

## LEGAL ARTICLE

**Shareholder dispute is tearing a company apart. Learn common grounds that often spark shareholder disputes and get ready before a serious problem arises**

# PARTNERSHIP FALLOUT: UNDESIRABLE JOURNEY OF JV COMPANY

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**Hopes are often high** upon entering any business but unfortunately a dispute almost certainly happens among business co-owners who once upon a time trusted each other. A dispute starts off with dissatisfaction of the company's owners, who are called shareholders. So, before we delve into the dispute itself, let's explore first who are these shareholders behind the dispute. Here are common ways to classify different groups of shareholders.

**Passive Shareholder.** A shareholder who owns an interest in the company in proportion to his/her contribution, but do not participate in the management.

**Active Shareholder.** A shareholder who is responsible to run the business and asserts complete control over day-to-day management.

**Majority Shareholder.** A shareholder who owns more than 50% of the outstanding shares, or owns the highest percentage of the shares compared to others, and consequently, holding the majority of votes at the general meeting of a company

**Minority Shareholder.** A shareholder who owns minority stakes in the company and does not have control in running the company.

Understandably, each group of shareholders has different needs and preferences on how the company is run.

Some shareholders might not be terribly satisfied with the way a company is operated by the directors who may be nominated by a different group of shareholders, say majority shareholders.

In another scenario, shareholders from different groups may jointly manage the company but cannot agree on how the company is run.

Naturally, dissatisfaction occurs once and a while. The disputes are more likely to occur when the company does not perform well as the shareholders expect.

### TOP COMMON THEMES FOR SHAREHOLDER DISPUTES

**Each shareholder dispute** is rather unique, but (not surprisingly) there are certain events that commonly trigger such dispute. It does not matter whether the company is small size, a family owned or a multi-million company, the themes behind this shareholder dispute are not totally new and unexpected. The list below while not exhaustive, reflects the most classic themes of shareholder disputes.

**Lousy Operating Result.** When the company posts a lousy operating result, there is always a big question mark on how the company is run and managed. Without any doubt, passive shareholders want a conclusive explanation from the director or executive, the active shareholder, why such thing can

happen. All too often blame is put on economic recession, a lack of luck, no shareholder support, or a bad business model. But those do not stop the disgruntled passive shareholder from further scrutinizing the company records. A dispute between shareholders will certainly erupt if there is a lack of transparency in the company records, leaving the passive shareholder in the dark.

**Conflict over Related Transaction.** A business deal between the company and its shareholders often triggers potential conflict of interest. Time to watch out for is when this related transaction benefits one group of shareholders at the expense of the company. The disadvantaged shareholders may decide to take action against the benefited party who apparently has violated its code of conduct.

**Excessive Pay.** A shareholder who act greedy by overpaying himself with an excessive director fee, a high salary or various types of company's perks that are not warranted by company's financial standing, will definitely face serious anger from other shareholders, which may lead to a nasty conflict between shareholders.

**Free Ride of Company Properties.** One shareholder certainly will not be happy if other shareholder uses the company's assets for the personal gain, i.e. the free use of company's car, office space and facilities.

**Fraud.** Sometimes the controlling shareholders engage in corrupt business practice and have gone an extra mile to siphon the cash out of the company. This fraud is clearly the breach of a fiduciary duty to the company and a criminal act of such shareholders.

**Not Enough Sweat Money.** The active shareholder who serves as a director or an executive of the company may feel that he or she is not compensated enough and is working for the company almost for free. Being those who are doing all the hard works, while others just sit back and enjoy the free ride, the active shareholders arguably want more reward and bonus.

**Lack of Support.** The active shareholder may expect some kind of contributions from the inactive shareholders, i.e. dealing with a customer, a supplier, a banker, a government agency and an alliance, that have never been forthcoming.

**Unfair Personal Guarantee.** An active shareholder with the majority stake in a company may feel it is unfair for the majority shareholder to solely provide a personal guarantee to company's banker in support of company's borrowing, while the inactive shareholder with the minority stake in the company provides no collateral at all the banker.

**Facing Deadlock.** For certain reason, a group of shareholder refuses to cooperate on many operation matters. These matters could be the reserved matters where the consensus from all groups of shareholders is required. Basically, the deadlock occurs.

#### GEAR UP BEFORE IT STRIKES

**By learning all these** common grounds behind a dispute, a shareholder shall gain valuable knowledge and become aware of many potential risks related to his or her shareholding. Of course there is always an underlying question: can a shareholder dispute be prevented?

The truth is nothing can prevent such dispute from occurring. Just like bickering and fighting between siblings, no matter how hard the parents try, a fight will always happen.

Until then, what shareholders can do is to prepare for and agree on a mechanism for resolving a dispute. This mechanism should be clearly documented in the Shareholder Agreement and the Articles of Association of the company. The key to remember is that it will be easier, cheaper, and less problematic to have this mechanism ready long before a dispute (finally) strikes. Hence, when there is a (sign of) dispute, shareholders can act charmingly according to the guiding mechanism to address the conflict, minimize the damage and reach the best possible outcome.

*This legal article was written by Narit Direkwattanachai, a corporate & tax attorney at NARIT & Associates with expertise in shareholder dispute. He holds a bachelor of laws (1<sup>st</sup> class honors) from Chulalongkorn University, a master of law from the University of Cambridge, UK and an MBA in finance from the Georgia Institute of Technology, USA. He can be reached at [narit@naritlaw.com](mailto:narit@naritlaw.com)*

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