

## Commercial Litigation Bulletin: Issue 31

### News

The new Companies Act 2006 is coming into force on 1 October 2007, this will bring in new changes for derivative claims. Full details will be included in the next bulletin.

### **You can choose your friends but not your relations... or should that be partners and shareholders?**

The Entrepreneurial spirit that makes people go into business with each other is a marvellous thing. However it is important to bear in mind that when starting out upon a business venture either in the form of a partnership or a Limited Company, it is as well to pay attention to certain formalities or at least take some minimum legal advice regarding the legal obligations that you are getting into. This Article examines the need not to take legal advice when the partnership or Limited Company contracts with third parties, but highlights the need for those well meaning entrepreneurs who are going to strike up a business enterprise together to make sure that they fully understand what are the legal rights and obligations that regulate the performance of that business venture as between themselves.

The two most common forms of legal vehicles in this country are:

- Partnerships.
- Limited Companies.

By definition those vehicles involve the participation of at least two or more individuals in their capacities as either Partners or Shareholders. Quite often we see disputes arising in Partnerships or Limited Companies and are what we term "intra business disputes". This is because the disputes come from within the business vehicle and are in effect between those individuals whose business enterprise it is.

Typically, Partnership disputes arise because one partner wants to leave the business or another partner feels that partner A or B is not pulling his/her weight; so far as shareholders are concerned, disputes based on similar principles arise when one shareholder wishes to leave the company or another shareholder feels that the affairs of the company are running in a way that prejudices their position. Sometimes of course it can just be a genuine falling out amongst the entrepreneurs for any one of a variety of reasons.

It is important then for prospective partners and shareholders to take advice as to what their rights and obligations are in relation to the other members of the business. In a partnership case for example think about these questions: What are you going to do about sharing profits and losses? In whose name is the building from which the business trades going to be? Are you going to have a formal partnership agreement or simply rely on the rather antiquated Partnership Act from 1890? These are just a few questions and indeed Litigation Lawyers could give you countless other examples of where people in

partnership have fallen out. Again similar points arise in relation to a Limited Company with the shareholders. For example: – Are you going to modify or change the Articles of Association? Will you have a shareholders agreement and if so what will it say? What "exit" provisions are there in the shareholders agreement for a shareholder who wishes to leave? How will we go about valuing the shares of a shareholder who wishes to leave? The basic position under the Companies Act and the standard Articles of Association will not always provide answers to these questions.

In both cases therefore i.e. that of a partnership and a Limited Company, unless the matter is properly analysed at the outset and regulated by well drafted legal agreements, you are almost certain to have ambiguity and uncertainty. Where ambiguity exists then sometimes litigation will thrive. The greater the clarity in the rights and obligations which the parties have with each other, the lower the risk of any ambiguity and therefore reducing the risk of any dispute.

Disputes that arise in a partnership or shareholder situation are ones that are best dealt with sooner rather than later. These disputes if allowed to fester can simply become bitter and acrimonious. The parties positions become entrenched and legal costs amount. Also what is "lost" is the wonderful business venture which the parties to the dispute embarked on. In these intra business disputes mediation or other forms of alternative dispute resolution are often the key to resolving disputes quickly and economically. Addressed in the right way a potential dispute if tackled early can allow the parties to resolve their differences, deal with the exit of one or more of them and give those remaining a decent chance of keeping the business in tact.

## **Rule Changes**

In April of this year there were quite significant changes to one of the original concepts introduced by The Civil Procedure Rules in 1999. With the introduction of The Civil Procedure Rules in 1999 we saw for the first time the concept of a "Part 36 Offer". Prior to the introduction of The Civil Procedure Rules there was only one formalised method under the old Court Rules which allowed a party to make an offer to settle the case, and that party was the Defendant.

Those old Rules were swept away by The Civil Procedure Rules and Part 36 became a very popular and well used tactic in Litigation. Part 36 had a number of significant advantages which, in essence, were

- Either party to the dispute could make a Part 36 Offer.
- The Part 36 Offer could be made at any time in the proceedings i.e. long before any legal proceedings were ever issued at the Court.
- There were quite serious costs and interests sanctions which the Court would apply in the event that the Part 36 Offer became relevant at the end of the case.

In April this year there were some modifications to Part 36. The concept of the Part 36 Offer remains but the important changes are effectively

- A Defendant who wishes to make a Part 36 Offer no longer has to make a payment into Court to support the Offer and obtain the full costs protection of a Part 36 Offer. Previously the practice was that the Defendant had to pay money into Court once

proceedings had been started to gain the full benefit of the Part 36 Offer. That requirement has now been dispensed with.

- If the Part 36 Offer is accepted then the party accepting the offer has 14 days from acceptance to actually make the payment under the offer. So if A makes a Part 36 Offer to B whereby A says he will accept £50,000 from B in settlement of the claim, then if B accepts that offer, B has 14 days in which to pay. If B does not make the payment within the 14 day period, then A may (at his option) enter Judgment against B for that sum.

These changes go to improve the efficiency of the Part 36 mechanism and remove what might previously have been potential problems which the parties to a dispute might have encountered in wanting to make Part 36 offers. These amendments simplify the Part 36 regime and are once again an example of the Court/Rules Committee sending a clear message to Litigation Lawyers and their clients involved in disputes which effectively is: "conduct negotiations freely amongst yourselves and try and resolve disputes without having to come to Court".

### **The Rise and Role of Mediation**

Since The Civil Procedure Rules in April 1999, there has been a steady increase in the profile of Mediation. Most of you are aware that Court proceedings can be expensive and costly.

A number of County Courts now offer their own Mediation service. It is common for legal proceedings to be stayed by the Courts to allow the parties to attempt Mediation. There is now an even greater emphasis on resolving disputes without recourse to legal proceedings. There is a culture of settlement where the parties to a dispute are encouraged to be flexible and commercial in dealing with disputes under the Mediation umbrella.

We have seen many disputes resolved successfully on commercial terms through Mediation. The Courts and litigation lawyers are keen to embrace this culture of settlement because:-

- Mediation is quicker than the Court process.
- Mediation is cheaper than litigation. A piece of commercial litigation can cost many tens of thousands of pounds, some times between £50,000 - £100,000 plus VAT and disbursements. Whilst Mediations are not free, in terms of proportionality, the costs are less. Generally it is possible to organise and have a Mediation for a fraction of the cost of litigation.
- Mediation allows the parties to play a bigger and more important role in resolving the dispute. It allows the parties to be creative with their solutions to resolve their disputes. The Court process does not allow the Judges to put forward creative commercial solutions.
- Mediation allows the businessmen involved in the dispute to participate effectively and deal with each other and the Mediator in a language they understand. The litigation process and the Court Room is an alien environment to most businessmen.

In contrast, Mediation allows the most important people in the dispute the opportunity to take control of the dispute and play a major part in the resolution of it.

The Courts ensure Mediation is considered by the parties at an early stage. Court Orders now require the parties to explain to the Court in writing their reasons if Mediation is not followed. Litigation lawyers and their clients need to be able to explain to the Judge their reasons for not Mediating a dispute. The Courts are also able to penalise in costs a party who unreasonably refuses Mediation. Costs remain at the discretion of the Court. The usual presumption is that the loser has to pay the winner's costs. That presumption can be thrown out if one party has unreasonably refused a request to Mediate.

As a result, businesses involved in disputes should be alive to the possibility of mediating that dispute at the earliest opportunity.

As evidence of the rise and role of Mediation, the Department's recent experiences of Mediation include a successful Mediation handled by Peter Day. Peter's work covers a variety of contractual and property related matters mainly in the County Court. Peter found the Mediation very refreshing and an extremely cost effective way of resolving what might otherwise have been an expensive dispute and one where the costs would almost certainly have been disproportionate to the amount at stake.

However by being able to facilitate and participate in a Mediation at what was a relatively early stage in the dispute, it meant that the parties' financial resources in terms of the amount that they were able or prepared to commit to spending on legal costs meant the dispute could be resolved, rather than allow it to fester in the County Court process.

Indeed Peter said, "The Mediation achieved the desired result. Although the Mediation was quite intense – a whole day at the offices of another Firm of Solicitors, it provided an environment in which the parties' minds were focused very closely on the issues in dispute and gave them a very narrow window of opportunity within which the dispute could be settled: I am pleased that all parties concerned saw commercial sense and decided to proceed with a series of constructive negotiations which lead to a settlement.

Mediation is certainly something I can recommend for clients to consider, especially if the value of the dispute is towards the "lower end" i.e. circa £20k, £30k, £40k where the legal costs have to be carefully controlled and monitored to ensure that they do not become disproportionate to the amount at stake in the dispute".

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