



Recent Case:
***Dissenting Shareholders in a Buyout -- Litigation Consulting
and Business Valuation Issues***

by Chris Hamilton, CPA, CFE, CVA, DABFA

Summary of issue:

Recently I was contacted to assist with the initial strategy discussion regarding a developing shareholder dispute. At issue was how to negotiate the departure of three partners without going through the process of expensive litigation.

The situation was that the majority of partners wanted the three partners to go. The three partners under the shareholder agreement had enough votes to block any formal move to force them out. Further, the written agreement clearly stated that the buy-in amount for each partner was \$100 and the buy-out for each partner was \$100. State law where the firm was located clearly stated that clients and cases were owned by partner- lawyers and not the firm. So, in addition to the \$100, the departing partners could also take their clients with them.

Further inquiry revealed that the balance sheet of the firm was substantial, as it included minimal cash and substantial accounts receivable and work-in-process. The shareholder agreement established a formula for compensation of the partners that basically shared revenue equally, regardless of the partner's contribution. A review of the history of the firm revealed that the shareholder agreement had been followed exactly for decades. Every incoming partner had paid \$100 and every departing partner had received \$100 and their clients. Compensation for decades had followed the formula.

So what was the issue here? The remaining partners all agreed that the three departing partners needed to go. However, under the shareholder agreement the three departing partners had enough votes to effectively prevent the forced departure. Stalemate!

Arxis

work:

I was contacted to discuss one question: What is the likely position of both sides if this case goes to court?

My conclusion was that the remaining partners will hold the line at the shareholders agreement: \$100 and their clients. The departing partners would likely pay for a valuation of the entire firm and claim that if the firm was sold, they were due the sale price times their ownership percentage. It seemed to me that the low end was \$100 and the high end of the negotiating range was their portion of the value of the firm.

Result:

It turned out that was exactly the position of both sides in this dispute. Given the potential for expensive litigation with devastating results to both sides (e.g., forced dissolution under the laws of the state where the firm was located) cooler heads prevailed and a settlement was reached.

About the author:

Chris Hamilton is a partner with the CPA firm of Arxis Financial, Inc., in Simi Valley. He is a member of the California Society of Certified Public Accountants (Litigation Services Committee), and the American Institute of Certified Public Accountants. Mr. Hamilton is a Certified Public Accountant, a Certified Fraud Examiner, a Certified Valuation Analyst, and a Diplomat of the American Board of Forensic Accounting. He can be reached at ph. 805-306-7890 or chamilton@arxisgroup.com.