

## • HOW MEDIATION CAN HELP RESOLVE DISPUTES IN FAMILY-OWNED BUSINESS

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This may sound familiar: Grandpa starts a business and hands it down to Dad. The sons take over the business, but unfortunately, stop getting along. The reasons for the disagreement can be personal or business. Perhaps they disagree about whether the business should expand or be sold. Perhaps there are hard feelings about how one of the brothers was treated in Dad's will. Regardless of the cause of the problem, the discord has become toxic. The brother, who is President, decides to fire one of his brothers, remove him from his board seat.

The next step is often the courthouse, where a TRO is obtained to stop these actions and press a "pause" button, and the "outcast" brother may seek dissolution. Meanwhile, customers, vendors, and competitors will likely get wind of the discord as the dirty laundry of the intra-family dispute is aired publicly, financial information may be in the court files and available online, and the business will be imperiled and its value may decline.

If the parties begin to talk buy-out, the talks may be endless. This is especially the case if the parties' operating agreement or shareholder agreement fails to contain any provisions for a

buy-out, or does not have a clause that mandates non-judicial resolution of disputes. The legal fees for the prolonged court battle will take their toll, too.

How can this be avoided? Family-owned businesses should consider including Alternative Dispute Resolution clauses (ADR) in their agreements; if there are no pre-dispute clause, the parties can always agree to resolve their disputes in a non-judicial forum, even if a court case has been filed or is being considered. Here's how these clauses can help.

## **What ADR Resources Are Available?**

Besides mandating settlement discussions among the principals, the parties can agree to use mediation. Mediation uses a neutral third-party to facilitate a resolution. Mediators are trained to use various techniques to help the parties resolve their dispute. Mediators can assist in finding the common ground on which a dispute can be resolved. It is an opportunity for the parties to "vent" and to air their grievances and to even re-write their agreements, find creative solutions to their dispute (such as a buy-out where there is no contractual or statutory basis for such), or to change the parties' business relationship.

A mediator does not decide who wins or loses. A mediator does not decide anything. A mediator may help each side evaluate the merits of their legal positions, but is really in the position of being a facilitator to help the parties arrive at a mutually agreeable solution.

Arbitration, however, is in stark contrast to mediation. In arbitration, an arbitrator is chosen to decide a case and resolve a dispute by having a hearing, reviewing the evidence (both documents and testimony) and deciding who wins and who loses. An arbitrator is like a private judge. While an arbitrator does not have to adhere to rules of evidence, it is much more similar to a trial in court – but with the added feature that it is private and out of the public view. The arbitrator's award can be converted into a court judgment thereby giving the parties a mechanism for enforcing it just as a court verdict/judgment would be.

Some agreements contain a "med-arb" clause, that is, that the parties must first attempt a resolution through mediation before arbitration. This "step clause" requires mediation as a condition precedent to the filing of a court case. The parties must follow this, and a court will stay an arbitration if the plaintiff files a court case before attempting mediation. Even if the parties do not have a contractual (pre-dispute) mediation clause, they can agree to mediate their dispute. The opportunity to mediate should not be rejected just because there is no litigation pending. Rather, pre-suit mediation can be a means of avoiding the high cost associated with litigation.

Using mediation early is not disadvantageous. Through the mediation process a party can insist that there be an exchange of information in advance of the mediation, a statement of what potential claims would or could be asserted in a future litigation can be required. The parties can agree to the exchange of appraisals or other expert reports before the mediation takes place. Experts and the company's accountant can be invited to the mediation, too. This can help in many ways. First, it provides a resource to evaluate monetary proposals and to explain them both to the other side, the business owner, and to the mediator. Second, the input of the

company's regular CPA can be quite useful in explaining prior transactions, the proposals and to help moderate the parties' positions.

Similarly, whether the parties have a contract provision that requires arbitration or don't, they can still agree to arbitrate their dispute.<sup>1</sup> There are many advantages to using an arbitrator instead of a judge. The parties can search for and/or require appointment of an arbitrator with certain skills, experience, or background. For example, the arbitrator can be an attorney or an accountant, appraiser, architect, engineer, etc. It can be required that the arbitrator has experience with a particular industry (whether as an attorney or business person), such as hospitality, apparel, construction, etc. Or, it can be required that the arbitrator have experience with a particular area of law or possess a certain competency, such as mergers and acquisitions or valuations.<sup>2</sup> Thus, the parties will have found someone with the expertise that they feel is necessary to resolve the dispute in a fair way.

Finally, an arbitrator can be used to help the parties break a deadlock, whether it be at the director or shareholder level. If used for such purpose, the arbitrator could hold a meeting with the parties, have them present their view of the issue on which there is a deadlock, and then the arbitrator's decision is akin to casting the tie-breaking vote. This is a great way to avoid a deadlock that is hampering the operations and future of the company.

## **Confidentiality**

Unlike court files, the files for arbitration or mediation are private and are not available publicly. The parties can further agree (and the arbitrator can order) that the materials are "confidential" and cannot be shared or discussed. In mediation, the materials are considered "confidential" because they are inadmissible settlement communications.

Mediation and arbitration, therefore, can provide both privacy and confidentiality so as to protect sensitive matters that business people would not want aired publicly. Efficiency, Economy, Fairness

Because mediation and arbitration are less formal than court proceedings, they can provide a lower cost. Avoiding expensive depositions is a consideration in favor of using ADR. In addition, the parties can avoid delays attendant with court calendars, as you are selecting a neutral to be available on your schedule.

Unlike our court system, in ADR mediators and arbitrators can work long days (long into the night). The parties (through counsel) will set up a schedule that makes the process their own. ADR can therefore not only be efficient, but can be set on a very fast pace. Arbitrators will often extend the hearing day-long into the evening (or start early) and can accommodate a witness's attendance through video-conferencing. These efficiencies can and should result in reduced expense for clients.

The limited appeal of an arbitration award also reduces costs and make the resolution faster.<sup>3</sup> Of course, this limitation is a consideration that some view as a reason not to arbitrate a dispute. Settlement talks can often drag on at a snail's pace (intentionally or otherwise). Mediation also can help speed up settlement negotiations because deadlines for the exchange

of appraisals can be set, and in a single mediation session the parties are required to respond to offers and demands. Further, mediation can be used to arrange for the retention of an independent appraiser to help the parties set a price or to be used for negotiation of a buy-out. With mediation, the process gives the parties a framework in which the negotiations can take place – with the mediator as an invaluable resource.

Alternative dispute resolution, including the use of mediation and/or arbitration, is extremely useful in helping to resolve disputes in family-owned businesses.

1. Even “judicial dissolution” proceedings under Article XI of the Business Corporation Law are subject to arbitration clauses. *See, e.g., In re Parness v. Saul*, No. 603497/09, 2011 N.Y. Slip. Op. 31879 (U) (Sup. Ct. N.Y. Cty., July 6, 2011) (court refuses to sign order to show cause due to arbitration clause). A clause can exclude arbitration of particular matters, too, such as valuation. *See, e.g., Katz v. Feinberg*, 167 F.Supp.2d 556 (S.D.N.Y. 2001), *aff’d*, 290 F.3d 95 (2d Cir. 2002).

2. *See, e.g., Pisane v. Fieg*, 2012 N.Y. Slip Op., No. 12246/11 (S. Ct. Kings Cty., Sept. 14, 2012). In *Pisane*, the company’s valuation was stale, and the arbitrator directed it be updated in accordance with the methodology contained in the Shareholders Agreement. The Court held that such determination and directive was not “without a rational basis or in excess of the arbitrator’s powers.” Slip Op. at 18.

3. In *Pisane, supra*, the Court confirmed an arbitration award that addressed valuation of a shareholder buy-out, noting that “Courts are reluctant to disturb the decisions of arbitrators.” Slip. op. at 12 (citations omitted). The *Pisane* Court held that the arbitrator “reasonably determined to use the methodology mandated” to value the Company that was contained in the Shareholder Agreement. The Arbitrator required the corporation’s regular accountant to update the valuation and then adopted it to support the award, which the Court determined was within his authority under BCL § 1118, that is to determine the price of an elected buy-out. Slip. Op. at 17-18.