

# What to Do When Talking Fails: Strategies for Minority Owners to Turn Stock Certificates into Money

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*Conflicts often arise over issues of liquidity and minority owners' power. This article explores minority owners' options after talking has failed to resolve that conflict. It discusses legal strategies that can facilitate reaching an agreement on those issues. It also addresses types of agreements between family shareholders designed to avoid this conflict.*

## The Problem

Many things can cause simmering problems between majority and minority to boil over. The majority owner gives the minority owner a lower paying job or lower expense account reimbursements. A minority owner who is not even employed by the business becomes frustrated because he or she is getting none of the benefits of ownership. Imagine the frustration of a 5% owner of a company worth \$10 million who cannot use that interest as collateral for a loan (because if the loan is defaulted, the banker could not turn the interest into cash), cannot sell the interest in the business, and gets no dividends or other advantages by owning the interest.

In family businesses that are owned in the second, third, or fourth generation by cousins or even second cousins, or the children or grandchildren of siblings, the problem can become even more acute. Sometimes the minority family gets nothing other than the chance to go to one family council meeting a year where the majority family tells them how well the company is doing.

In some situations, getting liquidity or the benefits of ownership is the least of the problems. In a business where the minority owns a relatively large percentage, say 40% or 45%, the

minority owners are often required by the bank to join the majority in personally guaranteeing loans. As if this situation were not bad enough, the minority owners may also have signed noncompete agreements that prevent them from leaving the employment of the company. Of course, the majority owners' management policies always have the possibility of threatening the existence of the company by taking out too much money, abusing expense accounts, or paying their family members far more than is appropriate. But when personal guarantees are involved, the minority owners are not merely faced with insufficient cash flow, but with personal financial ruin if the company collapses and they are required to pay off bank loans personally.

Certainly, this kind of behavior by the majority owner is never good for the business. In fact, it may not even be good for the majority owner. Treating the minority in this way is bad management which, in the long run, will lead to other difficult problems resulting from lack of trust among the owners.

## The Myths

When owners of a minority interest want to "get out," they are sometimes shocked to realize that

their expectations had been shaped by some very widely held myths. For example:

- An owner can always sell his or her interest for a “fair” price. In other words, a 10% ownership interest is “worth” 10% of the value of the business.
- The owner of a 10% interest is entitled to 10% of the business’ profits and other benefits.
- An owner is entitled to know all the details of what is going on in the business.
- The owner of a minority interest in a business is entitled to a voice in its operations.

Each of these notions is dangerously wrong in the sense that it creates false expectations, which often lead to disappointment, frustration, and anger.

## The Reality

The hard truth is, unfortunately, almost exactly the opposite:

The owner of a minority interest in a business is entitled only to those amounts the majority owners decide to pay. Some majority owners recognize moral obligations to share in a way that would be considered fair. But many others do not.

The owner of a minority interest is sometimes entitled to no more than a copy of the annual minutes. Sometimes, a minority owner gets financial statements summarizing the year’s results. But, because minority owners have no ability to do anything based on detailed financial information, judges often frown on revealing these details, especially when it could be used to the company’s disadvantage by a competitor.

Few people, if any, are interested in buying a minority interest in a non-publicly-traded company. Although rare, in some circumstances, a minority owner might not even be able to give it away to anyone except a family member. Typically, the *only* people interested in buying a minority interest are the majority owners.

- Although the owner of a minority interest is entitled to a voice, it is sometimes no more than a whisper. Often, the mi-

nority owner may say no, stomp their feet, and hold their breath until they turn blue, but the business will continue to be run as the majority owners choose. In some limited circumstances, the minority owner may have veto power over some unique transactions, but unless the business is planning one of these transactions (and unless the minority interest is large enough), this veto is of little value.

Understanding why this is true requires only an understanding of how corporations, partnerships, or limited liability companies are governed. These organizations are governed by a set of documents created when the organizations are created. For a corporation, they are the articles of incorporation and the by-laws; for a partnership, it is the partnership agreement; and in a limited liability company, it is the operating agreement.

Regardless of the name of these documents, decisions of a corporation, partnership, or limited liability company are normally made by application of a deceptively simple principle—the majority rules.

## The Majority Owners’ Power

The majority owners’ power means, among other things, that the majority owners can unilaterally decide the following:

*Who the business employs and what they pay them.* A 10% owner has no right to be employed by the business or to object to the employment of someone they do not like.

*What bonuses are given, who gets them, and how much they get.* A 10% owner, even if employed, might not get the same bonus, either in total dollars or percentage of salary, as the majority owners. A 10% owner has no right to get salaries or bonuses. If they are not employed by the business, they may often get nothing. If they are employed and unhappy about their income, they probably only have the power to quit.

*What employees get in terms of levels of expense reimbursements or other perks.* The majority owners may feel that a new BMW is appropriate each

year for the CEO or other officers. A 10% owner, even one who is employed by the business, has no right to have the company provide even bus fare to the annual meeting.

*Whether to declare any dividends or other distributions.* The majority owners can use up all of the company's money paying themselves a salary of hundreds of thousands of dollars, providing for a new car each year, and paying for first-class travel on business trips. A 10% owner has no right to receive 10% or 5% or any percentage of the company's "earnings."

***Selling a Minority Interest.*** As for selling a minority interest for a fair price, there is almost never an obligation on the part of anyone, even the majority owners, to buy the minority owner's interest. When you consider the few rights that minority owners have, it should not be surprising that the majority owners have little interest in buying out the minority owner. After all, majority owners, who usually are employed by the business, are often paying themselves the salary they want and are giving themselves the cars, vacations, offices, and travel that they want. Because they already have everything that the company can afford to give them, why should they invest money into buying more ownership interest when they don't need it?

In addition, although it is true that if the company is sold, the 10% owner is entitled to 10% of the proceeds, this applies only to the proceeds left over after the majority owners have received extra money that is often paid to the key employees of the business in exchange for their agreement to continue to consult with the new owners and not to compete with the new owners. Thus, in return for their promise to provide consultation or their promise not to compete in the future, the majority owners can get 10% or 20% of the entire "package" paid to them in a form that is not considered purchase price. If the majority owners take 20% off the top, the 10% minority owner will end up with only 8% of the proceeds (10% of 80%).

Finally, the reality of how the distributions are made in the event of a sale sometimes discourages the majority owners from distributing

cash to the minority owners. Rather, they choose to invest it into the business. Although this may appear as a virtue at first glance, it can be another way for the majority owners to abuse the minority owners. Majority owners get more leverage by having the business' excess cash reinvested and not distributed.

Assume that the 60% majority owners know that they would get 70% of the proceeds from the sale of the business (because of noncompete agreements, consulting agreements, and the like). If the business distributes money pro rata before a sale, the majority owners get 60% of it and the minority owners get 40%. If the majority owners make the company reinvest the money, the majority owners will eventually get 70% of it upon a sale and would also get 70% of any increase in the value of the business that is the result of this reinvestment. Even if the reinvestment is good for the business and sometimes for the minority owners, it will be even better for the majority owners.

### **The Problem: It's Not Family—It's Just Business**

This problem is sometimes misdiagnosed as being the result of the owners being family members. It is seen as a problem of family business. But, it occurs in many privately held businesses. In fact, it is even given a name. In the marketplace, this inability to sell the minority interest for its pro rata share of the business' value (that is, get 10% of the business' value for a 10% ownership interest) is referred to as the *minority discount*. It exists in virtually all companies.

The situation can more appropriately be viewed in simple economic terms. There is one very motivated seller and sometimes only one very unmotivated buyer. The buyer has no reason to buy, unless the seller is willing to sell at a deep discount. After all, the status quo is that the buyer (the majority owners) has everything they want. Why in the world should they buy the stock and use up cash they could otherwise spend on expanding the business, diversifying their portfolio, or buying a summer home?

Owning a larger portion of the business gives them almost nothing they don't have already.

## The Solutions

There are many ways to resolve this situation, provided that everyone is willing to be fair. But, like so many things, fair is a moving target that, in family business situations, is all too often clouded by family history and resentments.

In a situation involving the purchase of minority stock, fair is usually easiest to agree on if it is the result that would be appropriate if reached by strangers.

### ***When Talking Works—The Easy Solution.***

There are lots of ways to resolve this situation, but usually a solution first requires that the owners think of it as a disagreement only about money. The minority owners who want to be bought out need to recognize that to satisfy their desires, they will have to agree to a minority discount. The majority owners need to realize that they are going to have to invest some of their capital into purchasing the interest of the minority owners to avoid the potential damage that can be done to the business by owners who are trapped in an illiquid investment.

Agreements are often reached by open and honest discussions of both value and the minority owners' power to cause trouble. Often, the involvement of an objective and independent outsider can help. For instance, the minority and the majority owners can do the following:

- Each hire an investment banker or accountant to research the marketplace to determine the value of the business and the typical "minority discount" for that industry. Ideally, these professionals would then talk to each other and recommend an appropriate compromise.
- Hire a professional, trained mediator who will help facilitate a rational discussion. A good mediator never takes sides or decides who is right. Rather, he or she helps maintain a dialogue in which everyone stays rational and on task.
- Appoint a trusted neutral friend or adviser

who is empowered to make a decision that everyone agrees in advance to accept. But, *neutral* means that the person has no stake in the outcome. The company's accountants or lawyers are almost never neutral. They may not own stock, but they still have a stake in the outcome. One result means that they will go on in their role. Another result means that they will be replaced.

- Agree to binding arbitration. This means having someone else decide. It can be expensive because the presentation to the arbitrator is normally as long and as detailed as a trial.

### ***When Talking Fails—What Power Does a Powerless Person Have?***

Discussions often get bogged down in talking about what is fair, what is just, what is right, what happened years ago. No agreement about price is ever reached, and lots of resentments and painful memories can be stirred up. Sometimes these negotiations are so bitter that they make compromise less probable. The majority owners still have no reason to buy, unless they can purchase the minority interest at an unrealistically severe discount. The minority owners, on the other hand, feel angrier, both at the cash flow being provided by the business to the majority owners and their lack of a tactic for raising the price offered by the majority owners.

In these situations, the minority owners come to realize that the only question has become "What, if anything (other than lowering my requested purchase price), can I do to give the majority owners motivation to pay more money for my ownership interest?" The answer to this question becomes clear after coming to grips with what a minority owner would do if he or she and a cousin owned a goose that is laying golden eggs, but all the golden eggs are going to the minority owner's cousin. If the minority owner's cousin is not about to share any of the golden eggs with the minority owner, then the minority owner's only tactic (once asking, yelling, or begging has failed) is to threaten to kill the goose.

Many people might say that this is irratio-

nal, destructive, childish, or vindictive. They might also say that this is “destroying your family’s heritage” or “desecrating dad’s legacy.” On the other hand, someone might suggest that neither the family heritage nor dad’s legacy was that the majority shareholders keep all the benefits for themselves.

How does one go about doing this—threatening the existence of the goose unless the golden eggs are shared? And how does the minority owner go about killing the goose that’s laying the golden eggs for the majority owner? The answer is, unfortunately, rather clear when the question is posed in this manner—hire a lawyer who will file a lawsuit that threatens the existence of the business.

The first question, of course, is what kind of a lawsuit can do that? After all, no one, including the majority owners, have any obligation to purchase the stock of the minority owners.

## What Type of Lawsuit Can Be Filed?

Actually, there are several types of lawsuits that can be brought.

**Violation of Statutes.** Many states have statutes that provide remedies for minority shareholders who are being “abused.” (Similar situations are presented for partnerships or limited liability companies. Statutes applying to corporations are used only as examples.)

An example of these statutes might be helpful in understanding the power of the minority owners. A California statute provides for involuntary dissolution if those in control of the corporation have allowed “persistent and pervasive fraud, mismanagement or abuse of authority or persistent unfairness toward any shareholders or its property is being misapplied or wasted by its directors or officers” (Ca. Corp. Code §1800).

An Illinois statute provides that if a judge is persuaded that “[t]he corporation assets are being misapplied or wasted,” it can remove a director or officer, appoint a custodian to manage the business, require the purchase of the shares of the minority shareholder for their fair value, or

dissolve the company (805 ILCS 5.12.55).

Statutes such as these are common, but not universal. The laws of New York and Delaware do not give minority shareholders these rights.

**Breach of Fiduciary Duties.** A second type of lawsuit is one in which the minority shareholders claim that the directors, officers, managing partners, or majority owners have breached their fiduciary duty to the minority owners.

Each partner, officer, and director of a corporation, and often the majority owner, owes a fiduciary duty to the business and sometimes its owners. *Fiduciary duty* is a legal term describing the highest possible standard of honesty and care. A person’s fiduciary duty prohibits self-dealing between the fiduciary and the other party without full disclosure of all relevant facts and approval following a disinterested review.

**Derivative Actions.** Some of these claims may have to be brought as a derivative action. In other words, if the corporation is paying an excessive salary to its president, the corporation must be the party bringing the lawsuit given that it is the party being harmed. If the president also controls the company, a shareholder can sometimes bring a derivative action given that their ability to sue is derived from the company. But, even though these cases may not result in a payment to the minority owner, their virtue is in motivating the majority owner to pay more to buy the minority owner’s stock.

Examples of possible breaches of fiduciary duty would be self-dealing loans of excessive amounts with inadequate collateral or at lower than market rate interest; uses of corporate money for personal uses like purchases of art for the president’s home or payment for personal vacations; gaining personal profit from business opportunities that could have been exploited or enjoyed by the company; competing against the company; or use of company employees for personal uses, such as having the company provide for the president’s pool-cleaning service.

**Failure to Do One’s Job.** Under some circumstances, a lawsuit can be brought if the majority owners are also officers of the company and are not doing their job. A majority owner

who is president of the self-dealing company, takes five months of vacation, and spends much of the rest of the time in his office managing his personal portfolio is at risk.

**Family Preferences.** A lawsuit can be brought in cases where better jobs are given to the president's children or they are paid in excess of their skill or performance.

**Squeeze Out or Oppression.** A third type of lawsuit would be that the majority owners are trying to "squeeze out" or oppress the minority owners by abusive tactics to force the minority owners to sell their interest at below its fair value. These claims are rare—it's usually the minority that wants to sell. However, in those circumstances where the majority owners initiate discussions to buy out the minority owners and then change corporate policies to make minority ownership less attractive, a claim like this becomes more understandable.

**Deadlocks.** Most states have statutes that give a judge the power to dissolve a corporation in the event that the shareholders are so deadlocked that they cannot elect directors or the directors are so deadlocked that they cannot appropriately run the business. However, deadlocks do not occur as often as one might think. Usually, they require that the ownership be divided 50/50 or that one faction of the ownership simply refuses to make a decision. For example, ownership could be divided 40/40/20, with the 20% owner simply refusing to decide.

## Other Issues

**Will It Be Too Expensive?** A lawsuit like any of the above is expensive. Lawyers will charge large hourly rates and get large fees. The majority owners may hire blue ribbon lawyers who can cost the business hundreds of thousands of dollars.

But, the issue is not what the lawyers will get. The issue is what the minority owners are willing to invest to raise the price being offered for their minority interest. One thing is certain—talk has failed. If minority owners do nothing, they will get nothing. The rational question is,

"Will the investment of \$5,000 or \$50,000 or even \$500,000 in legal fees increase the price being offered by 10%, 20%, 50% or more?"

Certainly, the legal fees spent by the business ought not bother the minority owners. This money was not going to them anyway. It may be going to the company to finance its growth. It may be going to the majority owners to pay for fancy cars and large salaries. But, it is surely not going to the minority owners. The fact that the business hires a big firm with the high rates may actually be in the minority owners' interest. The legal fees simply reduce the size of the golden eggs that only the majority owners are getting.

**What Is There to Win?** "But," you might say, "these laws talk about dissolving the company. My goal is to have my interest bought, not to have the company dissolved. You told me I have no right to make them buy my interest. How does the dissolution of the company or disqualification of the majority owners as officers help get a minority owner a higher price?"

First of all, *dissolution* does not mean dissolution. It means that the company would be sold. This is not as Draconian as it may seem. After all, if the company is sold, the majority owners would be the most likely buyer. No one else knows the business as well as the majority owners, no one has as much information, and no one wants it as badly. Dissolution means that the majority owners would be forced to find financing or a new partner (who, presumably, negotiates financial restraints in advance). Because they are buying the company, they can hardly pay themselves for consulting or not competing. Unlike a sale to a third party, if the minority owner should win in a sale to their relatives, they would get their pro rata portion of the proceeds.

Second, disqualification of the majority owners as officers means that they lose their jobs and their jobs are many of the golden eggs the goose has been laying. Even if this is only a slight risk, it is a risk most majority owners will not take.

**Shouldn't I Find Out the Chances of Winning?** "But," someone might say, "I have consulted with a lawyer about this, and the lawyer said I can't force anyone to buy my stock and I

have very little chance of winning a case for dissolution, disqualification, squeeze out, or breach of fiduciary duty. Shouldn't I take the lawyer's advice and just wait longer?"

Maybe. Many lawyers will tell you they are not optimistic about winning. After all, the words of these statutes can be ambiguous, and lawyers' research will show that few minority owners have "won" cases like this. But, more importantly, if asked, they will admit they are likewise not sure of losing.

The good news about all this uncertainty is that eventually the majority owners will be told by their lawyers the same thing—they, too, are not sure of winning. The lack of precise meaning is exactly what will create, in the minds of the majority owners, ambiguity about the business' future and anxiety about the consequences of your claim.

A pessimistic prediction from the minority owners' lawyer is not surprising. But that does not mean the alternative (doing nothing or merely continuing to nag) is more promising than bringing a lawsuit. First of all, minority owners sometimes find out after they get involved in the situation that their chances of "winning" are greater than they thought.

Once they show their resolve by filing a suit, the majority owners may become more reasonable for a number of reasons.

First, they may want to avoid the possibility of permanent family fractures, tarnishing the family's reputation, or the exposure of family business finances that inevitably occurs during a lawsuit.

Second, judges, in general, will often take an aggressive role in trying to resolve family disputes. Judges have a great deal of leverage in encouraging compromise. They often use this leverage in very obvious ways to help effect a compromise in disputes involving a family business. It is not uncommon for judges to figure out what the marketplace might deem as "fair" and then pressure both sides to compromise at near that point.

Third, oftentimes, the greed of majority owners who are not willing to be fair is mani-

fested in other ways. For example, the salaries they pay themselves or their children may be abusive in terms of industry standards when compared to the profitability of the company.

Fourth, the expense account reimbursements of the majority owners may be typical of what their friends get from other privately held companies, but will seem abusive to a judge or jury who probably is driving a less fancy car, doesn't fly first class, and doesn't have vacations paid for by the company.

Fifth, sometimes you will find that the majority owners' children are being paid without regard to the quality of the work they are doing.

Finally, a "smoking gun" can sometimes be found in the e-mails of the majority owners or in their private communications with the company's lawyers or accountants, where they seek advice regarding how to "take advantage" of the minority owners. In some situations such as this, the communications to the lawyers or accountants can be disclosed to an unhappy shareholder.

***It's Like Horseshoes: You Don't Need to Win, You Only Need to Come Close.*** But, in a bigger sense, you don't need to win. Winning does not require that a verdict be entered for you in a lawsuit. Winning only requires getting a higher price for your ownership interest. In these situations, you don't need to win a lawsuit, you just have to create enough anxiety, uncertainty, fear, or ambiguity in the minds of majority shareholders so that they pay a higher price to buy you out than they would have otherwise. They will pay you more money to avoid the risk (even if it's a small one) of incurring a devastating loss at a trial.

In addition, the majority owners will find out that while the lawsuit (and appeal, if you do lose) is pending, operation of the business is under a cloud that may prevent them from doing what they want. Their bank will look at their behavior more suspiciously. It may restrict the amount of money that is available to them or require them to pledge more collateral for loans. It may refuse to renew a loan until the matter is resolved. Transactions like acquisitions that may be vital to the business will be put on hold. The ability to raise new capital is diminished or destroyed

until the lawsuit is resolved.

And, most certainly, all expenditures are potential evidence that the judge will review. The majority owners may feel compelled to limit their use of the business' money to fund their and their family's travel, vacations, expense reimbursements, bonuses, and even salaries.

Once majority owners come to grips with the situation they are in, they realize that they have many reasons to pay you a higher price than they have been offering. In some respects, they are in a no-win situation. Losing at a trial (even if they have only a 20% or 30% chance of losing) is a disaster, whereas winning simply puts them back to where they were before. They have nothing to gain and almost everything to lose. The minority owners, on the other hand, have almost nothing to lose (just their attorneys' fees), while having a great deal to gain. Eventually, the majority owners realize that they are on the wrong side of the risk-benefit analysis and find that purchasing the minority interest for a higher price than previously offered is a rational way out of their dilemma.

***Choosing the Right Lawyer:*** If the talking does eventually fail, the majority owners and the minority owners are usually even angrier with each other than they were when the talking started. This anger, if left uncontrolled, leads to two situations that make a bad problem even worse.

The first is choosing a lawyer who promises to give them the emotional satisfaction of getting revenge by behaving with an equal amount of anger. In other words, instead of choosing a lawyer who will devise a cold-hearted strategy for getting the best price, they choose a lawyer who tells them how horribly they have been wronged and promises to be a vicious Ninja street fighter to help them punish and get even with the people who so abused them.

This is almost always a mistake. Remember, winning is not the issue. The goal is to make the majority owners realize that the risk of a trial is too great a risk to take to avoid paying a higher price for the stock. It does not help the majority owners to reach this realization if the lawyer be-

haves in a vindictive and hostile manner. No one likes to compromise or make deals with people they dislike. There is no reason why the lawyer needs to be dislikeable. As a law school graduation speaker once said, "We need not one more lawyer who cannot disagree without being disagreeable... Peacekeeping is not surrender. On the contrary, it takes a special skill ... to see that the best true interest of your client lies outside the courtroom....Indeed, peace itself requires advocacy."

The second situation occurs when the minority owners (or even the majority owners) forget that it's not about family, it's about business. Ultimately, it is the owners themselves, not the lawyers, who decide to compromise and resolve the dispute. Anger and the desire for revenge warps their ability to be rational and understand when they have won the best price. The issue to the minority owners is how much money they can get without incurring inappropriate risk. The issue is not and should never be how much pain can be inflicted on the majority owners.

## **Can These Situations Be Avoided?**

Can this all be avoided before the dispute over price occurs? Of course. Many types of agreements can appropriately limit the power or benefits of the majority.

An agreement between the owners can be entered into early in the business' development, before there are so many owners that the negotiations are endless. Or, agreements between owners can be entered into late in the business' development as long as lawyers, accountants, and other consultants who see that everyone makes the accommodation that is appropriate to the reality of the other owners' power advise the parties.

The majority owners are entitled to impose a minority discount. It's not an issue of family. It's simply an issue of economics that is present in all businesses.

On the other hand, the minority owners also have the ability to cause a great deal of trouble to an abusive majority and should be given an exit

strategy if they want or need liquidity. And the majority owners should commit to behave in a way that earns the trust of the minority owners.

Creating a well-written and well-reasoned agreement such as this is time consuming, expensive, and requires patience by all parties concerned. It is not a do-it-yourself project that can be written on the back of an envelope by two siblings who may have the utmost of trust in each other. It will have serious legal and tax consequences and should be accompanied with the appropriate commitment to get it right.

Although it is not possible to provide a comprehensive list of all of the types of provisions or arrangements that are made or can be made, the following are examples of issues that should be considered.

**Requirements for distribution of cash.** Some businesses have solved the issue of minority owner liquidity by requiring that majority owners' salaries and benefits be limited so that some cash be distributed to the minority owners. Another common arrangement is to require cash to be paid to the minority owners in proportion to the bonuses or other compensation to the majority owners or employees of the business.

**Details for shareholders.** Sometimes regular meetings in which detailed information is shared can alleviate the frustration of minority owners. In this way, the minority owners can be reassured that the business is being run in a rational and sensible way.

**Limitations on consulting and noncompete arrangements if the business is sold.** As discussed, the majority owners' ability to receive large consulting or noncompete payments changes their motivations with regard to reinvestment and sale. Limiting such payments or agreeing that they will be shared among the owners pro rata is often helpful to generate an atmosphere of fairness.

**"Drag along" and "tag along" rights.** Under the worst of circumstances, majority shareholders could reject a sale on exceedingly favorable terms because it would mean that the majority owners would lose their jobs. Similarly, the majority owners could arrange for a sale and

exclude the minority owners unless the minority owners agree to an unrealistic and unfairly low price. To avoid this, the shareholders could agree that the minority could "drag along" the unwilling majority in the event of a sale (or require the majority to buy out the minority at an equal or higher price) and the minority would have the right to "tag along" on any sale that the majority consummates.

**Opportunities to be bought out at a price set by a predetermined formula.** Owners of privately held businesses sometimes can agree that the business' value is related to the value of a publicly traded competitor. In other words, some privately held companies conclude that if the stock market values a publicly traded competitor at 15 times earnings, that is the value of the privately held company. After this value is fixed and a minority discount agreed (both of these agreements are easier to reach if imposed by a parent prior to stock being distributed or in advance of there being a dispute), the business could be obligated by a contract to have a certain percentage of its annual earnings available to buy back stock of minority owners who would rather invest their money elsewhere.

**Arrangements for orderly management of the business in the event of a majority owner's death.** Succession planning is important for all businesses at all times. It is in everyone's best interest that there be an arrangement for the orderly transfer of power to a qualified successor in the event of the unanticipated death or disability of the majority owner.

**Require an independent board of advisers or directors.** One of the many virtues of an independent board of directors or advisers is that its presence often helps the minority owners avoid being oppressed and helps resolve the situation if it occurs. Usually, by focusing only on the health of the business, and not on any owners' short-term desire for wealth, an independent board helps all the owners reach solutions that are good for both the business and the owners.

**Know the minority rights before the ownership entity is created.** There are, of course, exceptions to the governance policy of majority

rules. To put it in terms more familiar to some people, different types of entities and different states have different bills of rights with regard to the protections for minority owners. These differences are so important that they should govern the choice of which type of legal entity is used to own the business and in which state it is created. For instance, under certain circumstances, a 10% partner could have dramatically more rights than the owner of 10% of the stock of a corporation. Some states give majority owners far more power than other states. That is one reason so many large companies are Delaware corporations. Sadly, the importance of the choice of entity is usually realized too late—after a dispute has arisen.

## **Conclusion**

Lawsuits are never fun. They are never as exciting as portrayed in the movies or on television. They almost never result in clear-cut winners or losers. Lawsuits always place an emotional strain on the participants. Nevertheless, lawsuits are sometimes the only way to solve a problem or resolve a dispute. But, it should always be remembered that lawsuits are not wars. They are not about extracting revenge. Rather, they are a way of using a dispute resolution mechanism paid for by the government (the courts) in which a third party (a judge) makes a decision in an otherwise irreconcilable dispute. If engaging in a lawsuit, the best advice is always to remember that it's not about love, respect, or revenge. On the contrary, it's just about money

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