

Legitimate expectations in family businesses



Family owned companies are often classic examples of what lawyers call “quasi-partnerships”. Whilst they are a corporate entity governed by formal documents such as articles of association, they are also subject to understandings and agreements about how they will operate.

These understandings can be quite informal and often not written down. However, in appropriate circumstances they will be enforced by the court and can have a major impact on the outcome of shareholder disputes.

It is an established principle of law in relation to what are known as “unfair prejudice” actions, that shareholders in a company may have “legitimate expectations” which go above and beyond their strict rights under the articles of association.

For example, in [family businesses](#) there may be expectations that:

- Shareholders will have a role in the strategic management of the business,
- Dividends will be paid regardless of an individual shareholder’s contribution to the business,
- Family shareholders will be entitled to a job within the company,
- Certain benefits, such as private healthcare, will be available to family shareholders.

If these expectations are breached then shareholders may be entitled to seek a remedy from the court (often the purchase of their shares at a fair value) on the grounds that they are being unfairly prejudiced.

However, there are limits to this principle and these limits are often tested in the context of [family businesses](#).

First, understandings / expectations may not simply flow down through the generations. In other words, the



children or spouse of a child of the founding shareholder may find that these expectations do not apply to them. They are outside of the circle of trust.

Secondly, the behaviour of the shareholders bringing the claim will be looked at closely and the weaker the claim for expectations is, the more likely it is that it will be possible to justify not meeting those expectations on commercial grounds or in light of that shareholders behaviour. For example, it may be held that an expectation of a job within the company by a second or third generation family member can be legitimately ignored if they lack any talent or if they have behaved badly.

In summary, understandings between family shareholders, even if not formally documented, are important and will be given weight by the court in unfair prejudice proceedings. However, the less well documented they are, and the further from the centre of things the shareholder is, the harder it will be to prove that there is a breach of such understandings and it is unfair. This is a good reason for the later generations of shareholders to encourage the family to properly document such understandings in a family charter or shareholders agreement.

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