

THE BENEFITS OF A SHAREHOLDERS' AGREEMENT

What is a Shareholders' Agreement?

A Shareholders' Agreement sets out the rights and obligations of shareholders of a company, and commonly covers matters governing the management and structure, initial and continued funding, administration, and business activities of the company. As part of the process of establishing a business, acquiring an interest in a business, or admitting another party into an existing business, the new and (if any) existing shareholder(s) in the company may enter into a Shareholders' Agreement.

A Shareholders' Agreement is a significant and very helpful document in setting up a business, or in acquisitions of partial interests in businesses, because it provides a mechanism for setting out the principles upon which the shareholders intend to run the business and deal with unforeseen circumstances and contingencies.

A Shareholders' Agreement is distinct from the company's constitution. Without a Shareholder Agreement, the company would be controlled solely by the exercise of shareholding or directorship rights through its constitution, which are generally insufficient to govern and control the business activities, as opposed to administration of the Company as a legal entity. The potential for disputes between the shareholders or other events to detrimentally affect the performance of the company is increased where there are no mechanisms in place to govern potential business activities and management of the company.

When is a Shareholders' Agreement used?

Shareholders' Agreements are commonly used in two scenarios:

- A Joint venture between two or more persons, where the parties to the venture agree to set up a joint venture company or partnership. The Shareholders' Agreement (commonly called a "Joint Venture Agreement" in this circumstance) provides a supervening set of rights and obligations, independent of the joint venture company's constitution (if a joint venture company is used). The Shareholders' Agreement sets out those rights and obligations (and any other details) that are inappropriate for inclusion in the constitution, or that the parties wish to remain confidential. The confidentiality arises because the Shareholders' Agreement, unlike the Constitution, is not required to be filed at the Companies Office and consequently available for public inspection.
- A Company with several or numerous shareholders. The Shareholders' Agreements sets out the shareholder's rights and obligations in relation to the company, and is essential to govern the management of the company, and to protect the interests of all the shareholders in the event of changing circumstances.

For example, consider if all the shareholders of the company are also directors of the company, and one of the shareholders decides to resign from their position as director, but remain a shareholder. That person would still be able to enjoy the benefits of the remaining directors' efforts in managing the company, without the need to assume the risks and potential liabilities facing directors under present company law. The Shareholders' Agreement could require that, if a shareholder wished to relinquish their position or resign as a director, then that shareholder would be obliged to offer their shares to the other remaining shareholders.

A Shareholders' Agreement is particularly useful in situations where a company has no majority shareholding, because of the correspondingly high potential for the company to be adversely affected by disagreements between shareholders. The Shareholders' Agreement could specify the management structure of the company, and provide a dispute resolution mechanism for resolving disagreements between shareholders.

What is covered by a Shareholders' Agreement?

Such an Agreement commonly includes, among others, policies governing the following matters:

- The company structure: Includes composition of the capital of the company, and its internal rules.

- The appointment of directors: Includes the power of each shareholder to appoint a director or directors, and the authority of such directors when making decisions. May also cover situations where additional directors are appointed in the event of additional shares in the company being issued to third parties.
- Management of the company: Covers the appointment of the company management (eg director, managing director), and requirements on the company management to prepare financial and management reports for the shareholders (eg monthly financial statements to be prepared in accordance with generally accepted accounting principles applicable at the time).
- Shareholding restrictions and the transfer of shares: This may include a provision that, if one shareholder dies or wishes to sell its shares in the company, the other shareholder has the first option, on certain terms, to purchase the shares. Other provisions may include prohibitions on transfers of shares or interests in shares except in certain circumstances, the procedure for the transfer of shares and the procedure for calculating a fair value for the shares.
- Adding new parties to the Shareholders' Agreement, and additional shareholders.
- Restrictions on the activities of the company (eg "major activities" involving substantial amounts, or affecting the nature or structure of the company) unless such activities have the unanimous approval of the directors of the company.
- Dividends, and the provision of additional funding by the shareholders: Includes the methods and the proportions in which the shareholders will provide funds to maintain the company, the amount of the profits to be allocated as dividends each year, and a procedure for resolving disputes that arise in respect of these matters.
- The rights of shareholders and directors: Includes shareholders' access to records, and any variations or additions to the statutory powers, rights and duties of shareholders and directors.
- Dispute Resolution: For example, a provision dealing with the resolution of disputes involving matters which could lead to substantial injury to the company as a going concern, and which seem incapable of satisfactory long-term resolution by mediation or negotiation. Such a provision could expressly include disputes such as disagreements over company financing, dividends, or the management and direction of the company, and would provide a mechanism for resolving such disputes.
- Non-competition provisions i.e. preventing either shareholder from setting up a business in competition to the company within a prescribed time period and geographical distance from the company.
- Confidentiality: Includes provisions relating to the exposure of company documents, both during the period of the Shareholder Agreement and following the termination of the Agreement.
- Duties of the shareholders with regard to the company and each other in the event of the company being liquidated.

Therefore, a Shareholders' Agreement is a valuable tool for providing a procedural framework to govern the internal management of a company or joint venture. Such an Agreement is essential where there is no clear majority shareholding in a company, to ensure the efficient management of the company and to minimise the potential for management disputes to detrimentally affect the company.

Because a Shareholders' Agreement has the additional advantage of not being available to the public, unlike the company's constitution, sensitive details regarding the role of the parties in company management, the rights and obligations of the parties or rights attaching to shares may be set out in the Shareholders' Agreement.

For the reasons set out above we consider that a Shareholders' Agreement is an important element in establishing, at the outset of a business arrangement, a sound operating platform to enable the future success of the business venture.

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