

# Avoid Disruptive Company Deadlocks

Companies are often formed by equal-share partners with a shared vision for their business. But when serious disagreements arise, such as over the future strategic direction of the company, that initial confidence and optimism quickly turns sour, resulting in a Mexican standoff. In legal circles this is known as a “deadlock”.

## What is a deadlock?

Deadlocks arise where shareholders have equal voting rights and the right to appoint an equal number of directors to the board of a company. (A dispute at shareholder level often becomes a dispute at board level.) For example, one shareholder may wish to take the business in a new direction or acquire a new business while the other party wants to carry on business as usual. Deadlocks can arise in both company and joint ventures and are disruptive or fatal if not resolved quickly.

## How can deadlocks be resolved?

Quite simply, by paying attention to the details and including a deadlock mechanism in your shareholders’ agreement. This encourages everyone to reach a quick and amicable settlement in the event of shareholder disputes. Here are the main options to consider:

### 1. Russian Roulette

Any shareholder can, by written notice, either require the receiving shareholder to purchase that shareholder’s shares or require the receiving shareholder to sell their shares to the initiating shareholder, at a specified price. The receiving shareholder can then sell their shares at the specified price or buy the other shareholder’s shares at the offered price. The risk of reversal incentivises the initiating shareholder to offer a fair price.

### 2. Texas Shoot-out

This is similar to Russian Roulette, except that if the receiving shareholder also wishes to buy the initiating shareholder’s shares, then both shareholders submit sealed bids and the highest bidder wins.

### 3. Put and Call Options

Under a put option, one shareholder is obliged to sell their shares to the other shareholder. Under a call option, one shareholder is obliged to buy the other shareholder’s shares. The shareholders’ agreement should set out the basis upon which the selling shareholder’s shares will be valued if the purchasing shareholder exercises their option.

#### **4. Alternative Dispute Resolution**

Where the dispute is over the interpretation of a clause in the shareholders' agreement or is factual in nature, the shareholders may agree to refer the dispute to an arbitrator or expert for a decision. This form of resolution is not appropriate where the dispute in question relates to business strategy.

#### **5. Voluntary Liquidation**

Voluntary liquidation involves the company being wound up, selling its assets and distributing the proceeds to the shareholders. This will usually be a last resort where none of the shareholders are in a position to buy the other shares out and the shareholders are unable to sell the company to a third party.

Before choosing a deadlock mechanism, carefully consider the financial and commercial strengths of the parties and the merits of each approach for your situation. That's because most of these procedures can be manipulated by an astute shareholder who has greater financial means than the other shareholders. In some circumstances, a combination or variation of these mechanisms will work.

We help our clients to meet expectations and resolve disputes, which is made a lot easier with early planning. To discuss shareholders' agreements, including deadlock mechanisms, speak to our Commercial Team.