SPEAKMAN LAW

Shareholder disputes – Managing exits by a shareholder

Take a private company setting, say 3 individual shareholders. The shareholding may be held in trusts but that makes no difference to the present discussion. One of the shareholders has begun to cause trouble. The other two shareholders want him or her gone. What can be done?

This is a scenario I have been presented with a number of times. Variants on this set of facts are many. One is that a shareholder simply wants to leave. The remaining shareholders then face the prospect of funding the purchase of the exiting person's shares. Failure to do so leaves the exiting person free to sell his or her shares to a third party. In that event the two remaining of the founding shareholders might be joined by one or more co-shareholders whom they have no regard for.

To answer the question what can be done, the first step is consider the shareholders agreement between the parties (if there is one). If this has been drafted with these sorts of problems in mind, it will contain put and call options. It will also contain a mechanism for a review. If so, the solution to the problem will largely be provided by the shareholders agreement. In those circumstances, the solution, ignoring the cash impact for the moment, is for either of the scenarios painted above to entitle a party to initiate a review.

If the review process fails to resolve the issue by other means, the put and call options operate. The put option entitles the exiting shareholder to have the remaining shareholders buy his or her shares (or otherwise deal with the issue). Otherwise the exiting shareholder is dependent on a sale being achieved through the pre-emptive rights process, failing which his or her shares would simply drift in the wind. The call option works the other way around. It entitles the remaining shareholders to buy out a troublesome shareholder, should the level of annoyance caused by that shareholder prompt that action.

In many cases, however, there will not be cash available to give effect to a sale process, whether that process be triggered by the pre-emptive rights or exercise of an option. What then?

The usual response is to consummate the sale on a deferred payment basis. Payment to the exiting shareholder might be delayed for one or possibly two years with interest running in the interim. An alternative is to raise the necessary funds by selling off a non-core division of the business or asset. If neither of these alternatives fit, the solution may be an orderly sale of the business on the market.

More often than not the shareholders agreement does not assist in these respects. In that case, the parties are left with company law remedies. These are reasonably widespread, but they certainly do not go so far as to grant the parties the option to buy one or other out. If you would like more information about these remedies please get in touch but the best solution is a well tailored shareholder agreement at the outset.