

Litigation

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Litigation Road
A Magical Mystery Tour

“All Things Must Pass”

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All things must pass.

All things must pass away.

—George Harrison, *All Things Must Pass*, “All Things Must Pass” (1970)

If you have spent any time watching the HBO television series *Succession*, it provides the best and most dramatic example of what can happen to a successful family business upon the death of the founder. Not to give away the plot, the show exemplifies the changes that can take place in family businesses (in *Succession*, a parody of the Murdoch family) when key players are no longer able to participate in the management of the family business.

According to FamilyBusiness.org, 24.2 million family businesses operate in the United States today. Most are small, closely held businesses. Many have existed for generations, which sometimes makes it less likely that corporate formalities (such as the execution of an operating agreement, the creation of bylaws, the recording of minutes, or the preparation of an organizational chart) have been observed. Nonetheless, when there is a change in control, whether because of a death in the family, retirement, or other event, the transition to a new set of managers, most often other family members, can be tricky. These changes in corporate governance are often fertile ground for litigation for a variety of reasons.

First, there may be no concrete succession plan, and the question of who is in charge may be in doubt following the death of the founder. In the show *Succession*, the founder allegedly scribbled his choice for his successor on a piece of paper discovered in a

vault after his death. This led to a power play among the founder’s children, which spanned several episodes. While it may seem obvious to the seasoned litigator that a successful family business should have in place a clear, well-thought-out succession plan, that is not always the case.

Second, family businesses are often factionalized—something that may not be apparent while the founder or other control person is alive but that can bubble to the surface quickly when a leadership vacuum emerges. Struggles for control or direction or both often follow the death of the founder or other leader. This is because people who start family businesses typically maintain tight controls on how the business is managed and what its future plans are, which can make the transition to new management challenging.

Litigation among family members following the death of the founder or other change in control is commonplace. When you are engaged to represent a family member in these matters, regardless of whether your client is in the majority or in the minority, or is the likely successor to control the business or not, there are certain steps you should take to determine what your client’s position will be and how to best resolve any disputes.

Determining Who Owns the Business

You may be surprised to learn that sometimes members of a successful family business do not really know who the actual shareholders are or what percentage of ownership they possess. In one case, the founder passed out share certificates to his children as

Christmas gifts. Years later, no one could find the stock certificates or the stock register, and the descendants disagreed on who owned the company and what percentage each owned.

Often, corporate records are kept in the possession of the company accountant or attorney, who can provide a treasure trove of useful information. Nonetheless, it may be, as is often the case particularly with a tight-knit nuclear family, that there are no records at all. There are even cases in which no agreement as to the division of ownership was ever reached. What then?

Financial records then become even more important because the intent of the parties may be determined by looking at which family members received which distributions. If the funds available for distribution are split equally, it can be a strong indicator of how company ownership was intended to be structured. Nonetheless, in many cases, funds are distributed without rhyme or reason. This presents additional problems in litigation because, before a court can divide up the assets or allocate benefits, it obviously must know who the owners are and how company ownership is divided.

Reviewing the Financial Records

Your client, and your client's adversary in a family business, will likely be very anxious to tell you who was the preferred scion and which family member was left out. While that may be interesting, the only real way to determine the truth of who owns the business, in the absence of a written agreement, is for counsel to hire a forensic accountant to drill down on the financial records.

This review will also tell counsel whether the business has been managed consistent with good corporate governance practices or has been operated like a private candy store where benefits are distributed by management based on caprice, favoritism, or some other criterion that defies objective measurement. The last of these three may justify a "lookback" to determine whether distributions and benefits should be adjusted, either looking to the past or to the future.

Typically, the lookback process is resisted by family members. This is because there is often a lot to contest and complain about when financial transactions are reviewed in hindsight by a forensic accountant. Who has been reaping the tax benefits of operating the business? Has one group or person been favored over the others? Has the company been paying expenses for certain shareholders and not for others? And, if so, for how long has this been going on? Remember that many of these practices, which may favor one group over the other, can date back decades. Is your client willing to spend the time and money necessary to determine whether he or she has received his or her fair share of the company's success?

Consider the statute of limitations in your state when analyzing these issues. Some of these practices may have been fraudulently concealed, which may delay the commencement of the



limitations period and give the practitioner the opportunity to look back at the books and records for a considerable period.

Often there is resistance. Simply obtaining copies of the relevant documents can be a challenge. For this reason, it is sometimes better (and easier) to simply file a lawsuit right away. There can be incredible differences in the documents that are produced voluntarily before a lawsuit is filed and those that are produced afterward under the watchful eye of the judge.

The financial records will also ultimately tell the story of how much the business is worth. In many closely held family businesses, the business's worth was never evaluated. The only time these issues really come to the fore is when the family is seriously considering a sale or when the business needs working capital. Otherwise, the issue is not given serious thought.

When a dispute develops, however, this becomes a crucial consideration. What is the family really fighting over? Is it millions of dollars, or is the business underwater? Typically, the more money involved, the more likely litigation will ensue.

The Mechanics of Litigation Involving Family Businesses

Broaching the question of whether to file suit is more nuanced in a family business than in a non-family business. For regular businesses, the question of whether to sue or not to sue was best summarized by Michael Corleone in *The Godfather*: "It's not personal—it's strictly business." In a family business, however, it is often both. And that makes things significantly more complex when decisions are made about whether to sue and when and how to settle.

But wait, says your client: "You want me to sue my sister?"

Sometimes the answer is yes, and sometimes it requires

proceeding with caution. For many family businesses, siblings are not close and filing suit is not going to change the family dynamic. But consider how a lawsuit among close family members may play out at Thanksgiving:

Please pass the stuffing. . . . Oh, by the way, when is your response due to the complaint that I just served on you?

In some circumstances, filing suit is not a real option, while in others it is the only option.

Family business litigation is akin to a combination of a business litigation and an action for marital dissolution. The ties among family members may be strong, and there may be nonparties involved who will be negatively affected by the filing of a lawsuit involving other family members (collateral damage). These considerations must be weighed when determining whether to file suit. Chances are, once the complaint is filed and served, Thanksgiving dinner will be canceled. Therefore, practitioners in this area should discuss with their client who, other than the client and his or her adversary, might be affected by the onset of litigation.

Negotiating Leadership

Sometimes the best and most economical way to resolve family disputes is through a buyout. Naturally, that requires valuation and negotiation. Minority owners in a family business can expect that the majority will only purchase an interest in a family business at a significant discount.

On the other hand, it is often in the best interest of the business as a whole for minority shareholders who do not have significant leadership roles to sell their shares. This also may be in the interest of the majority because it will allow the majority to run the business without interference from minority shareholders.

Mediating Early and Often

A wise man once said, “A bad settlement is better than a good trial.” While the average litigator may relish the thrill of the courtroom trial (or Zoom trial, depending on your jurisdiction), the average litigant may not be so happy about taking the case to trial. Couple that general reluctance with a case that involves family members, and the challenges for everyone involved become even greater.

Mediation is often the best alternative. However, the mediation of a case involving a family business is likely to be different than your last breach of contract case. First, you are not going to want to use your “go-to” business litigation mediator. A business mediator is likely to focus the mediation on whether it can achieve a good business deal. That may work for a breach of contract case, but it is going to be considerably more challenging in a case involving a family business.

The selection of the right mediator is crucially important. Attention should be paid to what cases the mediator has resolved involving families—not divorce cases or child custody cases but family business cases. The right mediator will know that in family business matters, emotions often play a key role. Family history is important. The mediator must be sensitive to family dynamics. Who was Mom’s or Dad’s favorite? How did the brothers or sisters get along as children? Where is the family from? How does culture factor into the equation? Which family member has been working in the business, and which family member has been sitting back collecting checks? These are just some of the preliminary questions that the right mediator must grapple with.

Timing is also crucial. How many times has a good lawyer pushed a case into mediation only to discover that it was premature—either because there had been insufficient discovery or because his or her clients were just not ready *emotionally* to settle.

A really useful tool used prior to mediation and to prepare for it is, believe it or not, taking depositions. Once the relevant documents have been produced and analyzed by a competent financial professional, it is often useful to put all the parties into a room, bring in the court reporter, turn on the video camera, and start asking questions.

Under oath.

If you are deposing the other side, invite your client to attend. Not on Zoom. In person. Suggest to your client that it would be a good idea for him or her to be in the room during the deposition. Often this may be the first time that family members have seen one another in a considerable period. Typically, one or two things happen in these circumstances. In some cases, the family members simply raise their hackles, double down on their anger, and refuse to talk to one another. On other occasions, sparring family members may greet one another with at least a handshake (a hug would be exceedingly rare).

Nonetheless, this serves two purposes. First, it helps to remove the barriers that may exist among people who may not have been in the same room for a considerable period. Next, it is often important, as in any litigation matter, to hear what the other family member has to say. Why certain things were handled the way they were handled. Why one family member felt entitled to take more than his or her share of the profits while concealing this fact from everyone else. Whether justified or not, it is often useful for the listener to hear the explanation, however facile or self-serving it may be.

Often, a family business mediation results in a settlement that each side is likely to be somewhat unhappy about. But it stops the legal fees from accruing and often provides some level of closure to the participants—closure that can be of greater importance in a family business dispute than in other commercial matters—because, in the words of John Lennon, “life is very short and there’s no time for fussing and fighting, my friend.” ■



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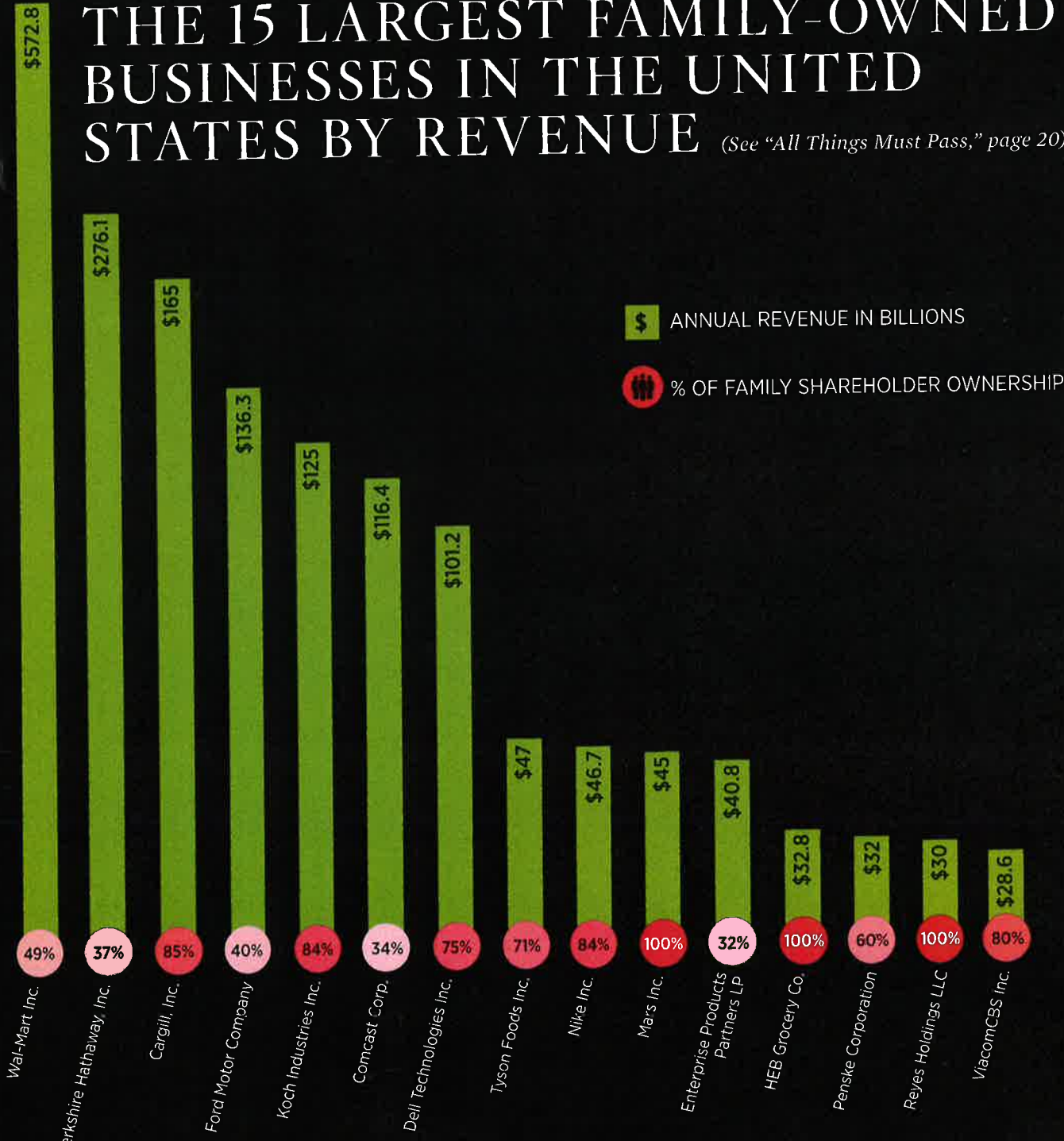
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THE 15 LARGEST FAMILY-OWNED BUSINESSES IN THE UNITED STATES BY REVENUE

(See "All Things Must Pass," page 20)



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