Technology

November 28, 2017

TransPerfect: Litigation Highlights Importance of Shareholders' Agreement for Start-Ups

A shareholders' agreement or, at the very least, a written understanding of the arrangements upon a potential break-up between the founders of TransPerfect could have prevented protracted conflict and costly litigation that has plagued the founders and the company for years. In an unprecedented decision, the Court of Chancery of Delaware in *TransPerfect Global, Inc. v. Elting (In re Shawe & Elting LLC)* ordered the appointment of a custodian to sell the company and distribute the proceeds without shareholder consent. This ruling was recently upheld on appeal by the Delaware Supreme Court in *Shawe v. Elting* and stands as a stark reminder of the importance of having certain shareholder arrangements in place at an early stage.

Background to the TransPerfect Decision

Elizabeth Elting and Phil Shawe founded TransPerfect in 1992 in their New York University dorm room. The company grew into a global powerhouse with annual revenues in 2016 exceeding $500 million. The company has three shareholders: Elting (50%), Shawe (49%) and Shawe's mother, Shirley (1%). The shareholders never entered into a written agreement governing their relationship and Elting and Shawe act as the only directors.

Elting and Shawe share a turbulent past. Once engaged to be married, they broke off romantic ties in the 1990s, subsequently impairing their ability to effectively co-manage the company. Shawe accused Elting of assaulting him and she accused him of breaking into her office to steal confidential emails. They consistently critiqued each other's performance and disagreed on how to manage the company. In 2014, Elting filed a petition against Shaw in the Court of Chancery seeking the appointment of a custodian to sell the company, arguing that such an order would be in the best interest of the company and its stockholders.

Court of Chancery's Decision and Eventual Sale to Shawe

Despite the company's impressive financial performance, the Court of Chancery found "the state of management of the corporation has devolved into one of complete dysfunction between Shawe and Elting, resulting in irretrievable deadlocks over significant matters that are causing the business to suffer and that are threatening the business with irreparable injury." The Court of Chancery acknowledged that while it is unusual to grant such relief, it was appropriate to do so in the particular circumstances. Under Delaware corporate law, the Court of Chancery may appoint a custodian to authorize the sale of a company when facing financial default or severe division among either its directors or shareholders. Shawe appealed and, in 2017, the Delaware Supreme Court affirmed the Court of Chancery's decision in a 4-1 split, upholding the decision to appoint a custodian to sell the business. On November 21, 2017, the custodian announced that Shawe and Elting reached an agreement whereby Shawe will buy Elting's shares in a deal requiring court approval and other ordinary closing conditions.

In the Canadian context, federal and provincial corporate legislation provide for even broader remedies against corporations and give shareholders the right to apply to a court for, among other things, an order liquidating and dissolving a corporation to rectify conduct that is oppressive, unfairly prejudicial or which unfairly disregards the interests of any security holder, creditor, director or officer. Under such legislation, Canadian courts have broad discretion to make any interim or final order they deem fit, including the appointment of a receiver or receiver-manager or the ordering of a buy-out.

Key Lessons

This case highlights some of the benefits of having shareholder arrangements in place early on. The Court of Chancery found that Elting and Shawe participated in "mutual hostaging" over hiring decisions, employee compensation, outside counsel payments, office leases

and other routine matters as they each sought to advance different agendas within the business. Elting and Shawe also confessed to their inability to elect successor directors, and that there was no prospect of being able to do so in the future. A shareholders' agreement would have outlined procedures for dealing with these types of disagreements. Deadlock provisions in a shareholders' agreement – including arbitration, mediation, the temporary addition of a third board member to operate as a "tie-breaker" or triggering of buy-sell provisions – could have established various ways to resolve stalemates and avoid an unfortunate ending such as this.

The Court of Chancery's decision and the Delaware Supreme Court's affirmation of the decision to sell the company without shareholder consent are unprecedented and highly contentious, and the combined legal and custodian-related expenses to the company are estimated to be significant. While every corporation is governed by its articles of incorporation, by-laws and applicable corporate legislation, it is often recommended shareholders enter into some form of shareholders' agreement at the time of incorporation or as soon as possible thereafter, to help prevent protracted conflicts and decrease the likelihood of costly litigation. Appreciating that early stage companies may not have the time and resources or need to negotiate a comprehensive agreement, founders should turn their minds to a simple form addressing at least the possibility of a future dispute. Working with counsel who can highlight these issues and assist in drafting these fundamental provisions in a highly efficient manner is very important. An ounce of prevention in this case would have been priceless.

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