



Shareholder disputes:

Issues associated with removing a shareholder who is also a director and employee of the Company

TW Update

Providing practical advice and guidance for **Owner Managed Businesses**

There are various reasons why a company would want to remove a shareholder. It could be that the shareholder is considering other investments or perhaps need their money for personal reasons. It could also be due to the death of a shareholder or in some instances, a dispute between the company and the shareholder.

When these issues typically arrive at Taylor Walton, nine times out of ten, it is because the majority shareholder or shareholders have an issue with a shareholder who is also a director and employee of the company. They come in to discuss the employment aspects but then, of course, we also have to talk about the shareholder aspects.

Having a shareholders agreement in place already, pre-emptively resolves a number of problems you will otherwise encounter if you do not have one.

There are a number of key factors to take into consideration and this summary discusses the key issues and three main areas of law which are employment law, litigation and corporate law (*The Company's Act*).

Typical reasons why you would want to remove a shareholder from the business

The company would consider a dismissal where an employee who has committed an act of misconduct, or perhaps after being supported for a period of time still shows incapacity, poor performance or a lack of skills.

Relationship breakdown is considered one of the more problematic areas because in this situation, both the individual and business no longer wish to be connected and wish to go their separate ways.

All of these situations can be very difficult from an employment law perspective, however even where there is a fair reason to dismiss that person as an employee we have to consider their rights as a shareholder when negotiating their removal from the Company.

Issues and litigation risks

There are two main areas of concern, firstly a claim for unfair prejudice under the Companies Act and secondly, claims under the Employment Legislation.

A shareholder may petition the Court for relief where the affairs of the Company are being conducted in a manner that is unfairly prejudicial to the shareholders' interests. A shareholder would claim that the removal as a director and loss of employment is prejudicial to their shareholders interest. Accordingly, it is necessary to deal with the shareholders shareholding in the company as part of a strategy to remove the shareholder as a director and employee of the Company.

In addition, there is a significant difference in approach where a proposed dismissal is fair for the purposes of Employment Legislation compared to a proposed potential unfair dismissal e.g. relationship breakdown.

We recently dealt with a situation where an employee/shareholder was dismissed for gross misconduct, the Company had a well drafted shareholders agreement which clearly stated that in the event that the employee was dismissed for gross misconduct, their shares would be returned to the other shareholders, or bought by the company for £1. This was a straightforward case.

However, in another recent instance where the employee/shareholder became disengaged and increasingly difficult to work with, unfortunately there was no shareholders agreement in place. We had to look at how we could remove that person safely from the business without it costing the Company and the remaining shareholders significant money.

A well drafted Shareholders Agreement reduces the issues and litigation risks involved. We would highly recommend this and should you need help with this, we would be glad to assist you drafting such an agreement.

Costing the dismissal

Senior employees can be expensive to dismiss. If they do not have a contract of employment, one has to insert reasonable notice. Nine times out of ten there will hopefully be, a directors service agreement or contract of employment however, the notice period itself (whether contract or implied by i.e. the principle of reasonable notice) could be six months or even twelve months.

We also have to look at the risks associated with the proposed dismissal, in the same way, we would look at the dismissal of any senior executive of the business. This means we have to consider the risk of other claims such as whistleblowing and discrimination. The cap for unfair dismissal compensation does not apply to claims for discrimination. When we are looking at incapacity or relationship breakdown, nine times out of ten, depression is often lurking in the background, which raises the question of whether or not there is a potential disability discrimination.

A well drafted director's service agreement provides the company with significant benefits, in this type of situation and we are able to assist with drafting a suitable agreement for your Company.

Does the board of directors have authority to dismiss?

This is one of the most important questions to ask. It might seem like the answer is obvious considering a Company is run by its board, and its board makes the decisions on behalf of the company.

However, in a scenario where we have two shareholders 50/50, both of whom are the only directors on the board, it would be difficult to obtain a board resolution to authorise a dismissal of the other director.

Even in situations where there are three or four people on the board, and one person decides that they wish to remove X as a shareholder, it might be difficult to obtain authority to dismiss consensus and this raises the question of what can be done in a 'deadlocked' situation.

This is another situation where a well drafted shareholders agreements can help to resolve any potential complications. To determine the best solutions to such problems, it is best to seek the advice of a professional who can guide you to the best decisions relating to the removal of shareholders who are directors and employees of the company.

Should you have any questions then please feel free to contact Heather Cowley (Employment team) on 01582 731161 or Jeremy Brockis (Corporate & Commercial team) on 0330 024 0832.

The information given in this update was, at the time of publication, believed to be a correct statement of the law. However, readers should seek specific legal advice on matters arising, and no responsibility can be accepted for action taken solely in reliance upon such information.

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