

What is a Shareholder Agreement?

Simply put, a Shareholder Agreement is a document that every company with more than one shareholder should have!

It contains the rules by which shareholders agree to operate the company and in general terms provides the basis of a legal agreement between them. A Shareholder Agreement is there to ensure that decisions are taken by consensus and discussion rather than unilateral imposition, or indeed quite the opposite if that is what has been agreed. It will provide clarity and certainty as to what can or cannot be done, resulting in a reduction of the areas where there might be conflict, and most importantly provides a framework for dispute resolution, exit strategy for disaffected shareholders, and resolution of shareholdings in circumstances such as divorce or death of other shareholders. All these factors can cause untold difficulties if the shareholders do not make sufficient provision.

Key Points:

- Determines the basis for important decision making
- Defines a procedure for the resolution of disputes
- Confirms the powers of the shareholders in the company individually or communally
- Prevents situations where changes in one shareholder's personal circumstances can have an effect on the company or other shareholders
- Sets out the limits and procedures for how the company is to be operated
- Provides a framework for exit strategies for the shareholders
- Safeguards each shareholder's financial interest in the company, and the interests of the shareholders' families in the event of the death of a shareholder

Why have a Shareholder Agreement?

A Shareholder Agreement provides a level of protection for all parties involved in the ownership of the company against the actions of the others, whether minority, majority or equal shareholders.

Shareholders typically rely on common sense and the tolerance of others to resolve matters; they may well be married, be family members or long-term friends. In either situation anything that can be done to reduce the possibility of conflict is a good thing and whilst these matters are usually very far from the thoughts of business partners starting out in new venture, just like a marriage, things do not always work out as expected.

A formal agreement prevents an impassable obstacle if things go wrong in the future. It is common for a newly formed company to be run in the initial stages more like a partnership but this is not a suitable basis upon which to continue to operate as a company grows and matures, and its owners' aims and objectives change. There is a need for structure, and a Shareholders' Agreement is one of the cornerstones of the company structure.

While there is a lot to consider when starting a new company, it is prudent to take a longer-term view for the future. The mere formation of a company is relatively simple to achieve and allows a business to start trading. It does not, however, define specific responsibilities and more particularly the limits of responsibilities of the shareholders.

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A Shareholder Agreement will help to resolve some common potentially damaging issues as follows:

(1) What happens if shareholders fall out?

Common sense and tolerance may not be enough to end a dispute where a specific action is called for. A Shareholder Agreement will provide the means to force an end to a dispute, by providing a structure within which the parties have agreed to abide. In the event of a stalemate situation a Shareholder Agreement will provide a procedure to allow the parties to go their own ways.

(2) What happens if a majority shareholder dies or is divorced?

The spouse of the shareholder may take his or her place. This is not necessarily what the other shareholders want, particularly as that spouse may be someone unknown to others? A Shareholder Agreement will provide a mechanism by which the other shareholders have first right of refusal to purchase the deceased's shares. In the case of a shareholder getting divorced, would they wish to be joined for board meetings by a former spouse who may well be hostile? An Agreement can prevent this.

(3) Can you sell your shares to anyone without approval from other shareholders?

Without a Shareholder Agreement it is likely that you can. This may not be in the best interests of the company. A common provision is a right of pre-emption. This means that if a shareholder obtains a commitment from an outsider to purchase shares, the shares have to be offered under the same terms to the existing shareholders for a specified period. If the other shareholders do not want shares to go to the outsider, they merely have to match the price and purchase. This will ensure that the on-going shareholders cannot have an unwelcome partner forced upon them to their detriment.

Whilst most new companies now have the benefit of pre-emption rights from the Companies Act, the terms written into a Shareholder Agreement can be far more detailed and specific to particular circumstances and individual requirements.

(4) Are any financial limits set?

Without a formal Shareholder Agreement, it may be possible for your fellow shareholders to agree contracts on behalf of the company no matter what the terms. With an Agreement in place this cannot happen or it will not be binding on the company, as the person in question will have exceeded their responsibilities.

Having control of an individual's ability to make a commitment on behalf of a company is of paramount importance in order to ensure the smooth and profitable running of the company.

How do I proceed?

CRO has two options available:

Standard Service: We will send you a detailed shareholder agreement document in template form with spaces for you to enter your specific details. Full instructions are included that guide you through the process. This is a quick and low cost option and covers all the standard issues that are likely to cause problems in the future.

Bespoke: If you have a specific need to add detailed scenarios or particular requirements to tailor your agreement, our bespoke option is the one to choose. This option allows for a degree of tailoring designed to suit your particular needs.

Contact us for further details or order a shareholder agreement when setting up your company online.