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Dispute Resolution Factsheets

Dealing with boardroom and shareholder disputes

Types of dispute

Disputes usually arise because of disagreements over the direction and development of the company, poor personal relationships, conflicts of interest (because a director has interests in another business), the terms of directors' service contracts, or concern over whether the board is meeting its legal responsibilities. They can also arise because directors are stopping money getting through to the shareholders by paying themselves high salaries, or keeping money in the company (for a rainy day) when shareholders think it should be paid out as dividend.

Anticipating disputes and catering for them in advance

Anticipating and providing for disputes in your articles of association or a shareholders' agreement in advance can save you a great deal of time, money and aggravation.

Articles or agreements usually require mediation first and, if that fails, a means for the shareholders to part company. Common examples are for the aggrieved shareholder to have the right to require the others to buy him out at a fair price; or each side must offer to buy the other out, and the one offering the highest price wins.

If a boardroom or shareholder dispute erupts in your company, take advice immediately

Disputes escalate because the parties don't find out exactly what their legal rights are at the outset. The longer you put off taking advice, the more time and money you will eventually spend sorting it out, and the more it will damage your business. Act at once.

Negotiate, rather than rely on your strict legal rights

It is almost always better to negotiate a solution, using your strict legal rights as bargaining counters, rather than end up in court. Ideally, reach a solution that enables the aggrieved shareholder to stay in the company. If that is impossible, common options are:

- The other shareholders have to buy him out at a fair price.
- The company buys his shares back - see our checklist on the Companies Act buy back procedure.

But you need to know your strict legal rights if you are to negotiate from a position of strength.

Key questions are:

1. Are you in control of the board? Most decisions in a company are made by the directors, by majority vote, with the chairman having a casting vote if there is a tie (although always check your articles of association to make sure). The majority on the board can therefore force through any decision that is made at board level (provided they turn up to board meetings).

2. Have you acted properly as a director? If you forced through a decision at board level, it can be challenged if you have acted improperly. You have legal duties and responsibilities, owed to your company. Breach them, and you could be made personally liable to pay over any profit you have made to the company, and reimburse it for any losses it has made. You may be covered by Directors' and Officers' Liability insurance, or your company may have agreed to indemnify you, against certain liabilities, but the best strategy is to act properly in the first place.

You would be breaching those duties if, for example, you use company property for personal use or you divert a contract that your company could have won to another business you own (or there is any other sort of conflict between your personal interests and those of the company), without approval of the shareholders or of the independent directors on the board (ie those directors who are neither directly nor indirectly involved). You also breach your duties if you fail to meet the minimum threshold required of someone with your functions in the company - for example, if you are the finance director, but you fail to keep proper accounting records or monitor the company's solvency. Also, if you don't comply with your company's articles of association, or you fail to

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comply with the Companies Act - for example, you don't declare any direct or indirect personal interest you have in a proposed contract or other dealings your company intends to have, with a third party, to the board.

If you haven't acted properly, you may still be safe. It is the company that has been wronged if you breach your duties, so it is the board that decides whether to take action against you - but you control the board!

There are rare circumstances in which someone else can bring an action on behalf of the company - what lawyers call a 'derivative' action. Take advice to make sure you do not fall within these rare circumstances.

3. Are you in control of shareholders' meetings? As well as controlling the board, you also need to be in control at shareholders' meetings. Some matters can't be decided by the directors but have to be referred to the shareholders for a decision. Different shareholder decisions require different majorities - having a simple majority of the votes at a shareholders' meeting isn't always enough to control it.

If you can cast more than 75 per cent of the votes at a shareholders' meeting, you can always force through any decision (called a 'resolution') at shareholder meetings. If you can cast more than 50 per cent of the votes at a shareholders meeting, you can force through some resolutions, but not all.

Which resolutions require a 75 per cent majority, and which a simple majority, depends on the Companies Act, your constitution and any shareholders' agreement. Check 'Matters Shareholders Decide' for the usual position, but take advice on your specific circumstances.

One resolution that can always be passed by majority vote at shareholders' meetings is a resolution to remove a director from office. This power is enshrined in the Companies Act. The threat of removal can sometimes stop a minority shareholder who is on the board from taking things further. See 'Removing a director: The Companies Act procedure', but take advice before acting - the procedure is complicated and lengthy; and you will often have to pay compensation for unfair dismissal.

4. Beware shareholder action. Minority shareholders can make a procedural nuisance of themselves. More importantly, shareholders have significant remedies if they have been 'unfairly prejudiced', or it is 'just and equitable' that the company be wound up. See 'Minority shareholders - what are their rights' generally, but take advice on your specific circumstances.

'Unfairly prejudicing' a shareholder

The biggest danger is that any shareholder can take you to court on grounds that the company's affairs have been conducted in a manner which is 'unfairly prejudicial' to his interests. These are personal actions, not actions brought by the company, so you can't stop a shareholder bringing one against you because you control the board and/or shareholder meetings. They consume time and money, and are a major distraction from the business. You can't use the company's money to fund your defence - if you try, the other side will take out an injunction to stop you.

If an unfair prejudice claim against you succeeds, the court can grant any remedy it thinks is fair. For example, it can order you to buy the aggrieved shareholders' shares at a fair price, or order you to sell your shares to him.

In private companies, 'unfair prejudice' actions are often based on a failure to fulfil the 'legitimate expectations' of the aggrieved shareholder about what the company was set up to do, and how it would be run. For example, if it was agreed (formally or informally) that:

- The company would carry on a particular business.
- All would be entitled to an equal say in how the company is managed.
- The directors would be fair when deciding on the salaries to be paid, the amounts to be kept in the company to fund growth, and the dividends to be paid out.
  and you act contrary to these legitimate expectations, the court may intervene. Always take advice on your specific circumstances.

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Shareholder's powers to wind the company up

The court has a general power to wind a company up, on a shareholder's application, if it is 'just and equitable' to do so. Like an unfair prejudice action, you can't stop this action being brought because you control the board and/or shareholders' meetings. An aggrieved shareholder will usually also ask that the company be wound up at the same time as he petitions for unfair prejudice (see above), citing the same facts in support of each claim.

5. Have you made a reasonable offer to the aggrieved shareholder? The courts are keen to encourage settlement in shareholder disputes. If you have made a reasonable offer to the 'aggrieved shareholder' to buy him out, you will not have acted 'unfairly' and it will not be 'just and equitable' to wind the company up. The courts have set out guidelines for such an offer. It's therefore vital to take advice on the terms of any offer you make.

If you submit to mediation or alternative dispute resolution, you are also unlikely to have acted 'unfairly'.

Always **take advice** early to save cost and time.

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