



DEADLOCK RESOLUTION BETWEEN SHAREHOLDERS

15 October 2024

A deadlock between shareholders occurs when there is an impasse in decision making due to an inability to achieve the necessary voting majority. This can happen in situations where shareholders have equal or nearly equal voting power, or where voting blocks are evenly split on key issues. Deadlock scenarios are particularly common in 50/50 ownership structures, or where minority shareholders hold significant *veto* powers (i.e. provisions in shareholder agreements which allow minority shareholders to block specific decisions unless they consent thereto, ultimately protecting the interests of minority shareholders and ensuring that major decisions cannot be made unilaterally by majority shareholders).

Common scenarios leading to a shareholders deadlock are the appointment of directors or key personnel, strategic decisions such as mergers, acquisitions or expansions, the declaration of dividends or distributions, funding or capital raising efforts, changes to the company's constitutional documents (i.e., memorandum of incorporation or shareholders' agreement).

The resolution of a deadlock is critical, as some could cripple a company, turning what should have been a strategic collaboration amongst its shareholders into a stalemate ultimately stalling fundamental decisions and bringing business to a halt, causing significant financial and operational harm to the company. If left unresolved, it may lead to company stagnation, increased tension and legal disputes among shareholders, the risk of the company being wound up, or the exit or sale of shares by one or more shareholders.

In accordance with the Companies Act, No. 71 of 2008, as amended, specifically Section 65(11) thereof, there are certain significant decisions that affect a company which require the mandatory passing of a special resolution by its shareholders (i.e., supported by at least 75% of the voting rights), and the inability to pass such resolutions can lead to a prolonged deadlock. These decisions often involve, *inter alia*, an amendment to the company's Memorandum of Incorporation, changes in share capital, the winding up of the company, a disposal of all or greater part of the company's assets, the alteration of the rights of a particular class of shares.

Ways to resolve or potentially avoid deadlock is through the incorporation of deadlock provisions/mechanisms in shareholders' agreements or a company's Memorandum of Incorporation.

Examples of such provisions are the following:

- *Chairperson's casting vote*: the chairperson may be given the right to cast a deciding vote in the case of a deadlocked decision;
- *Mediation/arbitration*: using mediation or arbitration to resolve a deadlock;
- *Status quo*: if the shareholders cannot resolve a deadlock, the *status quo* will prevail and the parties agree that this does not allow the winding up of the company, which might otherwise be the case (i.e., forcing the parties to compromise and find a solution);
- *Third-party intervention/expert determination*: an independent third party may be given the authority to decide the matter, or the matter may be referred to an expert;
- *Russian roulette clause*: one shareholder offers to buy the other shareholder(s) shares at a certain price. The shareholder receiving the offer must either sell their shares or buy the offeror's shares at the same price;
- *Texas shoot-out clause*: each shareholder submits a sealed offer to purchase the other shareholder(s) shares at a stated price to an independent third party, often the company's auditors. 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;
- *Share class distinctions*: where two classes of shares exist in a company (i.e., A shares and B shares) by granting a deciding vote to a class of shares in specific circumstances;
- *Sale of all the shares*: if the deadlock continues for a certain period, the shareholders may authorise a predetermined professional auditor or broker to arrange the sale of all the company's equity to the highest bidder;
- *Liquidation*: as a last resort, one or more shareholders may decide to liquidate the company.

Deadlocks are inevitable amongst shareholders, but by including deadlock resolution provisions/mechanisms in shareholders' agreements or the company's Memorandum of Incorporation helps prevent costly and damaging disputes, ensuring a smoother decision making process amongst shareholders. It is however important for shareholders to choose which of the aforementioned deadlock provisions/mechanisms best suits the circumstances of the company as they each have their strengths and potential weaknesses.

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