Shareholder Agreements

Why should I have one?

YOUR QUESTIONS... ANSWERED

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If you start a new company where there are multiple shareholders, it is a good idea to put a written shareholders agreement in place detailing what happens in certain situations. There is no legal requirement to have a shareholders agreement however it can be beneficial so that all shareholders are clear on their rights and responsibilities and can ensure that they can plan for their future and be certain that any intentions for their shareholding after they die can be effected.

The default position of what happens in the absence of a shareholders agreement depends on which Articles of Association you have adopted, however generally speaking, if anything happens to you, your executors will only have the authority to take the steps necessary to liquidate your assets and cash in your shares. They will have no powers to continue or grow the business.

SHAREHOLDERS DO FALL OUT

It can be exciting starting a new business relationship and it is often an optimistic period of looking forward to what the business can become. At the beginning of a new business relationship, it is often difficult to foresee a scenario in which the business partners would fall out, or find difficulty in making decisions. However, unfortunately disagreements can occur and trying to agree the provisions that should apply if you fall out when you have already fallen out is almost impossible. It is easier to formalise the approach that will be taken if the relationship does turn sour in an agreement at the outset, rather than to risk waiting until differences of opinion become entrenched.

As a Shareholders’ Agreement is a private document, there is generally no requirement to file it at Companies House, meaning its content can be kept confidential.
REASONS FOR A SHAREHOLDERS AGREEMENT

1. Regulate management of the company

Generally, the running of the company is left to the board of directors. However, the shareholders may believe that there are certain decisions that should not be left to the discretion of the directors and instead require shareholder approval, particularly if there are directors who are not shareholders.

2. Offers protection for minority shareholders

A shareholders’ agreement can provide protection for minority shareholders by reserving certain decisions, such as the ability for the company to issue further shares, which can only be made with the unanimous consent of all the shareholders. The agreement may also contain “tag along” provisions, which enables a minority shareholder to “tag on” to a majority shareholder in a share sale situation where the majority attempt to sell only their shares rather than seeking to find a buyer for all the shareholders.

3. Offers protection for majority shareholders

“Drag along” provisions would usually operate where an offer is received to buy all of the shares in a company and the majority shareholders wish to accept that offer. The rights allow the majority to force the holders of the remaining shares to accept the offer on the same terms so that they do not scupper the deal.

4. Control the transfer of shares

A Shareholders’ Agreement can provide a mechanism which, where one shareholder wishes to sell their shares, effectively gives the other shareholders or the company (as the case may be) a “right of first refusal” over those shares.

This can be used to try and restrict who may or may not acquire shares in the company.

This can be a useful tool, particularly for small businesses that may wish for the initial shareholders to retain the shares, rather than allow external investors and unknown individuals to come in. After all, you have gone into business with your business partner for a reason.

5. Potential to link shareholdings to employment

Often shares in a company are held by the directors or key employees of the business. If they were to resign or leave for whatever reason, you would more than likely want them to sell their shares, otherwise they could remain entitled to receive dividends that would be generated by the on-going shareholders’ hard work.

A Shareholders’ Agreement can provide a mechanism whereby a persons shareholding is linked to their employment, so that if they were to leave they must offer their shares up for sale. Otherwise, there is no requirement for them to sell their shares if they cease to be employed by the business.

A Shareholders’ Agreement can go further and include a mechanism which sets different valuation mechanisms depending on the circumstances under which the relationship with the company comes to an end.

6. Restrictions

In the event that a shareholder seeks to exit the company, the remaining shareholders may wish for restrictions to apply to the exiting shareholders’ ability to set up or work in a competing business. These restrictions can be stricter than may exist in any employment contract and can be very valuable in protecting the interests of the company moving forward.

7. Resolution of disputes

If disputes do occur, there can be specific provisions for dealing with disputes laid down. These may include at what stage there would be a referral to mediation, or who any arbitrator may be etc.

8. Demonstrates business stability

Having a Shareholders’ Agreement can demonstrate stability for your business, with the inference that you have planned ahead in order that any dispute will be easily and swiftly dealt with. This is important in particular for banks and other creditors that may be looking to invest in your company.

9. Can offer a varied dividend policy

A Shareholders’ Agreement can set out a varied dividend policy which may allow different dividends to be payable to each shareholder, where they have different classes of shares.

These are just a few of the reasons why a Shareholders’ Agreement is important and useful for a company to have in its armoury and to protect individual shareholders.

Any agreement should be reviewed periodically to check that it still operates in the way the company and shareholders wish it to and be updated and re-executed as shareholders come and go.
Factsheet - SHAREHOLDER AGREEMENTS

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