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corporate disputes

AN EPIDEMIC OF DISSATISFACTION

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2021 ISSUE

www.corporatedisputesmagazine.com

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McGUIREWOODS

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PERSPECTIVES

AN EPIDEMIC OF DISSATISFACTION

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The COVID-19 pandemic has caused people to look at their businesses and investments in a different way. There has been considerable frustration in the business world during the pandemic. Directors and managers have had difficult decisions to make, and the results have often not been to the liking of shareholders, many of whom, perhaps, have had unrealistic expectations about business performance in a world where markets in many sectors have shrunk radically, if not dried up entirely.

In some companies, this has exposed problems of which people previously were blissfully ignorant – sometimes because shareholders and investors have reassessed their priorities and taken the opportunity to consider their business interests from a new perspective; other times because the current global climate has highlighted hitherto hidden shortcomings of the business.

Not uncommonly, the tug of war between shareholder self-interest and director duties to the company have led to a breakdown in relationships, and consequently to shareholder disputes – whether between co-shareholders, or between shareholders and directors. Many such disputes are borne out of nothing more than a sense of unfairness, rather than any identifiable legal wrong. It is vital, therefore, that businesses and individuals alike deal with such disputes effectively, including in terms of time and cost, and, if possible, take steps to avoid

dissatisfaction evolving into a dispute in the first place.

One key way to avoid shareholder disputes is to get ahead of any disagreement by recording fully and accurately the intended relationship between the parties. Shareholders' agreements focus minds at the outset – when things are still rosy – and are a good opportunity for parties to properly consider what they want to achieve through the business relationship, the expectations of co-shareholders and the company itself, and what obligations each party is willing to assume and will fulfil.

It is important for such agreements to be reviewed and considered thoroughly before they are entered into. While market standard agreements often are a useful starting point, it would be dangerous to assume that one size fits all. It is essential that the agreement does what the parties want it to do, and that any inconsistencies with the company's constitutional documents are examined and resolved. Parties also need to be forward-thinking: it is temptingly straightforward to focus on the business now, but what will it look like in two years' time, or 20 years' time? Will any stipulated decision-making process and approach to remuneration stand the test of time? What is simply a poor bargain will not be met with sympathy from the courts; their role is to enforce the deal as it stands, not make it 'fairer'. Once a bad deal, always a bad deal.

Majority shareholders are usually able to use the constitution of the company to achieve their aims, whether by changing the composition of the board or passing other resolutions. The position of aggrieved minority shareholders can be trickier due to their lack of power over the company. Nonetheless, they have a number of options including (but by no means limited to): (i) applying to the court, by petition, for an order on the ground that the affairs of the company are being conducted in a manner that is unfairly prejudicial to its members' interests (unfair prejudice petition); or (ii) seeking to bring a derivative action in the name of the company – for example taking action against the directors for breach of duty, such as their statutory duties to promote the success of the company, to exercise reasonable care, skill and diligence, and to avoid conflicts of interest.

Section 996(1) of the UK Companies Act 2006 provides that, on a successful unfair prejudice petition, the court "may make such order as it thinks fit for giving relief in respect of the matters complained of". That wide discretion is illuminative in terms of the approach that should be taken to disputes with shareholders – parties really can get creative. What can the accused party offer to avoid the allegedly aggrieved party taking things further? Perhaps the shareholders' initial position is that they want more control over the business's affairs, but could they be placated by receiving corporate information in greater detail or more regularly? Have the shareholders' complaints identified something that has gone awry in the running of the company that should be addressed? If it does not seem appropriate to welcome the shareholder to the board, could the parties agree that the shareholder may nominate a director that they think might better represent their interests? Is the shareholder operating under a misunderstanding about an action taken or a payment made by the company, which could be corrected with an explanation? If the investor is worried about the state of their investment, should an exit by share sale be considered? Do the parties need a fresh start entirely, with the business sold and the investors (along with their funds and assets) going their separate ways? Does one shareholder immerse themself in several opportunities at a time, with their co-shareholders craving the assurance of non-compete commitments? If the shareholder or company is being unrealistic about value, would it be worthwhile to incur the expense of a professional valuer to inject realism into discussions?

Often, good internal communication is the key to maintaining satisfaction, or at least understanding, in a company's situation and staving off disputes.

By the time that something can be described as a dispute, often, relationships have broken down and the individuals involved are unlikely to be able to take an objective view. Involving legal advisers to take that objective approach in reviewing what has happened and proposing a way forward or having an

independent third party talk things through with the parties, can bring a fresh perspective and solutions. With any luck, such input may avoid the parties having to spend time and money on court action.

In the absence of sensible communication, or an effectively mediated resolution based on advice, it can be all too easy for positions to become entrenched to the point of legal proceedings, and any formal action puts all sorts of conduct under the spotlight – including that of the aggrieved shareholder. Unlike other actions that require the complaining party to come with clean hands, there is no such requirement when bringing an unfair prejudice petition. Nonetheless, particularly given the court's wide discretion as to remedy, the petitioner's conduct will be a relevant factor to be considered by the court when determining the petition. Shareholders are wise to remember that; and a company may be smart to convey an appropriately polite warning.

At the worst end of the spectrum, depending on the setup and roots of the company, sometimes disputes get personal. Although a director's chief concern must be the wellbeing of the company itself, in line with their duties to promote the success of the company and avoid conflicts of interest, a threat of action against them personally, understandably, would be a big concern.

A shareholder might attempt to pursue a director individually as a result, seeking their disqualification as a director (under the UK Company Directors Disqualification Act 1986) or termination of their service contract. Repercussions for the director in such circumstances can be huge. In addition, there will inevitably be a negative knock-on impact for the company of a director being publicly criticised – for example in market perception, business reputation and day-to-day disruption to the running of the company while the director's previous roles are reassigned. When emotions run high, the risk of such fallout is easily overlooked by the aggrieved shareholder. In some circumstances, vendettas against directors (however justified) can be somewhat of an own goal if how they are handled affects a company in which the shareholder retains an interest.

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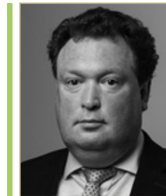
Although plainly it will only be appropriate to do so in certain situations, a company may seek to block a shareholder from pursuing particular actions against a director by formally forgiving potentially problematic conduct. Under section 239 of the Companies Act 2006, a company can ratify "conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company". Companies should, however, be wary of such ratification amounting to unfair prejudice about which the shareholder can complain.

There are several powerful statutory rights that may apply to a shareholder, such as the right to inspect company registers and the right to require the directors to call a general meeting. A clear understanding of what a shareholder can do – whether the business likes it or not – is key to any negotiating position. What, at first glance, may seem like an ambitious demand might have legal backing such that acquiescence is, in fact, a sensible option.

We are living in unique times, and most companies have never had to endure market conditions quite like those experienced in 2021. Nor can anyone be certain about the immediate future, and for long how businesses must hang on before they see the uptick they are all craving. Unsurprisingly, as businesses suffer, there is engendered a great sense of unfairness arising out of the fact that the circumstances are beyond their control. But action based purely on grounds of inequity is ill-advised. All parties should keep cool heads, get help with their options and, most importantly, identify whether there is a right to act.

Above all else, start with good communication. A clear understanding of why things are happening and decisions being taken, goes a long way to avoid disgruntlement turning into litigation. CD



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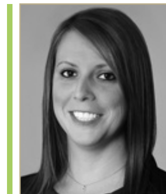

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