Shareholder disputes can be very damaging if not handled carefully

Shareholder disputes are very common, particularly in small closely held companies. Small closely held companies are effectively partnerships between shareholders in a company, often involving close interdependent relationships that under pressure can break down.

The main causes of a breakdown in a relationship between shareholders leading to a dispute are differing views:

- on management and direction of the company;
- in relation to shareholder performance and their role in the company; and
- in relation to the pay out of profit or retention for investment.
- growth and expansion.

Shareholder agreements

It is important to mitigate the risk of a shareholder dispute when going into business, whether that be starting up a new company with co-shareholders or buying into an existing entity. A heads of agreement followed by a shareholder agreement and constitution, gives clarity in relation to governance, control, and key decisions, reducing the likelihood of a dispute in respect of these issues later.

An initial heads of agreement can ventilate key commercial issues in respect of the business plan, share capital investment, debt, return on investment, each party's role in the company, expectations of that role, and terms of exit. Drafting a heads of agreement is a form of due diligence that can alert the shareholders in relation to differences and whether they are compatible.

A shareholder agreement will set out these provisions in more detail and also contain detailed deadlock, termination, and dispute resolution provisions. It is important to tailor these provisions relative to the governance and structure of a company.

However, even the best-drafted shareholder agreement and constitution is no "silver bullet" for preventing shareholder disputes. Once parties become unhappy in the relationship and decide to go their separate ways, no amount of legal documentation or process can necessarily prevent this.

Most exits are negotiated settlements that occur outside or during the formal dispute resolution process.

Resolving shareholder disputes

It is very important to get competent legal advice when a shareholder dispute arises from someone who is experienced in these matters. Shareholder disputes can become very personal and devolve into a major dispute, which can be very stressful for the parties involved and have a negative effect on the company's business, employees, and other shareholders. It takes an experienced hand to manage parties' expectations and guide them through the process.

Compromise is often important to allow for a clean break in a timely manner. If care is not taken, the dispute can be a protracted and expensive legal dispute which in some cases can take years to resolve at great personal, financial, and emotional cost.

Most of the time no one party is in a position to impose their will on the other and any solution must be an agreed solution.

Just and Equitable Winding Up

A frustrated party can apply to the court to wind up the company under section 241(4)(d) of the Companies Act on the grounds that it is *" just and equitable "* to do so.

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However, it is important to appreciate that this is a remedy of last resort and the court will only make an order where the relationship breakdown is serious and limits the ability of the company to function. In most cases, while the dispute is an unwelcome distraction, stressful and damaging, the business continues to function. The complainant must also come to the Court with "clean hands" and if the breakdown in the relationship or deadlock has arisen due to the complainant's misconduct, then the application is unlikely to be successful.

Unfairly Prejudicial Conduct

An aggrieved minority shareholder can also make an application to the Court under section 174 if a shareholder can show that he or she has been unfairly prejudiced by the conduct of the company. Again, there is a high threshold, and the bad business decisions of the company or exclusion from the company's affairs may not in itself be enough. The shareholder must point to actual company conduct which is prejudicial or unjustly detrimental to him or her or show that the conduct is well outside the shareholder's reasonable expectations of the company's conduct. If the company has made a reasonable offer to buy out the shareholder, this may cure the shareholder's prejudice. In addition, a court will also be reluctant to intervene where the shareholder agreement sets out an agreed process to resolve disputes.

Final Comment

A shareholder dispute is often essentially a divorce between business partners and while it is sometimes a reasonably amicable parting of ways, often this is not the case and matters can rapidly escalate if not handled carefully.

Want to know more?

If you have any questions, please contact David Goodman or a member of our specialist corporate or litigation teams.