SHAREHOLDER DISPUTES IN MEDICAL AND DENTAL PRACTICES IN AUSTRALIA

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KEY TAKEAWAYS

- Shareholder disputes arise from circumstances both anticipated and unanticipated at the time of formation of a business relationship.
- Shareholder disputes cause major disruptions to a business, which can ultimately harm the value of the investment or put the ongoing existence of the company at risk.
- The risks of a shareholder dispute arising, and the impact of it if it does, can be mitigated by ensuring a comprehensive shareholders' agreement is in place.
- If a dispute arises, resolution can be more readily achieved where share valuation methods, dispute resolution mechanisms, and shareholders' roles and rights are clearly defined.

SHAREHOLDER DISPUTES: ANTICIPATING THE CAUSES AND NAVIGATING THE CHALLENGES

Shareholder disputes are a common occurrence in today's business landscape. These conflicts often emerge from complex and interrelated issues that are usually not anticipated during the initial stages of developing the business. The context in which they arise, and the potential consequences, can make these disputes very difficult to resolve without significant disruption to the business and its owners.

Such disputes can also severely impact a business's operational efficiency, market value, and growth potential. Many disputes result in prolonged conflicts (including costly litigation) which erode shareholder value, tarnish professional reputations and, without resolution, can become a zero-sum game.

Shareholders should anticipate the challenges businesses face, the common causes of disputes and how they might be resolved with a view to implementing a number of protections that might facilitate swift, cost-effective resolutions and preserve the value of their investments (of time, money, effort and relationships) if a dispute arises.

HOW CAN THE PROSPECT OF A SHAREHOLDER DISPUTE BE MINIMISED?

No business endeavour should be undertaken without at least a reasonable understanding of the following:

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- The roles and responsibilities of each shareholder in the business.
- What is being contributed by each shareholder, and how they will be remunerated or compensated for those contributions.
- The circumstances in which each shareholder might choose to exit and the consequences of doing so.
- How the business might be valued if shareholders propose to sell their shares, or a buyout is ordered by the court to ensure that the shareholders' original intentions and respective contributions over time are reflected in that outcome and to prescribe the method of calculation that a valuer must adopt (remembering any agreement can be varied later, if necessary, and may not be binding on the court).
- What rights of access each shareholder has to the books and records of the business.
- When the court might intervene in the affairs of a company and what powers it has.
- What duties shareholders who are also (or are related to) directors or employees might owe to the company, and what restraints might arise on their conduct (including after they leave the company).

It will be impossible to effectively clarify (or agree) on those matters once a dispute has arisen or seems likely to arise. They must be dealt with upfront, regardless of the perceived strength of the parties' relationship, likelihood of commercial success, or nature and size of the business.

WHY DO SHAREHOLDER DISPUTES ARISE?

When Business Goals Diverge

Divergent goals among shareholders pose significant challenges. As businesses evolve, shareholders may develop conflicting visions for the company's future. Changes in shareholders' personal circumstances can misalign what were once shared objectives, leading to disagreements over growth, risk and direction.

Stalemates arising due to incompatible goals can hinder progress and profitability or even bring trading to a halt altogether.

When Corporate Governance Deteriorates

Corporate mismanagement can be both the cause and product of shareholder disputes. In the first case, poor governance can lead to inefficiencies and mismanagement that may contribute to a dispute. In the latter case, by the time a dispute has arisen it can be difficult to manage business functions that require shareholder cooperation. That difficulty can create or compound inefficiencies and mismanagement.

Disputes often arise when there is ambiguity or disagreement over governance structures or a misunderstanding of the duties owed by stakeholders. Effective corporate governance requires clearly defined roles, responsibilities and decision-making processes, yet these elements are often scrutinised only after disagreements have arisen.

When Interpersonal Relationships Break Down

Interpersonal relationships are often collateral damage to shareholder disputes, if not themselves a contributing factor. That element can exacerbate conflicts, emotionally bias parties, and make objective and solution-oriented resolutions much harder to accomplish.

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Interpersonal incompatibility is frequently not apparent at the start of a venture and is not just limited to differing personalities. Isolated clashes, such as differences in management style, communication issues or a breakdown in trust, might be all that is needed to spark tension.

When Shareholders Disagree About Money

Financial disagreements are frequently the trigger point for bitter disputes. These might surround disagreements about profit distribution, investment strategies and financial transparency. Disagreements about money are, in many respects, also more prone to heightened emotional influence.

The money factor between shareholders is unavoidable, even if it is only a minor concern at the early stages of business. After a business has had the opportunity to develop (and typically after the shareholders have invested a significant amount of time and labour into that development), the attitude of shareholders can shift, and perceived entitlements can later become irreconcilable.

HOW CAN SHAREHOLDERS MITIGATE RISK BEFORE IT ARISES?

Anticipating the common causes of shareholder disputes is useful for identifying potential risks early and taking proactive measures to address or avoid them.

Understanding your legal rights, stakeholder obligations and potential risks is crucial for safeguarding your investment. Taking stock of your governing documents is key to making informed decisions in relation to risk factors. During prosperous times, the importance of having a robust legal framework governing shareholder relations is all too often underestimated. This oversight can jeopardize investments if relationships turn sour in the future.

While the benefit of hindsight and objective high-level speculation might make these things seem obvious, it is very common for these factors to go unchecked until it is too late in the game.

Fundamentally, the shareholders should ensure a comprehensive shareholders' agreement is in place, dealing with the issues described above, so that there is no doubt about the parties' respective rights and obligations.

What if a Dispute Does Arise?

Some disputes are inevitable. Nonetheless, many can be resolved before undue time and money are wasted where the parties' rights, obligations and causes for complaint are clearly defined; the room for the dispute to escalate is reduced; and the parties are prepared to agree to a sensible approach to resolution. An early and less costly resolution might be achieved where the following occurs:

- There is a dispute resolution mechanism agreed to between the parties (in the shareholders' agreement) that:
    - forces the parties to engage in good faith settlement negotiations before the dispute is escalated to litigation, arbitration or some other formal determination process; and
    - predetermines how shares will be valued if a dispute arises, so that the ultimate outcome of an escalated dispute can be anticipated by both sides with greater certainty and considered during negotiations.

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- There is an early identification of what shareholders want out of the dispute (which might require advice about their rights and obligations).
- All parties are prepared to commit to identifying some mutually acceptable outcome, or an independent determination of the dispute, particularly if the relationship between the parties is to continue (which may be advantageous for various reasons).
- The parties settle on an approach that seeks to preserve the value of the business (including the shareholders' shares), rather than harming the other parties (as is often a motivating factor).
- If the relationship cannot be salvaged, it is possible to agree to a carefully managed exit from the business, possibly including appropriate restraints.

KEY CONTACTS



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