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17 JULY 2020

Corporate Deadlock: When Feuds Turned Into Stalemate

Corporate deadlock can occur at the shareholder or board level of a company, particularly when parties with equal voting and/or management rights take opposing stances and are no longer able to work together. A common scenario is where two directors and shareholders, each holding 50% of shares in a company, cannot reach consensus on future decisions governing the affairs of the company. Since neither party has control over the company due to the equal management and shareholding structure, neither one can compel the other to accept any proposal or pass resolutions, thereby resulting in corporate paralysis.

In the absence of a shareholders' agreement or specific provisions in a company's constitution to break such deadlock, several resolution mechanisms are potentially available to discontented shareholders. The course of action employed would depend on the reasons behind the deadlock and the actions of the other shareholder(s).

Options outside the courtroom

Before initiating court action, the following options can be considered by a company wishing to break the deadlock. After all, it may be undesirable to immediately seek recourse to wind up the company in light of the COVID-19 pandemic. Cessation of business operations will inevitably have a negative impact on many stakeholders, including the livelihood of employees who need to be laid off.

- **Introducing a newcomer**

If a deadlock situation occurs frequently at board level, companies could contemplate appointing a non-executive director with appropriate expertise in order to restore the routine devising of business strategies.

Where the dispute lies at the shareholder level, another

solution is to issue a new class of shares (with only voting rights attached) to business professionals such as a financial adviser.

In this regard, any decision-making needed in the future can be reached by a majority decision. However, this course of action will not have the desired result if parties are unable to agree on a suitable and impartial person.

- **Alternative dispute resolution**

Referring an unresolved conflict to an external party could unlock deadlocks at the board or shareholder level. On the one hand, if the dispute is fairly straightforward, an independent third party such as a mediator could be appointed to assist in reaching a compromise. On the other hand, if parties are unwilling to compromise on an area requiring technical expertise, arbitration would be apt in protracted disputes — a decision reached by the arbitrator will be binding, thereby putting an end to the dispute. Alternative dispute resolution is likely to be more efficient in terms of cost and time as opposed to resorting to litigation. That said, this option is only appropriate if the issues requiring resolution are factual and do not involve disagreements about business strategy.

- **Buyouts or sale of shares**

If a share valuation can be agreed between the parties, it is worth considering selling the shares held to the other shareholder(s). Alternatively, the discontented shareholder may seek for a third party investor to buy the shares held. It is pertinent to note beforehand whether this mechanism is specifically prohibited by the company's constitution or shareholders' agreement (if any).

Court intervention

If negotiations have failed and the deadlock remains unresolved, one of the shareholders may resort to initiating a court application.

- **Derivative actions**

Where it is alleged that a director has committed corporate wrongs, claims for relief can be remedied by way of a statutory derivative action pursuant to s 347 of the Companies Act 2016. Under these provisions, a shareholder of a company (with leave of the court) is able to initiate derivative proceedings on behalf of the company.

In *Perak Integrated Networks Services*,¹ the Federal Court held that an equal shareholder may initiate a derivative action for the benefit of a company in which the body of shareholders and board of directors are deadlocked. A caveat to this entitlement is that the company must be a going concern. Therefore, a shareholder will be barred from bringing a derivative action on behalf of the company if it is in liquidation.

- **Winding up petition on just and equitable ground**

In the event a company's business is no longer viable, a discontented shareholder may consider applying for a petition to wind up the company on just and equitable grounds under s 465(1)(h) of the Companies Act 2016. The premise relied on would be that there is a complete deadlock in the management of the company which cannot be broken. Although the court may exercise its jurisdiction to wind up the company where there is a complete deadlock, this drastic measure should be viewed as a remedy of last resort.

Persistent conflicts among shareholders and directors can jeopardise the smooth business operations of companies. Where feuds have turned into stalemate, companies are advised to employ resolution mechanisms in order to break the corporate deadlock and ensure continuing corporate existence.

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Published by the Dispute Resolution Practice

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