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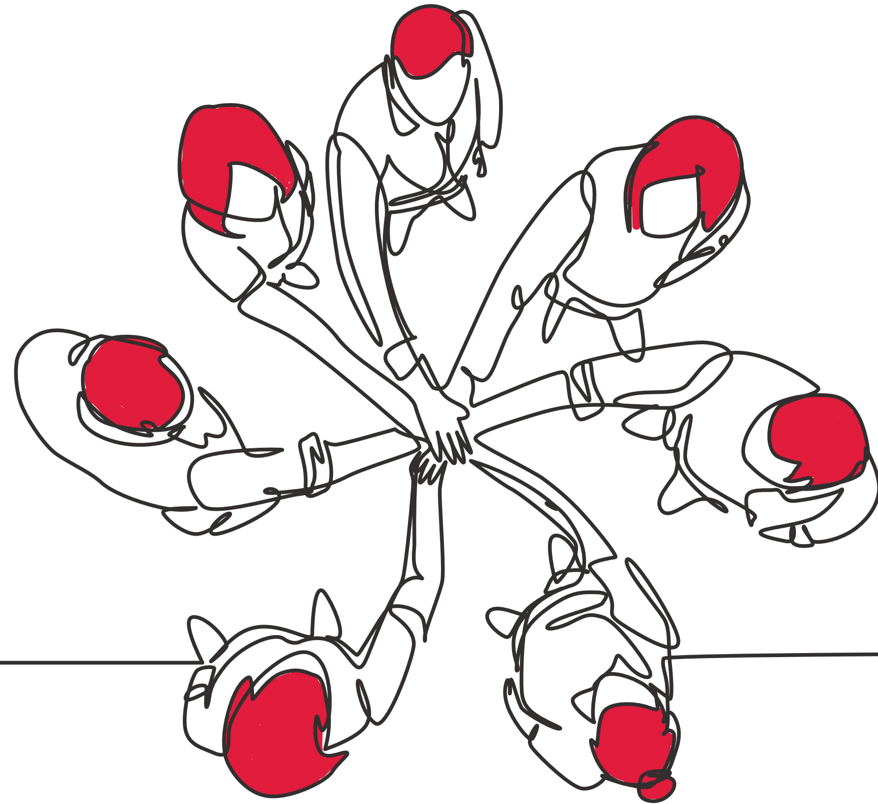
Oury Clark

Shareholder Agreements



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A Shareholders' Agreement is a private agreement between the shareholders of a company and, often the company itself, the contents of which are down to the shareholders' to decide.

The private nature of such an agreement means the shareholders are free to include anything they like in it, and it therefore often sets out exactly how shareholders intend to run their business.

The agreement typically contains instructions on how the company is run, and sets guidelines to follow upon the occurrence of certain events.

Why have a Shareholders' Agreement?

Whilst a company's Articles of Association will contain a lot of the rules concerning the operation of the business at a corporate level, there are laws around what can and can't be included in the Articles. A Shareholders' Agreement therefore allows the shareholders greater freedom to create their own rules by which the company must operate, both now and in the future.

A company is obliged to file its Articles of Association at Companies House for all to see, whereas, as noted above, a shareholders' agreement is private and personal to the shareholders.

What is normally in a Shareholders' Agreement?

- Shareholder contributions: how will the Company be capitalised and what funding or other contributions from shareholders will there be?
- Management composition of the board of directors: How will be board be constituted and are there any other executive management arrangements (e.g. appointment and responsibilities of a managing director or CEO)?
- Financial matters: Will the SHA cover the approval of a business plan and /or distribution of profits?
- Transferability of shares: Can the shares be transferred and to whom? Will such shares have to be offered to employees or other shareholders first?
- Minority protection: Are shareholders with minority shareholdings granted additional veto rights on certain matters to allow them to protect their position?

The Agreement will contain specific and practical rules relating to the company and the relationship between the shareholders, examples of which are as follows:

Scope of the Business

The Shareholders' Agreement can set out the operational scope of the business including the agreed geographical scope and market positioning and the mechanism by which any departure from the Company is managed.

Sale of Shares – Control of Transfer

The sale of company shares can occur for various reasons (business exit strategy, disciplinary issues, realisation of investments for cash-flow purposes). To prevent potentially undesirable third parties from acquiring shares in the company, a mechanism can be included in the agreement to handle the sale of shares in situations such as:

- a shareholder wanting to dispose of shares and gain return on their investment;
- the death, illness or bankruptcy of a shareholder; and
- a proposed sale of the entire company, where not all shareholders are in agreement.

A usual provision would be the inclusion of 'pre-emption rights' for the existing shareholders over the shares of their outgoing co-members, i.e. a right of first refusal. There may also be so-called "drag-along" and "tag- along" rights, which empower majority shareholders to force the other shareholders to sell their shares to third party buyers, or minority shareholders to force their entitlement to sell when shares are being sold by a majority shareholder in order that the whole company can be sold as one transaction.

Director Responsibilities

Shareholders' Agreements can be used to clarify who makes decisions within a company and to determine the power held by the shareholder or director.

The roles of director and shareholder within a company can be carried out by a single person. However in order to avoid the potential issues that arise where there is a conflict of interest, a Shareholders' Agreement can be used to establish which decisions can be made by directors without the input of the shareholders, in order to make a clear distinction between the roles.

Directors may have other jobs, directorships or external commitments to those of the Company. Accordingly, the Shareholders' Agreement, (drafted alongside the director's service agreement or contract of employment), can oblige each shareholder who is a director to devote an agreed amount of time to the company.

Protection of the Company

Shareholders of a company are likely to gain knowledge of certain confidential information about the company which would otherwise remain private, such as information about customers and suppliers. In order to protect a company's business interests, where a shareholder sells their shares, provisions can be included in a Shareholders' Agreement to limit the potential damage to the company, some examples of which are:

- non-compete;
- non-poaching of customers; and
- non-solicitation of staff.

Protection of Minority Shareholders' Rights and Invest-ment

Veto Rights

The inclusion of these provisions protect shareholders who hold less than 50% of the shares in the company, by giving them more input into fundamental decisions. These minority shareholders usually have very little say in the business of the company if they are out-voted by the majority, so veto rights in a Shareholders' Agreement are used to empower minority shareholders.

Unanimous and majority voting

Where certain decisions are crucial to the functioning of a business, it may be in the best interests of all the shareholders of a company, (but particularly the minority shareholders), to agree that a 90% or 100% majority of shareholders must agree to it (as opposed to the normal requirement for more than 50% or 75% of votes by way of ordinary or special resolution of shareholders respectively).

Let us Introduce Ourselves

Email: contact@ouryclark.com

Oury Clark London:
10 John Street, London WC1N 2EB

Tel: +44 (0) 20 7067 4300

Oury Clark Slough:
Herschel House, 58 Herschel Street
Slough SL1 1PG

Tel: +44 (0) 1753 551111

Examples of such decisions might include:

- business activity changes;
- approval of giving or receiving large loans;
- increasing or decreasing director pay;
- recruiting or dismissing directors; and
- issuing new company shares.

Notwithstanding the above, it should be noted that a requirement for unanimous or high percentage voting could cause practical difficulties to the company's ability to effectively make decisions, and could end up causing the company to stagnate, so such voting requirements should be considered carefully.

How long will it take to complete, and how long will it last?

Once all of the shareholders have agreed on the content that they wish to be included in the Agreement, they simply need to sign the Agreement and date it. At that stage the agreement will be effective in binding all of the parties to it.

If you believe this type of agreement would be beneficial to you, please do not hesitate to contact us.

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