

Deadlock Amongst Shareholders.....Now What?

When a small group of shareholders owning an equal percentage of a company's stock cannot agree upon the future direction or operation of the business, a deadlock can arise amongst them. Many local and small, family-owned businesses in Florida operate as closely held corporations, or "close corporations". These small businesses typically operate with fewer than 30 shareholders, enabling them to keep control of the company amongst trusted friends, family, and small investors. However, this structure can also present difficult hurdles in the event of voting deadlock amongst the small group of owners. When the corporate by-laws are silent as to any impasse amongst shareholders, the deadlock can halt the operation of the business and even halt its operations. To avoid these risks, advance planning is vital to prevent a deadlock from happening.

By nature, close corporations are especially susceptible to voting deadlock and impasse. The shares are not publicly traded or easily marketable. Thus, an exit from the business can be difficult for frustrated shareholders. Further, close corporation by-laws typically include a restriction on transfer of shares, making it difficult to break the deadlock through the sale of shares. This also allows shareholders to vet potential buyers and restrict the sale of shares to unknown and unacceptable new shareholders.

Several preventative techniques should be considered to avoid this future problem. First, shareholders may implement "Opt Out" Agreements which require remaining shareholders to purchase the shares of an exiting shareholder at a future, fixed price in the event of a deadlock, voluntary resignation, or other triggering event. Second, a "right of first refusal" may be included to allow shareholders the "first right" to purchase the shares of an exiting shareholder who wishes to sell their stake. Should the remaining shareholders choose not to purchase the shares, the exiting shareholder may sell their shares freely to a third-party. Lastly, a "shotgun provision" may be expressly included in the by-laws to mandate the automatic dissolution and liquidation of the company in the event of deadlock amongst shareholders.

When a close corporation's by-laws provide no remedies for breaking the deadlock, the option of last resort involves court intervention. If a corporation can no longer effectively operate due to deadlock amongst shareholders, courts have authority to order the dissolution of the corporation and a liquidation of its assets. Planning for these scenarios at the outset of corporate formation can save the shareholders of the close corporation from frustration and provide remedies for a smooth resolution to any deadlock.

A note to the reader: This article is intended to provide general information and is not intended to be a substitute for competent legal advice. Competent legal counsel should be consulted if you have questions regarding compliance with the law.

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