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## Corporate Commentary

Welcome to this monthly series for business owners, where I aim to demystify the corporate market and highlight trends in a non-technical manner.

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## When life gets in the way of a great plan!

Many businesses wait for problems to emerge, rather than anticipating them; early attention, can save a lot of aggravation and cost later. Here is some food for thought, based on real examples.

### Shareholders agreements – any point?

Two brothers ran a communications business, which was growing quickly; one was considerably older than the other, but they complimented one another. Following divorce, the older brother remarried, a significantly younger woman; he then had a heart attack and died, leaving his 50% shareholding to his wife.

Short term things went well, with decisions left to the active brother, and dividends shared. The older brother's widow re married, and her new husband began to throw his weight around. The active brother's decisions, and exec remuneration were being challenged, and investment/growth were slowed down.

Given their very different positions, a price could not be agreed for the surviving brother to buy out the widow's shares. Eventually the business had to be sold, to avoid continuing degradation of value. While sale provided an exit, the business could have achieved a better price, if it had been

able to continue growing, and shareholders had chosen the optimum time to sell.

### Divorce...divorce!

We are often asked if a shareholder can be obliged to transfer some shares to a spouse on divorce? Whilst it is unusual in divorce for the shares in a private company owned by one spouse, to be transferred to the other in a financial settlement, the value of shares will form part of the matrimonial assets divided in a financial settlement.

A requirement for the board to approve any new shareholder, will avoid any risk of shares being transferred to a spouse. If liquid assets are limited, an individual shareholder can still be financially embarrassed, potentially depriving the business of a key asset (if an active shareholder is distracted/demotivated).

A pre nup can help but may not be considered if a business is built during marriage. A company buy-back of some shares can also be useful (providing funds to help a shareholder meet financial commitments) but may disrupt the balance of control.

Unless the articles provide otherwise, dividends are shared equally by shares, meaning a non-

active ex-spouse, could benefit from the work of the active shareholders. If there is no “drag along” right, a disruptive ex-spouse could leverage their position to refuse to join in a sale of the company.

### **Planning for succession**

A clearly drafted Will avoids disruptive family disputes (disputes on estates are increasing). If before death all shareholders were actively working in the business, suddenly imposing a family holding may produce feelings of unfairness.

An obvious answer is for the remaining shareholders to buy out the shares of the deceased, and to provide for this in the articles; if the shares have a significant value, finance can be an issue.

Life insurance policies paid by the company, can provide a cash sum for the estate, tied to an obligation to transfer shares. If life cover is to be used/desired, it must be tied to “cross options”, to protect the continuing shareholders and the estate. A cross option means that the estate of the deceased can require the continuing shareholders to apply monies from life cover to buy the deceased’s shares (put option), and continuing shareholders can require the estate of the deceased to transfer the shares (call option). The option route ensures no earlier transfer takes place for tax purposes.

### **Other Issues with shares?**

**Employees:** Key employees can make good shareholders, angry ex-employees less so! A buy back right must be provided when the shares are issued.

**Minorities:** Minority shareholders may hold the majority to ransom on sale, if not subject to a “drag along” in the articles

**Statutory Rights:** All shareholders have a right not to be unfairly prejudiced. If active shareholders decide to increase their

remuneration or benefits, this can result in damaging disputes.

**Share options:** A very useful way to offer an equity incentive to employees, without the risk of statutory shareholder rights; share options can be cancelled if employment ends.

### **What should you do?**

If you don’t want to waste money, but you want to avoid any of the more expensive consequences above, book an hour with an experienced advisor, to talk through the issues relevant for your shareholding group.

Whilst ideal to go through this process when you set up your company, make sure the discussion takes place before an exit, or other key life events; the pressure that brings, makes it harder to reach agreement.

If you would like to discuss any of these themes further, please get in touch:

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