SMES, DIRECTORS & SHAREHOLDERS

Common FAQs for shareholders and directors

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1 How do shareholders' and directors' roles differ?

A company is an independent legal entity separate from its directors and shareholders.

A director of a company is responsible for directing its affairs on a day-to-day basis, promoting its success and protecting all stakeholders (i.e. shareholders, employees, the company itself and, in certain circumstances, creditors).

The shareholders of the company have an interest in its equity (i.e. the net value of its assets), which they own in accordance with the shares allocated to them. They have certain powers under the relevant legislation in terms of how their decisions (referred to as "resolutions") are reached; how the structure of the company is managed (including its funding arrangements and directors' appointments); and how they can deal with company assets (e.g. payments to directors). The shareholders otherwise have no role in managing the company or determining its direction, other than as determined in the company's constitution (i.e. the Memorandum and Articles of Association), any shareholder's agreement and by way of resolutions passed at general meetings of shareholders.

Directors must call an Annual General Meeting of shareholders ("AGM") but there is also an ability for shareholders, of the requisite number, to request a meeting outside of these time limits during the year – this is called an Extraordinary General Meeting ("EGM"). shareholders' decisions are normally reached by reference to the shareholders present (or voting by a nominated proxy, usually the chairman) voting on specific decisions and such decisions are passed either by an Ordinary Resolution (requiring 50%) or a Special resolution (requiring 75%).

2 What happens if directors or shareholders disagree on a decision?

The Company's Articles of Association and/or shareholders' Agreement sets out the rules as to how company decisions can be taken and what directors can do as part of their day-to-day governance of the company's affairs.

Beyond the day-to-day decisions, the majority of decisions made by a company (e.g. the removal of a director and the approval of "conflict" situations) require a simple majority (i.e. of 50.01% or above) of shareholders present at a general meeting to agree to pass an "Ordinary Resolution".

In the event that a director or shareholder disagrees with a decision made at a general meeting, it is first necessary to consider whether notice of the meeting was provided correctly and that all other formalities have been complied with and then secondly, whether an appropriate shareholder Resolution was passed to validate the decision being complained of. In the event that this is not the case then the decision (i.e. the Resolution) may be invalid and the decision will not stand. The status quo will therefore continue until a valid Resolution is passed and a decision made. This can raise difficulties in practice and specific advice should be sought on the relevant facts.

3 How can a director be removed from a company?

The most important point to note here is that the removal of a director requires shareholder support (save a decision to demote a Managing director to director). At a general meeting, shareholder support of in excess of 50% (i.e. an Ordinary Resolution) is normally required for a decision to be taken to remove a director from a company (unless varied by the shareholder agreement or articles

of association). It should be noted that 28 days notice (referred to as "Special Notice") must be given to the director of the resolution to remove him/her and, in the event that sufficient notice is not provided, the resolution to remove the director will be deemed invalid. Upon receipt of a Special Notice, the director is entitled to distribute to shareholders his/ her written representations contesting his/her removal as a director. The director is also entitled to make verbal representations at the general meeting itself (note that an actual meeting is required and that the resolution to remove a director cannot be passed by way of written resolution in lieu of a meeting). Following representations in defence of his/her position, the director will or will not be removed depending on whether the requisite majority of shareholder votes is cast in favour of the Resolution to remove the director.

4 What are a director's fiduciary responsibilities?

Directors have a number of legal responsibilities and duties to the company, primarily stemming from a general duty to act in good faith in the best interests of the company. More specifically, directors are required to act within the powers conferred upon them by the company's Articles of Association; they must promote the success of the company and exercise reasonable skill, care and diligence in their particular area of management and all decisions relating to the company; they must avoid conflicts of interest (save those declared and approved at a general meeting) and they must not accept personal benefits from third parties without authorisation at general meeting (subject to any alternate provisions within the Articles of Association).

5 How to resolve a "deadlock" situation

A deadlock situation commonly occurs in small or medium-sized businesses under the control of only a few directors and/or shareholders.

Occasionally, the directors may have a disagreement on certain decisions and, as a result, the board is split 50:50 and the decision is "deadlocked". It is not uncommon to have a provision in the company's Articles of Association to provide for this situation and provide a casting voting to one of the directors (usually the chairperson) or alternatively, to provide for a third party to intervene. If there is no such provision then the board is deadlocked and this will prevent the decision being decided upon.

In such a situation, the directors should then turn to the shareholders who have wider powers to terminate a director's appointment or pass Resolutions on specifically addressed matters. However, especially with a small business, an identical situation can occur where the same individuals are both shareholders and directors with no other parties involved. In these circumstances therefore, a deadlock situation is likely to continue.

The solution to a shareholder deadlock will again be dependent on the company's Articles of Association and any shareholder agreement. If there is no provision to deal with this deadlock and no alternative provision for (e.g. formal mediation), then the parties must look to negotiation to resolve the problem or, ultimately, their respective legal options.

If the shareholders must resort to a legal route to settle the dispute or recover their interests (sometimes as a minority shareholder – see below) then the available options include seeking to wind-up the company, issuing a petition against a director for unfairly prejudicing a shareholder right or seeking a derivative claim on behalf of the company (derivative meaning that the authority derives from your equitable interest in the company).

5 What rights do I have as a minority shareholder?

Any shareholder with at least 5% shareholding can, subject to a company's Articles, require the board to call a general meeting of shareholders and to propose a Resolution for consideration by the shareholders at a general meeting. The decision, whether requiring an Ordinary or Special Resolution, will or will not be passed according to shareholder support.

In the event that a minority shareholder's rights are being breached, they are entitled in the appropriate circumstances to apply to the Court for an Order stipulating that the Company has acted or continues to act unfairly (pursuant to Section 994 of the Companies Act 2006). Such a Petition is commonly referred to as an "Unfair Prejudice Petition". Dependent upon the facts, such a Petition, if successful, may give rise to an order giving such relief as necessary in respect of the matters complained of. This may include an order made to regulate the company's affairs, require the company to do or refrain from engaging in the action(s) complained of, authorise proceedings to be issued on behalf of the company, direct alterations to the company's Articles of Association or provide for the purchase of shares by other shareholders.

Where appropriate, minority shareholders can also apply to the Courts for a company to be wound-up upon the grounds that it is just an equitable to do so (pursuant to section 122 of the Insolvency Act 1986). Such a Petition can lead to the company being wound-up in the event that no alternative solution exists, including the purchase by the company of the petitioning shareholder's shareholding. However, great caution needs to be taken in such matters as the Court is hesitant to allow minority shareholders to disrupt a company's business in contravention of the majority's rights and so, orders of this nature are considered to be a last resort in resolving a dispute between shareholders.

Legal action can be taken against the directors personally in respect of negligence/ breach of their fiduciary duties (which they owe to the company) by way of a derivative action, this means that the application would be issued in the name of the company itself against a director in his / her personal capacity. Such an action can result in the director being forced to compensate the shareholder,the company or, if merited, the director's removal from office.

As a general note, other than as described above, minority shareholders have a limited entitlement to affect the company process through day-to-day communication with directors and/or shareholders (especially in smaller businesses with common directors and shareholders) or via criminal redress, through the police or the use of a mediation service, where applicable.

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