Shareholder Disputes - Breaking the Deadlock

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There are excellent and accessible forums throughout the North of England in which to resolve shareholder disputes when they arise, says Lisa Linklater, a barrister in the commercial department at Exchange Chambers.

Disputes are never good for business, particularly when the business is in dispute with itself. There are countless successful, valuable owner managed businesses in the North of England across a number of sectors. Therefore, it is no surprise that many of the leading judgements in the field of shareholder disputes have been determined by courts in the North of England or involve businesses based in this area. This article explores the legal options available to shareholders when relations turn sour and considers the practical issues that may arise.

A clean break? Unfair prejudice petition

The classic litigation process for the resolution of shareholder disputes, particularly when initiated by a minority or equal shareholder, remains the unfair prejudice petition under Section 994 Companies Act 2006. While the court has wide discretion as to the relief it may grant, the most frequently sought and granted order remains the purchase of shares. This allows the value of the business to be preserved as a going concern while bringing about a clean break between the shareholders who can no longer constructively work together.

A shareholder may petition where “the company’s affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself)”. In the House of Lords decision that remains the touchstone in this area, O’Neill v Phillips, Lord Hoffmann noted: “Although fairness is a notion which can be applied to all kinds of activities its content will depend upon the context in which it is being used. Conduct which is perfectly fair between competing businessmen may not be fair between members of a family. In some sports it may require, at best, observance of the rules, in others (‘it’s not cricket’) it may be

unfair in some circumstances to take advantage of them. All is said to be fair in love and war. So the context and background are very important."

There is a uniform thread of the type of conduct that may be "unfairly prejudicial" that runs through all companies. However, the agreements between shareholders and their relationship will determine the parameters of unfairly prejudicial conduct in any particular case and will vary from company to company. For instance, if the minority shareholder can establish a 'quasi-partnership', equitable considerations will come into play.

While some minority shareholders may pursue a petition with the motto "only one allegation need stick" to prove unfairly prejudicial conduct, care is needed in the assessment and pursuit of the allegations. This is particularly the case since funding will often be an issue for the minority shareholder, who will often have been squeezed out of an income from the company and for whom any reduction of their recoverable costs is likely to deplete the return on their shareholding.

The outcome of such proceedings is often (but not necessarily) a share purchase order of the minority's shares; this may not necessarily be unwelcome by the majority. Indeed, in one unfair prejudice petition trial in Leeds in which I was recently instructed, one of the respondents openly stated in the witness box that they wished to buy the shares of the petitioner. An understanding of the factors that may affect the valuation process generally (such as when a minority shareholder discount may be applied) and specifically in the company at the heart of the dispute are crucial in securing the best commercial outcome for one's client.

Standing in the shoes of the company: Statutory derivative action

A claimant may use the statutory derivative action in the Companies Act 2006 to 'stand in the shoes' of the company in bringing a claim against a director or another person, such as a company that has knowingly assisted the director in his or her breach of duty. Derivative actions have the attraction to claimants that the company may be ordered to indemnify the claimant for costs, thus reducing the personal risk to the claimant. However, they are expressly restricted by the Companies Act 2006 to a very narrow set of circumstances, primarily a breach by a director of his or her duties to the company. In addition, the court acts as a gatekeeper, the claimant having to apply for the court's permission to continue such proceedings. Moreover, the outcome will not be a clean break between the shareholders but recovery on behalf of the company.

Sledgehammer to crack a nut? Winding up on the just and equitable ground

The presentation of a winding up petition on the just and equitable ground (Section 122(1)(g) of the Insolvency Act 1986) to resolve a shareholder dispute has long been seen as a 'sledgehammer to crack a nut'. However, there do remain occasional situations where it is appropriate to resort to a winding up petition, for instance, where a company is deadlocked. However, a petitioner may well score an 'own goal'. The petition will be highly disruptive of ordinary trade (due to the automatic avoidance of transactions unless validated—127 of the Insolvency Act 1986). Additionally, the result, if successful, is

that a liquidator will be appointed with consequent fees. If the company is insolvent, the petitioner will be unable to establish the necessary interest to petition for the winding up of the company on this ground.

Specialist courts in the North of England

The Business and Property Courts (BPCs) in Leeds, Manchester, Newcastle and Liverpool are part of the High Court and provide the ideal forum in which to resolve such disputes if alternative dispute resolution is not fruitful. The BPC in each of these cities includes a specialist companies and insolvency court. The use of a court local to a business is likely to save valuable management time and cost.

Alternatives to resolving disputes

There are particular attractions to shareholders in exploring and using alternative dispute resolution procedures to resolve their disputes either before or during litigation. For instance, while the court has a wide range of powers on an unfair prejudice petition, it will only exercise those powers once it has made factual findings and determined that there has been 'unfairly prejudicial conduct' on the part of the majority. Alternative dispute resolution can offer an unlimited range of commercial options to resolve a dispute that are not offered by a court order alone. The commercially astute will see alternative dispute resolution not as a weakness but an opportunity to creatively structure a deal for their benefit. Alternative dispute resolution may also meet a client's wider objectives and allow a more positive dialogue than that of the adversarial process. I was reminded of this when a client embraced me following the successful resolution of an unfair prejudice petition at mediation shortly before the commencement of a trial in the BPC in Manchester.

The recommendation of strategy to a shareholder seeking to resort to litigation to resolve an internal dispute will involve a number of factors, including: nature of the dispute, size of shareholding in the company, client resource, the business and financial strength of the company, the sector in which the company is operating, and how the tensions between the shareholders have manifested themselves. Whichever strategy is selected, there are excellent and accessible forums throughout the North of England in which to resolve disputes between shareholders when they arise.