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## Resolving a Conflict of Interest

Lawyers explain the steps to take if your business partner violates his or her obligations to the business

by [Karen E. Klein](#)

**My business partner and I have owned a technology company for six years. It's an S-corporation and we are 50-50 shareholders, each with a board position. Our bylaws are boilerplate and our stockholder agreement is pretty weak, focusing on when we can or can't sell the business. Recently I found out that for the first four years, my partner was getting paid by one of the corporation's customers through a local university to work in the same technology we do in the company. Is this a conflict of interest on his part? What should I do? —C.G., Rome, N.Y.**

Yes, this is a conflict of interest. In legal terms it's called a "diversion of corporate opportunity." This means your partner took work for himself that the corporation could have done. This is most likely a breach of your partner's fiduciary obligations and his duty of loyalty to the corporation, says Stuart Blake, co-founder and chief executive officer of The General Counsel, a law firm based in Newport Beach, Calif. It's also a serious breach of trust between the two of you as partners.

Relying on boilerplate documents and a weak shareholder agreement may make this dilemma more serious. "This is the pitfall of not having an attorney help draft your corporate documents when you set up your S-corp. With a more detailed agreement, including buy/sell provisions, noncompete clauses, and conflict-of-interest provisions, you could extricate yourself from this situation much more easily," Blake says.

### **PUT THE EVIDENCE IN BLACK AND WHITE**

What you should do depends largely on what you want from your partner and from the corporation, says Rubin Ferziger, a business attorney based in New York. Do you want to continue with the corporation, but recover the lost profits and perhaps other damages? Are you considering dissolving the corporation and going off on your own? Does your business depend on your partner or could you carry on alone?

"Take your shareholder agreement to an attorney and explain what has happened," Ferziger suggests. "You should also discuss the situation with your family and with an accountant who is not affiliated with your partner."

Make sure you have documentary evidence about the competing work your partner did, says Ray Gallo, a Los Angeles attorney with Gallo & Associates. "Having it in black and white minimizes the possibilities for arguments and litigation. Present the evidence to a lawyer you engage to act as counsel to the corporation to make this determination," Gallo says.

If the lawyer concludes your partner has violated his duties, sit down with your partner promptly, Gallo says. If you want to continue working together, both of you should agree that he won't do this again and—ideally—that he'll put the money he made into the corporation. "Hopefully it'll go well," he says. "If not, you'll have to choose whether the money

at issue is worth fighting over. Either way, you'll have to decide whether this is a guy you should continue in business with. If your gut reaction is that he cheated you, the answer is no."

[Karen E. Klein](#) is a Los Angeles-based writer who covers entrepreneurship and small-business issues.