

# The Legal Implications of Deadlock in 50/50 Owned Companies

Companies with 50/50 ownership between two shareholders carry inherent risks of control deadlock emerging if the parties disagree or lose trust. Without dispute resolution mechanisms, 50/50 companies often collapse when fundamental divides arise. This guide examines the legal implications of deadlock and options to avoid terminal failure.



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## Causes of Deadlock in 50/50 Owned Companies

There are various common causes of intractable disputes between 50% shareholders:

- Loss of trust or confidence in the other as co-owners, often due to perceived breaches of understanding.
- Disagreements between the shareholders on company strategy and direction. Failing to agree budgets.
- Concerns over financial transparency or suspicion of inappropriate related party transactions.
- Unresolved arguments over dividend payments. Retained earnings may be high while one party wants dividends paid.
- Demands from one shareholder to be more actively involved in management.
- Conflicts of interest where a director or shareholder has outside business interests diverting focus.
- Personality clashes and communication breakdown exacerbating divisions.
- Underperformance of the business itself causing financial stress.

If relationship breakdown reaches an irreconcilable point, decision-making can become impossible due to the 50/50 deadlock.

## Impact of Deadlock on Company Performance

Without a decisive majority, fundamental disagreements between 50/50 shareholders lead to:

- Inability to pass ordinary or special resolutions.
- Failure to approve significant matters like budgets, strategy, investments, major contracts.
- No shareholder meetings take place due to inability to agree agendas.
- Board meetings become unproductive with matters endlessly deferred.
- Financial and dividend decisions get blocked.
- No changing of authorised signatories to operate bank accounts.
- Appointing new senior employees or directors is prevented.
- Business opportunities are missed due to delays approving initiatives.
- Contract defaults if procurement and commitments halt.
- Suppliers and customers lose confidence affecting trade.
- Senior staff become demoralised and start to leave.

The company effectively seizes up with shareholders unable to cooperate. Performance inevitably suffers.



## Improving Shareholder Communications

Open communication channels minimise the risks of disagreements arising:

- **Annual General Meetings** - Updates on performance, Q&A forums to engage shareholders.
- **Annual financial reports** - Share annual accounts even if not a legal requirement.
- **Interim updates** - Share periodic trading updates, budgets and board meeting minutes.
- **Email/Newsletters** - Regularly advise shareholders on progress, strategy and plans.
- **Informal briefings** - Take time to communicate directly when opportunities permit.
- **Address concerns** - Be responsive to shareholder queries and complaints.
- **Onboard new investors** - Ensure any incoming shareholders understand policies and reporting.
- **Shareholder portal** - Online resource with documents, messaging and FAQs.

Promoting transparent and accountable governance prevents rumours spreading.

## Using Mediation and ADR Before Positions Harden

Mediation and alternative dispute resolution techniques may break deadlocks:

- An independent mediator explores if common ground exists between shareholders during confidential meetings.
- If agreement is reached through mediation, consent orders can enshrine the terms formally.
- Arbitration is also possible with an arbitrator issuing a binding settlement after considering submissions.
- Expert determination can be used where an industry expert weighs arguments and produces a definitive valuation or decision.
- Non-binding early neutral evaluation from a respected lawyer can give shareholders a reality check on the merits of their cases.

However, both shareholders must engage constructively for mediation or ADR to succeed. Imposed solutions rarely endure.



## Seeking Share Buyouts or Shotgun Offers

One shareholder can propose buying the other out to break deadlock:

- Formal share purchase offers establish a buyout price and completion timetable. These spark negotiations.
- “Shotgun” clauses in articles allow one shareholder to propose a sale price for the company, forcing the other to either buy them out at that level or sell their own shares at the stated price.
- If buyout offers are rejected, the offering party may then increase pressure by threatening winding up petitions or formal disputes.
- Sufficient funding is essential to make a credible buyout offer. Involving directors or existing shareholders in takeover proposals adds weight.

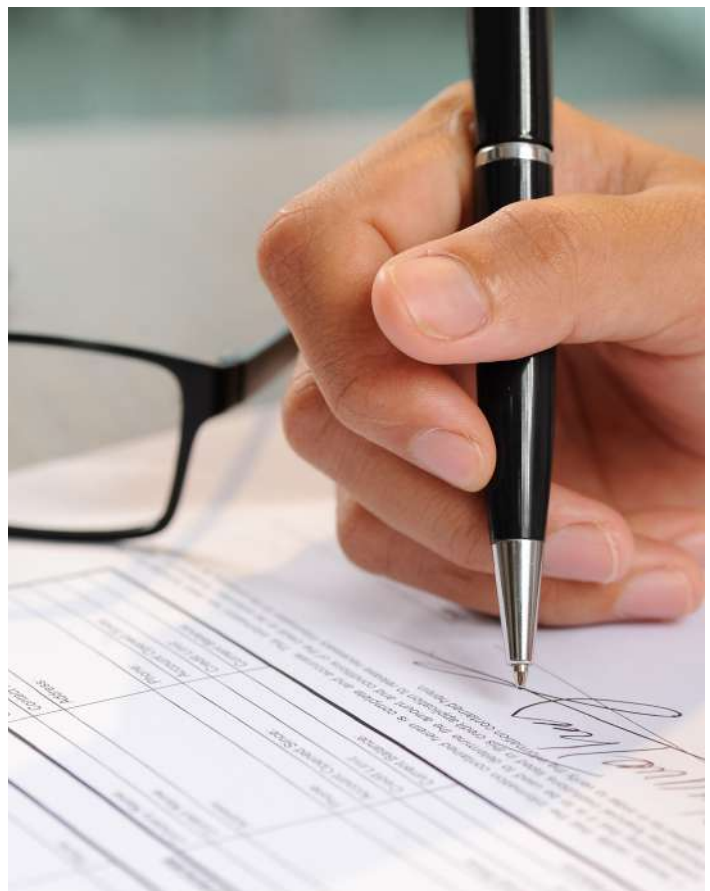
Where one party clearly values future control and prospects higher than the other, buyouts can break deadlocks.

## Petitioning for Winding Up Orders

If deadlock causes severe company paralysis, either shareholder can petition the court for a winding up order as just and equitable, arguing:

- The bedrock of the company (trust between shareholders) has irretrievably broken down.
- One shareholder is acting prejudicially against the other's interests.
- There is no way for the parties to continue working together as directors.
- The company can no longer practically function and trades at the mercy of interminable disputes between owners.

Winding up leads to formal liquidation, asset sales and distribution of sale proceeds to shareholders. The business is dissolved. Orders are the last resort when relationships terminate utterly. Judges will require clear evidence of unsalvageable deadlock before ordering this final measure.



## Making Controllership Applications

Under Section 994 of the Companies Act 2006, a member of a 50/50 company can apply to court for an order declaring sole control:

- This involves persuading the court that irrational, prejudicial behaviour by the other shareholder makes joint management of the company impossible.
- The court can appoint the applicant as sole director with full control if fault for the deadlock is attributed largely to the other party.
- Just and equitable winding up may be ordered in parallel if cooperation remains untenable.

Controllership applications act like a petition for divorce between warring 50/50 shareholders. The evidential burden is high however and the other shareholder will vigorously contest allegations.

## Using Ejector Seat Articles

Special article provisions can be included when companies are incorporated, allowing:

- Automatic removal of a director if they miss a certain number of consecutive board meetings without consent.
- Termination of a director if they become bankrupt or breach fiduciary duties.
- Expulsion of a shareholder if they become insolvent or act clearly against the company's interests.

When triggered, ejector seat articles allow one side to decisively win the argument by legally removing the dissenting party from influence. Care is required to ensure proper grounds apply before relying on ejector remedies.



## Filing Statutory Claims for Unfair Prejudice

If the conduct of one 50% shareholder unfairly undermines the other's interests, Section 994 of the Companies Act 2006 enables proceedings for relief from unfair prejudice. This may involve:

- Making allegations of exclusion from management, lack of financial transparency or misuse of resources by the other shareholder.
- Court can order remedies like requiring company information to be supplied, prohibiting further prejudicial behaviour, or reversing prior unacceptable actions.
- In serious cases, ordering shares to be purchased or winding up the company.

However, prejudice must be proven. Tactical litigation will be vigorously defended while escalating costs and tensions. Litigation is adversarial and often leaves negative legacy even after cases conclude.



## Transferring Shares to an Independent Trustee

To restore decision-making powers if deadlock disables the company, shares can be transferred to an independent professional trustee with sole voting rights.

- Requires cooperation initially to appoint a mutually acceptable trustee such as a solicitor, accountant or bank.
- Safeguards like restricted actions requiring owner consents can be agreed.
- The trustee exercises shareholder powers pragmatically in the entity's best interests until underlying issues potentially resolve.

Trustee control provides temporary respite for businesses paralysed by shareholder disputes. But underlying tensions frequently resurface once trustee terms expire.



## Going To Court-Ordered Auction Processes

If all other resolution attempts fail, courts can order one shareholder to set a sale price for the company with the other given the choice to buy at that price or force a sale to the proposing shareholder at the same price. This 'shotgun' mechanism with judicial supervision can decisively break the deadlock.

Alternatively, the Court may impose an auction process involving:

- Shareholders prepare rival business plans for the company.
- The court reviews the plans and decides if one is clearly in the company's best interests or whether both remain viable.
- If plans are equally reasonable, an auction is held for the shares.
- External bidders are also invited to tender bids through brokers.

While seemingly arbitrary, judicially-forced auctions can cleanly resolve paralysed 50/50 situations by placing objective value on the entity. However, imposing unwanted solutions must be approached cautiously by courts.

## Valuing the Company's Shares Objectively

To divide a deadlocked company's assets or set shotgun offer prices, objective independent valuations are required. Standard valuation methods include:

- Discounted cashflow valuations based on multi-year forecasts.
- Net asset value based on balance sheet assets.
- Earnings multiples of peer companies traded on stock markets.
- Rules of thumb for the sector based on revenues, customer numbers etc.
- Indicative strategic market value if a sale scenario assumed.
- Weights assigned to different methodologies based on reliability.



Appointing a jointly-instructed chartered valuation professional ensures impartial analysis acceptable to both shareholders. But underlying methodology disputes can still arise. Courts ultimately determine fair values if shareholders cannot agree.

## Dividing Business Assets During Dissolution

If a 50/50 company must be dissolved due to terminal deadlock, assets are sold and distributed equally to shareholders after settling liabilities.

Issues to be addressed include:

- **Realising assets** - Plant, equipment, property and other assets must be sold, often necessitating formal valuations.
- **Debt recovery** - Collecting outstanding customer invoices to maximise realisations.
- **Settling supplier liabilities** - Paying suppliers prevents claims arising later.
- **Mitigating tax liabilities** - Tax planning to optimise treatment of assets sold and final liquidations.
- **Employee settlements** - Redundancy payments must comply with employment law protections.
- **Retention of records** - Statutory records must still be maintained for prescribed periods.
- **Final reporting** - Final accounts prepared to formalise history and asset disposals.

Forensic analysis of accounts, asset lists and tax issues is key to maximising equity returned to shareholders when dissolving a company.







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