

Key matters to include in a Shareholders Agreement

The key purpose of a Shareholders Agreement is to govern the relationship of shareholders and directors. A well drafted Shareholders Agreement can avoid costly shareholder disputes in the long run and create a framework for the sustainable management of the business. We often see businesses without a Shareholders Agreement ultimately being destroyed or losing significant value due to shareholder disputes, which could easily have been avoided by having an agreement in place that have mechanisms for quickly resolving the matter.

When drafting a Shareholders Agreement there are a number of key provisions that should be covered off on. The following is a checklist that will assist you in preparing your Shareholders Agreement.

KEY ITEM	WHAT TO CONSIDER	CHECK
DIRECTOR APPOINTMENTS	The Shareholders Agreement should include who has the right to appoint and remove directors, and when that right may be lost (for example if a shareholder's shareholding drops below a certain percentage).	
DECISION MAKING	<p>The Shareholders Agreement needs to specify how decisions will be made in respect of the business. You will need to consider which issues will be decided by the Board and which by the shareholders. For example, issues about the material changes in the nature of the business, entering into contracts above a certain dollar value and major transactions would commonly need to be approved by shareholders.</p> <p>If you have a large shareholder base, you may want to consider leaving the majority of decisions with the Board, particularly if the Board contains a good cross section of representatives of shareholders.</p> <p>You will also need to consider what percentage of votes will be required to decide the different decisions. For example, certain decisions of the company may require unanimous approval rather than a majority approval, such as selling the business.</p>	
DISPUTES	You need to consider how you want to handle deadlocks in voting (such as where there is a 50/50 split on decisions) or situations where disputes cannot be resolved.	
OBLIGATIONS	<p>You should ensure that the Shareholders Agreement clearly sets out the obligations of each shareholder and their rights, particularly if it is expected that certain shareholders will provide certain services or commit a certain amount of time to the business.</p> <p>If a shareholder is obtaining shares based on the services that they provide to the company, you may consider having their shares vest in tranches over time upon the achievement of certain KPIs. A mechanism for achieving this can be included in the Shareholders Agreement.</p>	
TRANSFERS OF SHARES	<p>You should consider whether shareholders will have the right of first refusal on the issue or transfer of shares, before the shares are issued or sold to a non-shareholder. This is commonly referred to as a right of pre-emption. This will assist in reducing the risk of dilution.</p> <p>You should also consider whether you want certain shareholders to have the right to require other shareholders, or be required by other shareholders, to participate in the sale to a third party (often referred to as drag along or tag along rights). For example, majority shareholders who are selling their shares to a third party could require a minority to also sell their shares to a third party in order to effect a sale of the entire company. This avoids the potential for a minority shareholder to hold up a sale.</p>	
EXIT STRATEGY	<p>The Shareholders Agreement should include reference as to how shareholders are able to exit and what happens to their shares.</p> <p>You need to cover off on exits in unforeseen circumstances, such as if a shareholder becomes insolvent or dies.</p>	

KEY TAKEAWAY

The above checklist is only a summary of the key matters we recommend you consider when drafting your Shareholders Agreement. There are numerous other matters that need to be considered, and it is important that the Shareholders Agreement is tailored for your particular business and is flexible enough to give effect to your future intentions.

If you would like further information on what matters should be included, or if you would like assistance putting together a Shareholders Agreement, please get in touch with one of our team members today.