EASY GUIDE TO SHAREHOLDER AGREEMENTS

Working without a shareholder agreement

All limited companies must have a set of rules (called Articles) which say how the business is to be run and managed. The Articles usually say that the directors look after the day-to-day management of the business. The shareholders get a say over a few important matters, such as who becomes a director. Shareholder decisions are made by a majority – i.e. more than 50% of the voting shares. Majority shareholders can overrule minority shareholders, who only have limited powers to block decisions.

The Articles only set out very broad rules about how the company is to be run and managed. Shareholders who have different interests to protect are not catered for. Articles do not lay out a route map for how decisions should be made, or how shares may be valued, transferred or sold.

Shareholders can think that a shareholder agreement is not needed. Perhaps they have an informal understanding of how the business is to be run, and they think they would to be able to sort out any problems that crop up between themselves.

The risks of not having a shareholder agreement

Shareholders often want to change the rules in the Articles, or to set things out in more detail. For example, what should happen when a director shareholder wants to leave, or to transfer shares, or the business needs to plan for growth and exit.

The scenarios that are covered by a shareholders' agreement happen all the time in business. Shareholders, and especially those who are also directors, have different interests in how the business is run and how to get value out of it. They are unlikely to all have the same views on things like directors' pay, dividend payments, and how much each person can influence strategy and direction.

If the shareholders want an equal say in how the business is run, similar to a partnership, then a shareholders' agreement is necessary to provide such equality.

Shareholder agreements are also necessary to protect the interests of joint venture partners and investors with a minority stake.

If you do not have a clear set of rules and processes, then you are vulnerable to disagreement or conflict. This is likely to be destructive to the business, and expensive to resolve. Anticipating those issues now will save time and money further down the line.

What often happens is that shareholders don't think about a shareholder agreement until an issue arises that can't be resolved by friendly agreement. By that time, relationships are so strained that the issues end up being passed to lawyers to sort out. It is worth avoiding this by anticipating those circumstances now with a shareholders' agreement.

What a shareholder agreement usually covers

The shareholder agreement usually sets out the shareholders' intentions about **how the business is to be run and grown**, including:

- How the board of directors is made up and how directors are paid
- Dividend policy
- Levels of borrowing, and future funding

The agreement usually also **specifies how decisions are to be made**. The shareholders may decide that important decisions should be unanimous, effectively giving minority shareholders the power of veto. This includes things like:

- Appointing and removing directors
- Changing the Articles
- Issuing further share capital
- Buying or selling a business, or certain assets

Procedures for **the issue and transfer of shares** are also usually set out in a shareholder agreement. The ability of the business to raise funds by issuing shares needs to be balanced against the danger to other shareholders that their shares will be diluted. In deciding how shares can be transferred, the ability to sell and get value from shares has to be balanced against the risk of a change of control, or of undesirable shareholders acquiring a stake. Here the approach can be:

- Allowing the minority shareholders a veto over further share issues
- Requiring the company (on a share issue) and the shareholders (on a share transfer) to offer such shares to existing shareholders first, in proportion to their existing shareholdings, before they can be offered to anyone else

A shareholder agreement will also set out **what happens on exit**. This includes the processes for buying people out, share valuation, and what happens in the event of **dispute**.

What next?

Call us or **email us** if you think that you may need a shareholders' agreement.

We will help you to identify what the interests of individual shareholders are, who will make the decisions, how the voting rights should add up and what the shareholder value should be. Then we will put it in a shareholders' agreement for you.

Want to know more? See **here** for how we can help your business.

We recommend that you talk to a lawyer before going ahead with a shareholder agreement or taking other legal steps on behalf of your business

New Leaf Law does not take any responsibility for any events that arise as a result of your use of these guidelines.