COMPANY AND PARTNERSHIP DISPUTES

If you are running a business it is inevitable that you will occasionally have disagreements with your fellow directors/shareholders/partners. There's nothing wrong with that, and it's the sign of a healthy business if owners and managers can challenge each other constructively. This Guide sets out how to resolve disputes between directors and shareholders/partners for the good of the business – and what to do if that's not possible.

1. WHAT TO DO WHEN DISPUTES OCCUR

Boardroom and partner disputes can be complex and involve contract, employment law and company law issues. However disagreements between directors and shareholders/partners can usually be resolved in the best interests of the business. Directors and shareholders should review the company's Articles of Association, the Shareholder/Partnership Agreement, board minutes and employment contracts. These documents should show how to resolve a difficult situation.

If the dispute is serious enough, it can be taken to board level, for a vote of the directors/partners. Within a company the issue could even be taken to a company general meeting with a shareholders' resolution.

2. DEALING WITH A 'PROBLEM' DIRECTOR

Being a director of a limited company is a responsible and challenging position, with onerous statutory obligations. Shareholders can be very demanding, particularly when they are family members and close friends. In smaller businesses where the directors are the also the shareholders, serious disagreements between them can mean the business is no longer viable.

Why Directors Fall Out

Matters quickly become more serious if it is discovered that one or more of the directors is acting against the interests of the company or shareholders. This may or may not involve dishonesty. Examples include:

- The director no longer comes in to work, or has started working (even if part-time) for a different business.
- The director is setting up or dealing with a rival business.
- The director is suspected of making side-arrangements with customers or suppliers.
- The director excludes other directors from the decision-making process and/or makes important decisions that other directors have not agreed on.

What Steps Can Be Taken Against A Director?

If there is a Shareholder Agreement, it will often set out how important decisions must be made. For instance, it may say if they must be unanimous, and not made by a single director alone. Otherwise the Articles of Association (the company constitution) may specify this.

The ultimate sanction against a director is to let them go. Where there is no formal agreement and the Articles are silent, a simple majority of shareholders can usually agree at a general meeting of the company to remove a director from office. However, companies need to be careful that they do not then face a claim for unfair dismissal from the director.

There is a sting in the tail for a director whose activities lead to the company going bust, or otherwise being wound up. If a company is liquidated then the liquidators are empowered to review the final years of the company's life to look for any misconduct on the part of the directors. They can bring a claim against a director who was engaged in unlawful or fraudulent trading.

3. THE RIGHTS OF SHAREHOLDERS

If you are a shareholder in small or private company, it is easy to feel taken for granted. Although you own part of the business, if you are not a manager or otherwise involved in it on a day-to-day basis, you can feel left out and in the dark about what is going on. Sometimes the directors will overlook their responsibility to hold company meetings and provide accounts to shareholders. If you want out, how can you retrieve your initial investment?

What Powers Does A Shareholder Have?

The larger your shareholding, the greater your rights. However, you should go through the company's Articles of Association to see if it gives you any special rights which the law generally does not.

Company law also gives shareholders right. All shareholders can attend and vote at a general meeting of the company. If you own at least 5% of the shares you can call a general meeting and require a written statement to be circulated to all other shareholders. A useful right if you own 10% of the shares or more, and have concerns about the company finances, is to have the company's annual accounts audited (at the company's expense).

While these powers might not seem to amount to much, they are often enough to bring a majority shareholder or board of directors into line. The threat of having to explain themselves at a general meeting, or of having the accounts audited, can be sufficient to cause a change of behaviour.

A very powerful right is available if you own 25% or more of the shares. This is the power to block or prevent the passing of a 'special resolution'. A resolution like this would be required to change a company's Articles of Association. A majority shareholder might want to try to change the articles to give them greater voting rights, for instance.

What Else Can A Minority Shareholder Do?

The ultimate shareholder weapon to exercise control over the company is to remove a director. However, that requires a 50% shareholding, and so if you're a minority shareholder that option is not available. What else can you do?

As a minority shareholder you can ask the court to become involved, if you are being excluded from management, or the company is being run contrary to your interests. This is known as protection against unfair prejudice. The court has the power to order a full account of the affairs of the company, and even to order that the company is sold or wound up. It can even order that one shareholder buys another's shares, or that money paid from the company's bank account is repaid.

In some circumstances, you can also bring an action in the name of the company against the directors. You would do this in a situation where the director has made a profit at the company's expense, for instance.

Shareholder Agreements

It is often helpful in a small private company to have a Shareholder Agreement. This is a private contract between the shareholders of a company, ideally made when the company is formed. It is in addition to the company's Articles of Association. The Articles are the company constitution, and the Shareholder Agreement can give detailed instructions on how the company is to work.

For instance, the Shareholder Agreement will specify how decisions are to be made in the business. Certain decision might require unanimous approval of the shareholders, such as changing the company name, borrowing above a certain level, appointing a new auditor, etc. It will also say whether any restrictions apply to a director leaving to work for a competitor, such as a time limit before they can do so.

The Shareholder Agreement can also specify what happens if a shareholder wants to sell up (and how their shares are valued) – it will usually give a right of first refusal to other shareholders. This can also apply when a shareholder who dies, to avoid the administrative inconvenience of the outgoing shareholder's family inheriting a stake in the company.

4. PROBLEMS IN PARTNERSHIPS

Running a business in partnership implies that you have (or had) a relationship beyond a simple business connection: partnerships require a meeting of minds about how the business will be run and the direction it is going. Above all, they require trust. But partnerships can come undone, and cease to function properly, where there is a personality clash or one partner is not pulling their weight. Or, even worse, where it is discovered that a partner is making a secret profit.

Sorting Things Out, Or Ending The Partnership

Where a partnership has been formulated properly with a written agreement or partnership deed, there will often be a prescribed mechanism for dealing with disputes. If necessary, the deed may specify how the partnership is to be brought to an end.

If there is no partnership deed, statute law may require a partnership to be dissolved – even if it is otherwise a thriving business. The problems that can result from old-style unlimited partnerships are one reason one it is now much more common to be constituted as Limited Liability Partnerships (LLPs).

How can a partner get their capital out of the business, if they want to retire? If there is no partnership deed, the answer is probably that they can demand to be paid out immediately. That can imperil the entire business, and so the deed should specify the process: usually, it will state that accounts are drawn up to the date of retirement to establish the value of capital; and then that capital can is paid out to the outgoing partner over a period of time.

5. IF ALL ELSE FAILS…

Sometimes the relationship between directors, shareholders or partners breaks down entirely. This might be because the business has simply run its course in its current form, and someone needs to leave to enable it to move on. But it will almost certainly happen if a director or partner has been acting against the interests of the business and other shareholders/partners, such as planning to start a rival business.

If there are fundamental disputes about the future of the business, plans for the future and the direction it is going in, then there may be no alternative but to bring the business to an end and formally wind it up. For a partnership, it is a reasonably straightforward process – in theory – to end the partnership and distribute the partnership assets to the partners. With a limited company, it is a little more complicated. But with goodwill on all sides, it can still be achieved quite quickly.

The ideal outcome is to end the business with a minimum of fuss, so all involved can take their share of the value of the business and move on.

This Guide is for reference purposes only, and does not provide advice for any particular set of circumstances.

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