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Shareholders' agreement

Arguably the most important document to any private company is its shareholders' agreement.

What is a shareholders agreement?

A shareholders' agreement is a document setting out various terms agreed between the shareholders concerning their relationships with the company and with each other. Unlike the memorandum of association and the articles of association which are open to public scrutiny, it is a private document.

Why should we have one?

Private limited companies have shares with prescribed voting rights. In most cases these are ordinary shares with one vote per share. Therefore, if one member holds over 50% of the shares they will have a controlling interest.

However the commercial realities of any particular business may not always make this very basic control mechanism desirable. For instance, a company may be reliant on the skills and knowledge of a minority shareholder or a minority shareholder may have lent money to the company.

A shareholders' agreement can provide a more equal distribution of power, helping to protect the interests of minority (in terms of shareholding) members.

The shareholders' agreement can also set out prescribed strategies designed to assist in resolving issues when:

- one of the shareholders dies
- it is not possible to have unanimous agreement
- a deadlock arises between the shareholders
- a shareholder decides to sell his interest

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What should be in it?

Whilst every company will be different, the following points should be assessed when considering the content of a shareholders' agreement:

- **matters requiring the unanimous consent of the shareholders**

Certain decisions should only be made with unanimous consent. These might include:

- entry into any voluntary liquidation or winding up
- a change in the nature of the business or the way the business is conducted
- amendment of the articles of association or the memorandum of association
- a change of name
- selling or disposing of the assets of the company
- alterations to the rights attaching to shares
- merger with any other company
- acquiring any asset or interest exceeding a specified sum
- entry into any contract of a value greater than a specified sum
- amendments to the share capital of the company
- borrowing money in excess of a specified sum
- giving a guarantee other than in connection with the companies ordinary business
- lending any money other than in the ordinary course of business
- removal of any director appointed by a shareholder
- holding any meeting of shareholders unless all are present or they have appointed suitable representatives or proxies

- **maintaining control over the balance of ownership of shares**

Terms might include provisions regarding the distribution of any new shares issued by the company, e.g. to be offered to existing shareholders in proportion to their current holding. Further terms may contain similar provisions should a shareholder decide to sell their shares, die or become incapacitated. This helps to prevent the controlling power behind the business being diluted by new shareholders who may not have the same commercial interests in the business.

- **defining the relative powers of the shareholders**

Limits could be set out within which individual shareholders are able to transact on behalf of the company without consultation and agreement. Without such controls individual shareholders may be able to enter into contracts and other commitments on behalf of the company to any level.

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- **defining exit routes for shareholders**

Careful consideration needs to be given to shareholder exit strategy. At some time shareholders will need to exit, whether because their circumstances have changed, they have become incapacitated, they wish to retire or they have died.

Provision could be made to give existing shareholders a first right of refusal to buy an exiting shareholders shares, perhaps in proportion to their existing shareholding. Further or alternative provision could be made for the company to buy back the exiting shareholders shares.

- **setting out formal arrangements for the resolution of disputes**

A shareholders' agreement can be used to set out an agreed structured approach to resolving any disputes, quickly and efficiently.

If the company becomes deadlocked over any particular issue then the agreement could provide for how issues or disputes are to be resolved, e.g. by the appointment of a third party to arbitrate.

If you would like further information or advice please contact Steven, Tom or Philip who will be happy to assist you or visit www.gardandco.com.

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