

Corporate & Commercial

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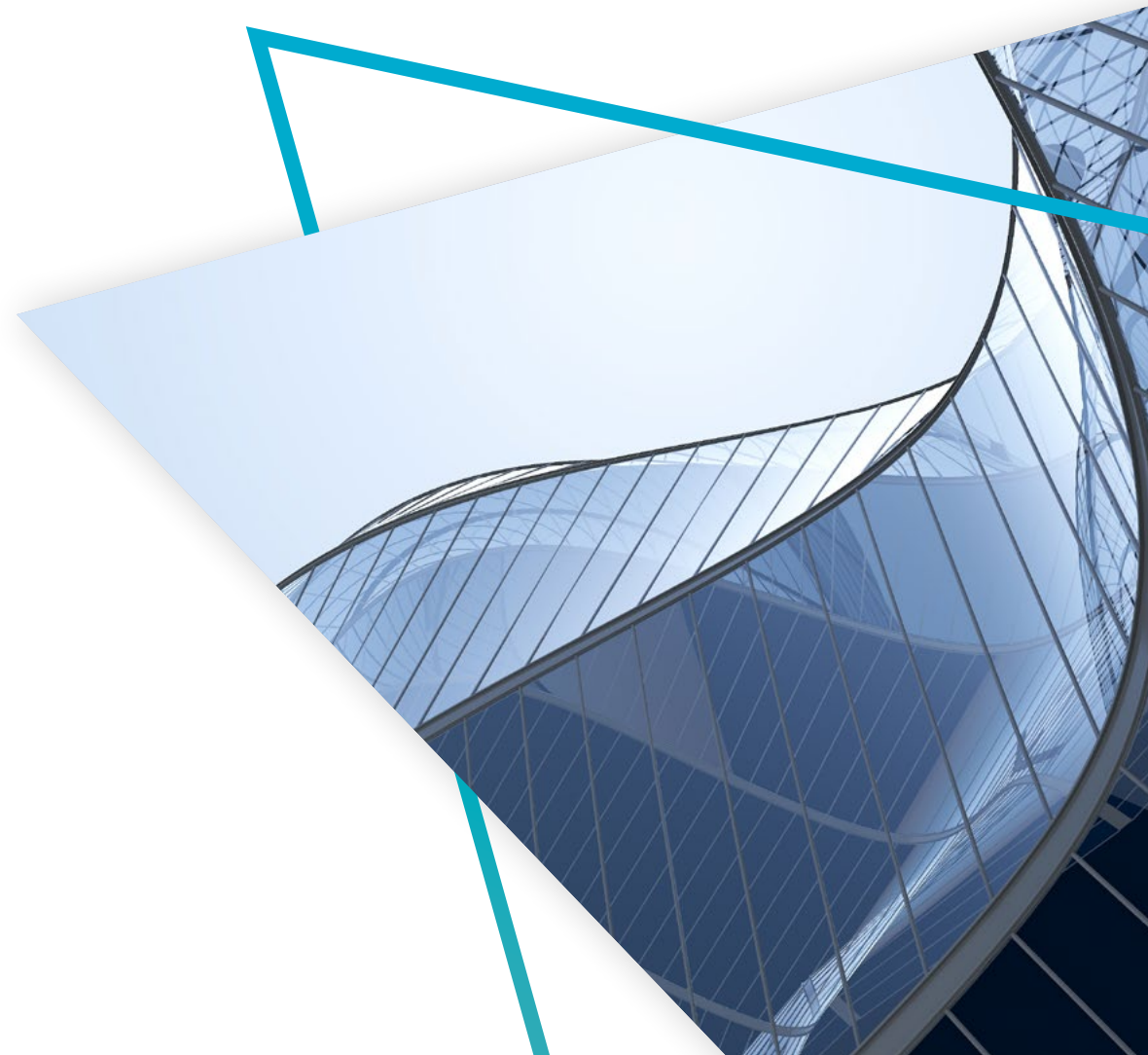
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SOUTH AFRICA

Unlocking stalemates: Solutions for shareholder deadlocks



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Unlocking stalemates: Solutions for shareholder deadlocks

Imagine this – the future of your company hangs in the balance, but the room is split down the middle. Critical decisions are stalled, tempers are flaring, and progress has ground to a halt. Welcome to the frustrating world of corporate deadlocks. Such an impasse can cripple even the most dynamic of companies, turning what should be a strategic collaboration into a stalemate. But fear not, for there are creative solutions designed to break these deadlocks and get your company back on track. In this article, we explore some of these deadlock-breaking mechanisms. We don't cover possible processes preceding the shareholder deadlock stage – such as referring matters to respective CEOs of shareholders for discussion before going to a vote at shareholder level – which could be used in conjunction with the suggestions below.

What is a deadlock?

A simple deadlock occurs when votes for and against are equal and nobody has a casting vote. While this could occur at board or shareholder level, ultimately what matters is shareholder level, as a majority shareholder can always change the board. While multiple shareholder scenarios can result in a deadlock, we deal here with the simplest scenario where two shareholders in a company each hold a 50% shareholding of the ordinary shares of a single class.

One way of resolving this potential problem is through the incorporation of deadlock provisions within the shareholders' agreement and/or memorandum of incorporation (often collectively described as the "**constitutional documents**"). Common examples of these deadlock clauses are outlined below.

Status quo

Let bygones be bygones!

It is common to include a clause in a company's constitutional documents stating that if shareholders can't resolve a deadlock, the *status quo* will prevail and the parties agree that this does not entitle winding up of the company, which might otherwise be the case. While this is not the most effective solution to break a deadlock, it allows the company to keep operating and address other important issues. This approach in a sense forces the parties to compromise and find a solution.

Expert determination

Let's involve others!

Shareholders may decide to refer a matter to an expert, though this option is rarely used as it is difficult to select the appropriate expert without knowing the nature of the dispute upfront. Traditionally, disputes are categorised into legal, accounting, or other domains, each potentially requiring a different expert or appointer of the expert.

Moreover, shareholders may be reluctant to entrust crucial decisions to an 'outsider' who may lack comprehensive knowledge of the company's ethos and operations.

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The time and cost involved in appointing an expert can render this mechanism impractical, especially when swift decisions are imperative. Locating an expert willing and qualified to offer insights on commercial matters also presents its own set of difficulties.

Arbitration and/or mediation may also not be chosen for the reasons above.

Using class share distinctions

Divide and conquer!

Where two classes of shares exist, this gives rise to the possibility of a deadlock resolution based on specific issues, by adding a tiebreaker vote (or weighting) to a class of shares in specific circumstances. For example, in a company with a simple business of renting one investment property, with A shares held by a property expert and B shares held by a financial investor, the A shares might have a tiebreaker vote on the decision whether or not to sell, while the B shares have a tiebreaker vote on which property practitioner to use for the sale. However, this circumstance is very uncommon.

Sale of all the shares

Bye-bye!

If shareholders cannot resolve the deadlock and it continues for a specified period, shareholders may irrevocably authorise an independent auditor or another predetermined professional broker to arrange the sale of all the company's shares to the highest bidder.

This mechanism is generally more practical than trying to find a buyer of a 50% shareholder in a deadlocked company but can be time-consuming.

Russian roulette

Yes, you read that right! This is not a mistake.

This mechanism allows any shareholder to issue a notice to the other shareholder(s), offering to either buy them out at a specified price or requiring them to buy out the issuing shareholder at that same price.

The shareholder receiving the notice then has the option to either sell their shares at the specified price or buy the other shareholders' shares at the specified price. The purpose of this mechanism is to ensure that a fair price is offered, as the shareholder issuing the notice bears the risk that if the specified price is too low, they might be compelled to sell their shares at that price.

Shareholders would only agree to include these deadlock-breaking mechanisms if both parties are financially equal. A shareholder who is financially stronger and is aware that the other shareholder lacks the financial strength to buy its shares, might exploit the mechanism by offering a low price. Some protection can be provided by a long period to respond to enable the arrangement of finance.

Texas shoot-out

Again, this is no mistake!

This mechanism requires each shareholder to submit a sealed offer to an independent third party, often the company's auditors, offering to purchase the other shareholder's shares at a stated price. The submitted bids are then opened simultaneously at a predetermined time, and the shareholder that placed the highest bid is required to purchase the other shareholder's shares at the lowest price.

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Again, this may favour a shareholder who is financially stronger, but it does give each shareholder an equal opportunity to do their respective investigations and submit a bid. It is important to include the timeframes within which each shareholder has to undertake their investigations and submit their respective bids.

Liquidation

End of the road!

If all else fails and shareholders are unable to reach an amicable solution, one or more shareholders may opt to liquidate the company. This would generally be sub-optimal, especially if the company is successful or holds mainly intangible assets.

Conclusion

Deadlocks are an inevitable part of corporate governance, but they don't have to halt all progress. By including one or more of these mechanisms discussed above, companies can ensure a smoother decision-making process and encourage cool heads to prevail in the emotionally charged atmosphere of deadlocks.

Each deadlock-breaking mechanism has its strengths and potential drawbacks, so it's crucial for shareholders to choose the one that best aligns with their unique circumstances and corporate culture. Ultimately, the goal is to provide a sensible process to navigate and ultimately resolve any deadlock between shareholders.

**David Thompson, Muzammil Ahmed and
Peter-Wallace Mathebula**

CONSISTENTLY EFFECTIVE

2023

1st by M&A Listed Deal Flow.
2nd by M&A Unlisted Deal Flow.
by M&A Unlisted Deal Value.
by M&A Listed & Unlisted BEE Deal Flow.
by General Corporate Finance Deal Value.
4th by General Corporate Finance Deal Flow.

2022

1st by M&A Listed Deal Flow.
3rd by M&A Listed Deal Value,
M&A Unlisted Deal Value,
M&A Unlisted Deal Flow
and General Corporate
Finance Deal Value.

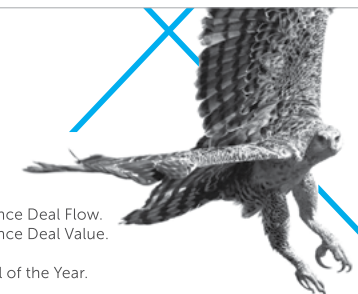
2021

1st by M&A Deal Flow.
2nd by General Corporate
Finance Deal Flow.
2nd by BEE Deal Value.
3rd by General Corporate
Finance Deal Flow.
3rd by BEE Deal Flow.
4th by M&A Deal Value.

DealMakers

2020

1st by M&A Deal Flow.
1st by BEE Deal Flow.
1st by BEE Deal Value.
2nd by General Corporate Finance Deal Flow.
2nd by General Corporate Finance Deal Value.
3rd by M&A Deal Value.
Catalyst Private Equity Deal of the Year.



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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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