Mediation and the Business Divorce

Resolving Disputes When the Business Relationship Ends

By Barry Y. Weiner

Divorces among principals in a business frequently occur due to retirement, sickness, death, internal disputes, and financial successes or reversals. Business divorces can be very disruptive, difficult, messy, expensive, and fraught with risk, particularly for an ongoing business operation. Ideally, the parties can control the circumstances and result of a business divorce by entering into a partnership or shareholder agreement at the outset of the business relationship. However, in the absence of such an agreement, parties typically face unpleasant options if hostilities arise, such as suing each other or a forced dissolution and liquidation. With each of these options, third parties or circumstances, rather than the business principals, will dictate the result.

To minimize these undesirable options, warring parties to a business divorce who do not have preexisting agreements dictating how the business separation shall be handled should seriously consider mediating their dispute. Confidential and informal, mediation permits the warring parties to take a step back from confrontation and explore a resolution of the dispute with a neutral entity. Three factors, however, can profoundly affect the quality of the mediation and the result: timing, mediator selection, and preparation. These factors are of particular importance in a business divorce where emotions may be running deep and wide.

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While a mediation and resolution early in the dispute may result in cost savings, limit one's exposure, and bring finality, those considerations may be outweighed by others. For instance, the parties may not have sufficient information to make decisions on settlement, in which event a voluntary exchange of such information or discovery in court/arbitral proceedings may first be required. Similarly, if the parties emotionally or psychologically require some "blood letting" or reflective time to contemplate the situation and their settlement position, the timing may not be right. In those cases, while counsel might consider raising the prospect of mediation with clients and perhaps opposing counsel, the better decision may be to revisit the idea at a later date. In a business divorce with an ongoing operation at risk, however, time may not be on anyone's side.

While the timing may be right for the mediation to proceed, if the mediator is not right, the mediation may well be a waste of time. Accordingly, counsel should take the time to carefully review the background, experience, reputation, and availability of potential mediators. Specifically parties should look at the following when selecting a mediator:

- The mediator's training and experience with the process.
- The mediator's experience in business disputes of the type and nature involved in the particular case.
- A mediator who will not only facilitate discussion among the parties but will evaluate claims as well.
- Someone with a background as a trial lawyer. While not an absolute precondition, this is helpful in fully appreciating the trial process and the chances of success.
- A mediator who is willing to adapt the process to the circumstances, parties, and counsel.
- Availability on the dates selected for the session with the parties, as well as before, during, and after the mediation. The mediator must be able to give you his or her undivided attention for the time the case requires.

In other words, don't shortcut your due diligence in selecting the right mediator. Carefully think through how the candidate matches up with the issues and the parties involved, and don't be afraid to ask questions and seek commitments. If, however, the candidate is unavailable to respond to your questions, move on to someone else. If he or she is that busy, the odds are that your case will not be given the kind of attention it warrants.

In order to maximize the opportunities presented by a mediation, the mediator should, prior to the mediation session, speak with counsel, collectively and individually, to fully appreciate the factual, legal, and practical issues that separate the parties. These pre-mediative sessions can go a long way in identifying the parties' common interests in a resolution, and substantially improve the mediator's preparation for the upcoming sessions with the parties. Parties should

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also confirm that the mediator will follow up after the mediation, as persistence is an important characteristic.

With the decision to mediate having been made, a mediator selected, and presession contact with counsel completed, the mediation sessions with the parties can begin. After an initial get-together consisting of the mediator's greetings, summary of the process, and whatever openings have been agreed to, separate break-out sessions with the mediator are in order.

Following an appropriate period for venting, the mediator in these separate meetings should explore with each party what that party believes is a fair basis for the split-up. The mediator should be prepared to explore options with the parties. In a business separation, options include (1) an internal sale by one principal to the remaining principal in the company; (2) a sale of one's business interest in the company to a third party; (3) a sale of the entire business to a third party; or (4) a planned dissolution and liquidation of the business.

Ultimately, the mediator needs to identify a commonality of interest among the parties and to develop a shared basis on which the business divorce might realistically be concluded. If expert assistance is required (e.g., market value, accounting, and tax matters), the parties should come to the mediation with that information. Beyond the mediator leading and facilitating the discussion, the active participation of the parties and their counsel is a critical component if an agreement is to be reached. A prepared and skilled mediator alone is not sufficient.

In the development of these discussions, most parties and counsel expect, desire, and need a balance between facilitating and evaluating from the mediator. While the process is designed for the parties to reach agreement through the facilitation of discussion by the mediator, at some point, mediators should be prepared to offer evaluative comments as to positions to continue moving the discussion along to a resolution, particularly when asked. Evaluation should not happen too soon in the process because there can be nothing more destructive than a mediator with no patience who insists on offering opinions at the beginning of break-out sessions as to how to resolve the dispute; it is a sure way to adversely affect confidence in the process and the mediator and to anger the parties and counsel. Conversely, if a mediator steadfastly refuses to offer evaluative comments, the mediation will be negatively impacted as well. To effectively deal with this issue, counsel should specifically discuss his or her expectations with the potential mediator at the interview stage.

If an agreement is reached, the mediator, with the assistance of counsel, should prepare a written agreement to be signed by the parties before the session concludes that day, even if it is subject to a more formal agreement. To the extent disputes arise with respect to finalizing the formal agreement, the parties should include a clause authorizing the mediator to be the final arbiter of such dispute(s).

Three examples of business divorces follow where the above considerations are illustrated, the first of which involved no mediation, the second an early mediation that failed and was never revisited, and the last where mediation was aggressively pursued and succeeded.

Stewart and Mike

Three years apart in age, brothers Stewart and Mike engaged in a successful law practice for many years. The practice operated as a partnership but without any written agreement, and the two brothers acted as principals, overseeing the work of two to four associates. Stewart managed the business side and Mike the sales side of the practice; each was a capable practitioner and split the profits equally.

In his mid 50s, Mike became ill, requiring surgery and rehabilitation that lasted the better part of a year. During Mike's rehabilitation, Stewart ran all aspects of the firm, providing Mike with a flat weekly draw. As reports became less frequent, Mike became increasingly depressed and openly contemplated retirement.

As the year wound down, Stewart approached Mike with a partnership dissolution agreement that provided Mike with a $200,000 total amount payable over five years. In the depths of his depression, Mike signed the dissolution agreement. Within six months, however, Mike's health returned and he attempted to go back to work with Stewart. Stewart, however, refused to permit it, relying on the dissolution agreement. Mike was furious and hired counsel who promptly filed suit seeking (1) to vitiate the dissolution agreement based on the circumstances surrounding its execution, (2) to dissolve the partnership pursuant to the Uniform Partnership Act, and (3) an accounting. What then followed was a hotly contested lawsuit lasting four years, including a court trial on the dissolution agreement issue and hearings before a master on the accounting. Mike ultimately prevailed for over $2 million and Stewart appealed. Shortly after the appeals court affirmed the decision, Stewart had a massive stroke and died. From the time suit was filed, the brothers never spoke to each other again. At no time was mediation engaged in or even suggested.

In the first instance, Stewart and Mike would have greatly benefited from a partnership agreement, including provisions for dissolution executed well before Mike became ill. In the absence of such an agreement, an early mediative intervention should have at least been suggested by their counsel. Despite the enmity (indeed, because of it and the relationship), an experienced mediator with a strong presence at the very outset of the dispute might have been able to put the brakes on the lawsuit and thereby provide a cooling-off period. Simultaneously, or shortly thereafter, the mediator could have commenced separate discussions, at first with each counsel, then with each party, in a careful, patient, step-by-step

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approach to a resolution. Ultimately, in the absence of an agreement as to money, the assistance of an accountant jointly selected by the parties might well have provided the final piece to an agreement.

Alpha Corp. v. Beta Inc.

Alpha Corp. and Beta Inc. formed a joint venture to develop shopping malls. Alpha was to own, develop, and manage and Beta was to design and construct. The parties successfully developed their first project and then executed a preliminary agreement to develop a second on a different site. The preliminary agreement provided that Beta would assist Alpha in the permitting of the mall, in return for which Alpha agreed to exclusively negotiate the final contract to design and construct with Beta once the permits were granted. As for the final contract, the parties further agreed in the preliminary agreement to build the mall for $250 million, generally using the commercial terms and specifications as the first project, but with site-specific costs to be negotiated. Though the second project did obtain the necessary permits, the parties were unable to negotiate a final price, being some $15 million apart.

Alpha then sued Beta for breach of an agreement to build the mall, asserting that the preliminary agreement contained all the essential material terms of the final contract, expressly, by incorporation or by formula; and for unfair and deceptive trade practices in seeking to extricate Beta from those obligations. As for damages, Alpha demanded several hundred million dollars of lost earnings, plus $5 million representing its out-of-pocket expenses incurred during the permitting process.

Shortly after preliminary discovery uncovered e-mails among Beta management supporting Alpha's allegation that the preliminary agreement contained essential terms of the final contract and that Beta management wanted out of the project, the parties agreed to mediate the dispute. However, the mediation failed, with Beta offering approximately $5 million in cash and credits for future goods/services and Alpha demanding $50 million in cash.

Thereafter, discovery recommenced with a vengeance on both sides, with thousands of documents requested and produced, 50 days of depositions along with 40 witnesses, and frequent motion practice.

After discovery was concluded, Beta filed a motion for summary judgment on all claims, which the court granted, finding that the unambiguous preliminary agreement did not contain all the essential material terms of the final contract as Alpha had asserted. Without a binding contract, the unfair and deceptive practice claim based on such a contract was dismissed as well. An appeal unanimously affirmed the court's decision.

Counsel fees in prosecuting and defending the case totaled well over $10 million, and the mall was never built. After the unsuccessful mediation at the beginning of the case failed, no effort was ever made by the parties or the mediator to reinitiate the mediation process.

Though hindsight is 20/20, the failure to settle at the early-stage mediation should not have deterred the parties or the mediator from revisiting the matter at a later date. In particular, given the sophistication of the players, their evident level of stubbornness, and the nature of the legal issues, the mediator should have at least checked back with each side from time to time to assess the status of the case. Indeed, once discovery had ripened so as to permit further claim evaluation, mediator discussion with counsel about a resumption of mediation should have then taken place, and in all events before motions for summary judgment were scheduled to be filed. Given the court's ultimate decision, had the parties revisited mediation at or near the conclusion of discovery, a resolution might well have been achieved. The lesson to be learned is for the mediator and the parties to practice good follow-up and persis-tence; it certainly will improve the chances for success.

George Talbot & Sons

George Talbot & Sons was a high-end furniture and accessory design and manufacturing firm. The present-day principals were George Talbot's 39-year old son, Frank, the president and CEO, and 68-year old Edwin Church, a long-time investor originally brought in by Frank's father. Frank and Edwin each owned 50 percent of the stock in the company.

The company and its principals had been highly successful over the years and well rewarded from the profits. Frank was also the recipient of a handsome salary and benefit package. The company was approached by a European conglomerate that wanted to purchase the company for 10 times its annual gross revenue, an unusual and very substantial offer for a manufacturing firm of this nature. The offer, which was to remain open for 90 days only, did not include an employment or consulting agreement for Frank. Frank did not want to accept the offer; Edwin was enthusiastically in favor of doing so. The corporate documents of the company did not contain a mechanism or formula for breaking the deadlock, only a mandatory mediation clause. As the clock on the 90 days began to tick, the discussion between Frank and Edwin became very hot and acrimonious, and each wisely sought separate counsel. When counsel could not quickly resolve the dispute, they pointed out the mandatory mediation clause to the clients and the risks of inaction (among them, loss of the offer, an expensive lawsuit, potential dissolution, and liquidation).

As a result, a mediator was selected by the parties. He promptly obtained position papers from each counsel, including settlement positions, and then spoke privately with each lawyer to flesh out their concerns and issues, both legal and personal. He learned that Edwin insisted on a 50/50 split, and that Frank might consider selling but

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only if the split was on an 80/20 basis to accommodate his lost earned income and to recognize his contribution. In joint discussions with counsel, they reached agreement on how the mediative process should proceed and the importance of reaching a quick compromise. Counsel also agreed with the mediator to promptly bring the corporate tax accountant into the loop with a view toward analyzing any potential resolution.

In the formal mediation sessions that followed with the parties, their counsel, and the accountant, the mediator explained that opening statements would be dispensed with. The mediator then articulated for both sides in a clear, concise, and professional manner the facts, the concerns of each side as he understood them, and the substantial risks to both parties if a compromise was not reached. He then pledged his commitment to stay with them as long as it took that day and the succeeding ones to resolve the matter.

In private sessions with each side, the mediator first explored the potential for rejecting the offer and resuming the association. This was quickly rejected by both sides. The mediator then explored the option of Edwin selling his interest to Frank; but given the richness of the conglomerate's offer, the cost (with the accountant's input) was simply not affordable. The mediator then explored the sale to the conglomerate and the concept of an unequal division of the proceeds.

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After much discussion, Edwin finally agreed to consider the concept. After an additional day of negotiations and shuttle diplomacy, the parties agreed to sell to the conglomerate with the proceeds to be split 60 percent to Frank, 40 percent to Edwin. All accounting and tax concerns were considered and disposed of with the assistance of the corporate accountant. At the end of day one, the mediator also worked into the night with both counsel to begin drafting a settlement agreement, which was finalized and signed early evening on day two.

In this instance, the mediative process worked, starting with the careful selection of a committed mediator, followed by solid communication and preparation, including a sensitively designed process, and the persistent pursuit of a commonality of interests.

With some variations as to facts and identity, the three cases detailed above represent real people and actual disputes. The sad conclusion to Mike and Stewart's story occurred many years ago, well before mediation as an ADR process was developed and utilized. The Talbot matter took place in the mid-90s, while the Alpha/Beta dispute was of recent vintage. Despite the very different time periods and circumstances, however, each case illustrates the opportunities a well-prepared mediation can present, even for disputes as difficult as a business divorce.

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