Using Root Cause Analysis to Settle a Business Oppression Case

by: Jonathan B. Frank

The existence of a business oppression case means that a once-productive relationship has broken down. Trust has been eroded. Money has been diverted. Suspicions have mounted — and names have been called. Like a marital divorce, the business partnership has been severely damaged, possibly irreparably (for this article, "partnership" refers to all forms of business combinations). The future of the business is now in doubt. Michigan law, like the law in most other states, allows a partner to sue, to present evidence of oppression, and to ask the judge to fashion a remedy that matches the specific facts of the case. Remedies include the payment of damages, restructuring of the business relationship, appointment of a receiver, and/or a mandatory buyout.

Nearly all oppression cases (like nearly all cases in general) settle. The cost of oppression litigation, especially with accounting, fraud, and valuation experts, can be high. The daily grind is more intense than most cases. And in the end, business owners prefer certainty; the long list of possible remedies makes the outcome in court uncertain.

So why is it so hard to settle an oppression case? Because unlike most cases, which are primarily about money, oppression cases are multi-faceted. Indeed, the remedy or settlement may or may not be about money. Settlement negotiations in oppression cases are not as simple as "I start high, you start low, and we agree in the middle."

To settle oppression cases, it is critical to identify the underlying cause of the problem, isolate the precipitating event, and work to repair or at least stabilize the relationship. Unlike a marriage, a business partnership was built on an economic foundation. If the partners can make a reasoned economic decision, they should be able to separate from each other and move on.

Root Causes for Oppression Cases

In industry, "root cause analysis" is a widely-used method for understanding and solving problems which focuses on solutions that are specific to the particular problem. The five basic steps of root cause analysis are: (1) define the problem; (2) collect information; (3) identify causal factors; (4) identify the root cause(s); and (5) develop and implement solutions. In multi-faceted business oppression cases, root cause analysis is a useful tool to develop a framework for settlement, especially because of the recurring nature of certain root causes:

- Unrealistic or imperfect expectations at the outset of the business relationship. Taking on a partner sounds like a great idea, and often it is. But, like marriage, partnership is most successful when there is a combination of optimism, practicality and the ability to grow and adapt. Optimism alone will carry a partnership through the early, hopeful stages, but no further.

- Incomplete / inaccurate documents. Many business partners are hesitant to fully document their relationship, in part for fear of introducing negative "what if" scenarios. They may substitute simple boilerplate documents (often found online) for well-tailored agreements drafted by lawyers.

- Misunderstanding of legal rights. I use this analogy: business partners can be like third-graders playing football at recess. They may think they know the rules, but they really don't. When a dispute arises, there may be no mechanism to resolve it on the playground. Someone picks up the ball and runs off. Others push and shove. Someone runs off to get the gym teacher to be the referee. If and when order is restored, the game can continue. But sometimes it's too late and the game disintegrates.
- Imperfect communication. Over time, partners get busy. They neglect the care and feeding of the partnership itself. Issues that one partner deems important may be irrelevant to the others. Regular, periodic reports devolve into random, event-based, or crisis-based emails or texts.
- Abuse of power/information. Especially in cases where there is a majority in control, questions about the use/misuse of power arise. Certain legal rights related to the use of power may not square with perceived principles of ethics/morals/fair dealing.
- Mounting suspicions/lack of respect. As problems grow and are unaddressed, all partners are likely to construct an overarching theme that captures their view of the other side's actions ("she's being greedy," "he's getting lazy," "she's trying to ruin me and drive me out," "he's broke and he's stealing from me," etc.). Regardless of whether the theme actually matches the actions, the theme supports a growing sense of suspicion, disrespect, and distrust.
- Unstable family dynamics. On top of everything else, long-standing family grudges become magnified. The goofy brother becomes the brother who's just trying to capitalize on everyone else's efforts. The rigid mother becomes domineering and secretive.
- Different goals/we've grown apart. This one is the least combative, and therefore the easiest to resolve. Sometimes partners, like spouses, simply decide they would rather be doing something else. No yelling. No threats. No need for a referee.

Case Studies

Some case studies will help to illustrate these concepts.

- A minority partner in a long-standing successful business began to feel that the other partners were ganging up on him and concealing information. Communication between partners became non-existent. None of the partners had a good sense of their legal rights. When the minority partner expressed his unhappiness (probably not as diplomatically as he could have), the majority fired him and stopped paying him distributions due to him as an owner; they believed he had lost interest in the business, had taken and used confidential information, and was secretly competing (none of which was true). Early efforts to mediate were unsuccessful because there were still high levels of misunderstanding, suspicion, disrespect and distrust. A year of litigation helped to clarify the legal rights, tenuously re-establish the personal relationships, and put the dispute in a clear economic context. On the courthouse steps, the partners agreed to a fair buyout of the minority.
- Long-time friends became successful business partners by expanding their retail locations, but did not properly document their relationship, relying instead on a series of loose oral agreements. The minority misunderstood his legal rights regarding the new retail locations and believed the majority was mistreating him, concealing information, and diverting revenue.

There were serious gaps in the flow of information. Their friendship, and their spouses' friendship, completely broke down. A series of pre-litigation meetings with all partners and counsel allowed the partners to understand the true legal structure of their relationship, gather relevant information, rebuild their personal relationship, and agree to a fair buyout of the minority.

- 50/50 partners who came together based on complementary business skills began to lose confidence in the other's ability to operate the business. The partner in charge of financial issues began to exert control in a way that offended the other partner, who was in charge of operational issues. The financial partner began to question the operational strength of the business. The operating agreement did not address 50/50 control issues. Without a clear understanding of their legal rights, each partner took action that inflamed the situation. Productive communication ceased. After a lawsuit was filed and order was restored over finances and operations, the partners attended two mediation sessions, re-established lines of communication, but could not agree on terms for a buyout. A third party who knew both partners intervened to buy out one partner and enter the business. The interesting win/win aspect of this case was that the selling partner had grown increasingly pessimistic about the business, while the partner who stayed and the third party were optimistic. As a result, they were willing to pay a price that all partners thought was fair.
- Three family members ran a retail business, but one became distracted by other ventures and stopped contributing in any way to the business. Issues arose regarding the fairness of payments for income and/or distributions. Although there was constant communication, it was mostly hostile. When the distracted partner started to actively interfere with the operation of the business, the other two invoked the well-drafted operating agreement to expel him. After a lawsuit was filed, a court-ordered mediator worked with the partners to engage in productive communication and better manage the business, which was operating profitably. Once the partners' legal rights were clarified, the partners reached an agreement regarding terms of a buyout with the assistance of someone who had a relationship with all the family members, allowing all partners to resolve their issues with some measure of dignity.
- Two long-time partners in a series of real-estate investments now were in different financial circumstances and could not agree on whether and how to dispose of their investments. Without a clear understanding of their legal rights regarding termination of their partnership, one partner took steps to market the properties without informing the other. The other partner constructed a theme around "corporate bullying." Both partners stubbornly refused to cooperate with the other — they could not agree on buyout terms or even a structure. Before litigation, the partners and counsel attended a mediation session that allowed both partners to express their different goals in a respectful setting. That accomplished, they quickly agreed to a mediator-run auction between the two of them on a property-by-property basis.
- Two friends in a software business stopped communicating effectively with each other about ownership and development of their intellectual property. Both became suspicious of the other. Instead of revealing or

addressing their suspicions, they each took actions that ultimately threatened the business. Their operating agreement, developed from an online form, did not properly address the nature of their business and contained harsh provisions that neither partner intended or understood, but that both partners decided to take advantage of in a series of emails to each other. Before a lawsuit was filed, but after they understood their legal rights, they agreed to terms of a buyout. As with a case noted above, a win/win solution was possible because the selling partner had grown increasing pessimistic about the business, while the buying partner was optimistic. As a result, the buying partner was willing to pay a price that both partners thought was fair.

Root Cause Analysis Works

I would submit that in each of these cases, the ultimate solution was not immediately obvious. Successful resolution depended on a thorough and time-consuming root cause analysis. If partners stopped communicating effectively, some work was required to restore trust and re-open lines of communication. If partners misunderstood their legal rights, some work — often through motion practice — was required to clarify those rights. If partners had unequal access to information, some work was required to equalize access and enable verification. If partners had differing views about the future of the business, some work was required to understand the magnitude of the difference and translate that difference into an economic solution. And since in most cases there was a fractured personal relationship, some work was required to let all partners express themselves in an honest and productive way so that they could at least try to salvage some aspect of the relationship. On the other hand, in three recent oppression cases that did not settle, the primary root cause was one partner's stubbornness and inability/unwillingness to accurately assess the potential risk, along with thematic explanations for the other's behavior that went unchecked. As a result, it was impossible to construct an appropriate settlement structure.

The beauty of root cause analysis in industry is that it provides a repeatable structure to identify and solve problems. In the context of oppression litigation, root cause analysis allows business partners, who at some point in the past had a productive personal and/or business relationship, to respectfully retain control over their outcome.

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