consensual process in much the same way as mediation.

Benefits of a Receivership

Receiverships can focus attention away from owner disagreements back to where it belongs, to the business' overall financial health, value and future. If resolution cannot be achieved, Receiverships provide a stable process by which the value of a business can be maximized while allowing for an ordered resolution of the claims ownership has against one another.

A Receivership may not prevent deadlock but it does present an option around it. Along the risk/return scale, what have you got to lose? Better yet, what do you have to gain?



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