BUSINESS RELATIONSHIPS TURNED BAD

- Shareholders' dispute and the importance of a shareholders' agreement -

Every business carries risks. Other than commercial risk, there is always that one risk that business owners tend to overlook and that is the risk of having a deadlock amongst the owners.

More often than not, shareholders do not find the need to seek legal advice from the start. They often do not have a shareholders' agreement nor a considered constitution in place catering for events of dispute.

Legal advice is often sought for when things have gone wrong and parties are caught in a dilemma.

But engaging a lawyer before kick-starting my business is costly.

To relate, we think the scenario illustrated below might ring a bell.

You ventured into a business with a friend, setting up with the vision of becoming the industry leader. As a commitment to the alliance, you and your partner decide to play roles as employees and directors of the company with each holding 50% equity stake.

All went well. But as the business grows, views toward that once perfect vision no longer coincide. Over attempts of trying to amicably resolve the issue, sentiments intensified and one of you decide to call it quits.

Both partners no longer foresee a future working relationship and the exiting partner wants to offer to sell his share to you at a price too exorbitant to afford.

It is unlikely business owners would want the business to fail simply because of a disagreement between the owners.

So, get a reliable conduit.

Throughout our practice, we have experienced shareholders who can no longer speak with each other or neither can they bear being present within the same space.

The involvement of an impartial party as the mediator to resolve the dispute might then be the only option available. Such person can either be a professional (like lawyers, accountants or company secretaries) or a friendly third-party facilitator whom both shareholders are comfortable with.

He / she can be the conduit for communication between the arguing partners and help identify the essence of the dispute and reach a resolution palatable to both.

But, there are limitations to a non-professional.

A friendly facilitator may be able to help suggest solutions but unlike a legal practitioner, he / she may not have resources to help document the settlement terms.

Having a lawyer to navigate will be helpful. Parties can decide to have the break-up terms documented in the form of a settlement agreement and to have the lawyers facilitate the entire process until its closure.

How do we break the deadlock?

Sale of shares by the exiting shareholder – He is willing to sell his shares to the staying shareholder to continue to operate the business at a price accepted by both.

Parties can execute the sale and transfer fairly quickly without the need to carry out any due diligence exercise on the company as both have been playing an executive role in the day-to-day operations of the company. This can be done by way of a share sale agreement.

Or, the exiting shareholder can offer to sell and transfer his shares to a bona fide third-party purchaser, unless prohibited by an existing shareholders' agreement or the company's constitution.

However, if such a third-party purchaser is someone not known to the staying shareholder, this may not be an ideal option.

Nonetheless, if accepted, it would be best to craft a shareholders' agreement governing the relationship to avoid future disputes.

Don't want to exit? Take a passive role instead.

If the disputing shareholder do not wish to leave the company but is agreeable to relinquish his executive role by taking up a more passive position in the company as a silent / sleeping shareholder, this can also be a solution to the falling-out, so long as he remains entitled to his proportion of dividends declared by the company (in accordance with the Companies Act 2016 and the company's constitution, as applicable).

Other ensuing considerations might follow if he were to agree to take up a passive role. Negotiations vary on a on a case-to-case basis.

******

These are just some of the examples that can be adopted as settlement to the deadlock. They are not case in stone.

As you may now realise, it is very much a hassle whenever there is a deadlock between shareholders.

Resolving disputes is not impossible but deadlocks can be avoided.

Why not have a bespoke set of rules documenting the partners' understanding before things get out of hand?

Shareholders' dispute can result in stressful times for the shareholders as well as the employees who have been there since the inauguration of the company.

This might take a toll on the company's day-to-day operations and inevitably impact the overall performance of the business.

If a shareholders' agreement is already in place, how do I bind the new incoming shareholder?

Every shareholders' agreement should have a deed of adherence.

A new shareholder will usually be required to execute a deed of adherence and agree to be bound by the provisions of the existing shareholders' agreement already in place, unless the existing shareholders are open to negotiate a new shareholders' arrangement with the newcomer.

Do we still need a shareholders' agreement when the new Act now provides more flexibility to companies?

Though the company law in Malaysia has in recent years introduced more flexibility into the governance and operations of a company such as doing away with the need to have articles of association (unless listed), legal practitioners still see increasing need to have shareholders' agreement in place to govern the shareholders' relationship in a company.

Provisions under the Companies Act 2016 govern the duties and responsibilities of the board of directors. If you as a business owner, also holds the post as a director, these provisions suffice (but may not be adequate) as a guidance on how you should manage the business and affairs of the company.

For instance, provisions under the Third Schedule of the Companies Act 2016 governs the proceedings of the board unless otherwise governed by the company's constitution (if adopted).

But every business is unique on its own with distinctive characters. Hence having a set of tailor-made rules agreed amongst the shareholders will benefit the company.

As a prudent business person, it is always important to plan ahead, for better or for worse. Not only should you budget ahead for the business, having proper precautions towards the unforeseen is also of great significance. Hope you now appreciate the importance of having a shareholders' agreement!

****

The author to this newsletter is Gillian Chew. Gillian is a Partner of Donny & Ong since 2017. She mainly advises on merges & acquisition transactions, equity capital markets as well as general corporate commercial matters including shareholders' matters.

CONTACT US

| **T** +603 6211 1316
| **F** +603 6211 1876
| **A** A-2-10, Plaza Damas 3, Jalan Sri Hartamas 1, 50480 Kuala Lumpur
| **W** www.donnyong.com
| **E** admin@donnyong.com

DONNY & ONG
ADVOCATES AND SOLICITORS
柯王律师事务所