

A Litigator's Guide to...

# Shareholder Disputes



Shareholder disputes can be very damaging to a business, causing a raft of practical issues including deadlocks in decision making, impact to wider staff morale and poor business performance.

These disputes can occur in companies of all shapes and sizes but are often seen in small to medium-sized owner-managed and family-run businesses, where misaligned objectives or personality clashes can escalate into more significant disputes. Disputes can occur for any number of reasons including disagreements over decisions, personal contributions to the business and issues surrounding dividends.

In this guide, we give you some background on the legal issues that commonly arise from shareholder disputes, our thoughts on how to avoid them and how to react should a dispute arise.

## The Legal Issues

Of all the types of commercial disputes we see, shareholder disputes are unusual for a number of reasons. There is often a high degree of tension that has commonly been building for some time. Typically, there will be no 'easy' route out; the protagonists are locked into the business until a solution is found. Above all, these disputes will bring into play a wide range of legal issues which need to be considered to properly understand the rights and obligations of the parties, in order that we can unlock the dispute and find a resolution.

Common legal issues that crop up include:

### *Shareholder Agreements and Other Contractual Terms*

These situations are often much easier to manage if shareholders have put in place a professionally drafted shareholders agreement and we often encourage our clients to speak to one of our trusted business partners to get an agreement in place. That way, there are 'rules of the game' in place, which can help avoid an disagreement or provide for what to do if one arises.

Often though, there is no clear, written agreement and (as with any other contractual situation) consideration needs to be given as to whether there is other evidence of any agreed terms, whether from correspondence, verbal discussions or possibly implied from the conduct of the parties.

### *Unfair Prejudice*

An unfair prejudice claim can arise where a shareholder considers that the affairs of the company are being conducted in a manner that is unfairly prejudicial to their interests as a member. This often come into play where there are minority shareholders or in "quasi-partnership" arrangements i.e., where companies are, in

practical terms, run as if they were a partnership between certain individuals where there are common expectations over their involvement in the business.

In this situation, a shareholder can bring a petition under s. 994 of the Companies Act 2006 and ask the court to intervene. If a shareholder can establish unfair prejudice, the court has a very wide discretion to make orders to remedy the position including, for example, ordering the company to take or refrain from certain action or ordering the purchase of a member's shares, potentially at adjusted valuations to take into account conduct.

### *Directors' Duties*

Many shareholders are also directors of the company and therefore owe statutory and fiduciary duties. Disputes between owners are commonly highly-charged can lead to 'bad behaviour'. While strictly speaking, duties are owed to the company rather than to other shareholders, urgent steps may need to be taken by other directors/shareholders to protect the company from further damage. Breaches can also provide a tactical advantage or disadvantage in certain situations.

A breach of a director's duties can result in serious consequences. The director could be removed or be subject to a personal claim against them including by way of a derivative claim i.e., a claim brought in the name of the company by other shareholders.

### *Employment Issues*

Where a shareholder is also an employee, employment rights may have a bearing in the dispute and will need careful management. We work alongside specialist employment lawyers who can advise on these aspects where needed.

## **How to Avoid a Shareholder Dispute**

Prevention is better than cure and the best way to avoid a dispute is to ensure there is a comprehensive shareholders' agreement in place from the outset and that it is kept updated. Done well, it protects both the business and its shareholders, setting out clearly the rights and obligations of shareholders. It can also deal with the way in which disputes are resolved. We commonly recommend to clients that they speak to one of our specialist business partners to ensure a suitable agreement is put in place.

Beyond setting out the contract terms, the very act of sitting down and discussing key ownership issues (that is then embodied in an agreement) will help avoid any misunderstandings and ensure all owners are aligned in their objectives.

A good shareholders agreement will cover the following areas where we regularly see disputes arise:

- Contributions - what will each shareholder bring to the business, whether in terms of capital, labour and/or business opportunities?
- Decision making – who has what level of day to day authority/responsibility and what matters require a certain level of unanimity or majority?
- Dividends/rewards – do the parties wish to have a clear dividend policy or otherwise an agreement to consider regularly/perhaps once certain business objectives have been met?
- Exit – Do the parties have a clear exit strategy? If not, what happens when a shareholder wants to leave? Are there circumstances where one party might be forced to leave due to certain conduct?

## What To Do If A Shareholder Dispute Arises

Even with careful planning, disputes can arise. We would recommend that independent advice is sought quickly when a dispute arises. Early intervention can help mitigate the risk of the dispute escalating and the potential damage that can cause to the business. It also helps ensure that no action is taken that may prejudice the client's position and increase the likelihood of a beneficial outcome to the dispute.

Finding the right strategy is key. These disputes have the habit of getting messy and expensive very quickly and we can use the legal and commercial tools at our disposal to understand the root of the problem and look to achieve an early resolution before things escalate.

Very often, we will work 'in the background', without being visible to the other shareholders. With careful management, a solution can usually be found, whether that be one party buying out the other, agreeing to sell to a third party or finding an improved way of working together towards a common goal, often with much clearer parameters in the form of a new shareholders agreement.

As a side issue, parties to these types of disputes must be particularly careful in respect of how they are funded. For example, if the advice is being obtained by an individual shareholder and not on behalf of the company itself, then it would usually not be appropriate to use company money to pay for it.

## How We Can Help

We have a wealth of experience in advising and representing clients in all types of shareholder disputes. We act for businesses of all sizes as well as individual directors, shareholders and partners.

We are always happy to speak informally in the first instance and help where we can. If the case warrants a formal instruction, we offer a high level of service from our experienced team. Please get in touch if you would like to discuss.

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