

BOARDROOM DRAMAS: SHAREHOLDERS IN DEADLOCK

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The separation of ownership and control in most companies envisages a division of power between directors and shareholders.

As officers of the company, directors are entrusted with wide-ranging management powers, excluding certain powers exercisable by shareholders in general meeting under the Companies Act, or those covered by the company's Memorandum and Articles of Association (M&A).

To minimise the risk of abuse, fiduciary duties are imposed on directors under the Companies Act and common law. These duties require directors to act honestly in the best interests of the company, to use reasonable diligence in discharging their duties, to avoid positions of conflict, and to act for proper purposes.

Shareholders, on the other hand, are owners of the company and are entitled to certain fundamental rights. However, when these owners are unable to reach the requisite consensus in their meetings, the operations of the company may reach a deadlock. This is especially so in joint venture situations where shareholders have the right to appoint directors and/or approve business decisions.

A well-drafted shareholders agreement with comprehensive deadlock provisions can sometimes help resolve the deadlock, but not all companies are protected that way. The typical company's M&A is usually inadequate for deadlock resolution. In such situations, shareholders may be forced to resort to drastic measures, including winding up the company.

WHOSE BEST INTERESTS?

In a shareholder deadlock, different shareholders can have conflicting interests. A decision may be detrimental to one group while benefiting others. The key issue facing directors is to decide whose interests serve the company, since the directors owe a primary duty to act in the best interests of the company.

The company's M&A typically provides for the chairman of a meeting (usually also the chairman of the Board) to have the right to demand a poll after a vote on a show of hands results in a deadlock. The chairman may also be able to have a second or casting vote in the event of a deadlock, if the M&A so provides.

Critically, the chairman must consider the issue carefully before making his decision. Failing to act in the company's best interests will render him liable for breach of his fiduciary duty.

THE BEST INTERESTS OF THE COMPANY

A useful approach is to act to benefit the company commercially instead of benefiting individual groups of shareholders. As long as directors act honestly and objectively in the company's interests, the courts will generally not interfere with a business decision – even if it is commercially unsound in hindsight.

In this context, directors need not always act in a manner that results in pecuniary benefits for the company. They can consider intangible benefits such as maintaining goodwill, or making strategic long-term investments. The Companies Act also allows directors to consider the collective interests of the company's members and employees in deciding where the company's best interests lie.

FAIRNESS BETWEEN SHAREHOLDERS

In a situation where it is hard to determine what the company's best interests may be, the decisive premise may be to consider what is fair as between different factions of shareholders, where a decision affects each faction differently.

For example, if the motivation of one shareholder group is to confer collateral benefits on themselves, or indeed, to oppress the other group of shareholders, that is unfair and the directors should not condone such an action.

Another frequent scenario is when two groups of shareholders have different time horizons. For example, an investment fund group close to the end of life of its fund locking horns with founder shareholders or employee shareholders.

The first group is under pressure to deliver immediate appreciation in the share price and could be pushing for realisation of short-term

gains. The second group may be prepared to take a longer term view and may resist any disposals for short-term gain.

Who is to say which group's interests best represent the company's interests? These tough calls challenge directors to try and strike a balance. Directors must also be mindful that an unhappy shareholder may pursue court action for minority oppression under the Companies Act. This underlines the necessity of acting honestly and in good faith when deciding in favour of one faction over another.

The court has power, in limited circumstances, to relieve a director in proceedings brought against him for breach of duty by the company, if he is shown to have acted honestly and reasonably in the relevant circumstances. Directors are well advised to document their decision-making processes and reasons for acting in a particular manner.

Ultimately, when caught between two or more shareholders in a deadlock, directors should have a clear focus: their fiduciary duties to the company override any duty to the individual shareholders, and their primary function is to act appropriately. ■