

Ashtons
LEGAL

Shareholders Agreement Guide



EXCEPTIONAL CLIENT SERVICE EVERY TIME



www.ashtonslegal.co.uk

In essence, a shareholders agreement is an agreement between two or more shareholders in a private limited company setting out the terms upon which that company shall carry on business and how the shareholders propose to exercise their rights in relation to the company, as well as regulating the relationship between the shareholders themselves.

Why should you have one?

A shareholders agreement is a governance tool. It enables the shareholders to agree the provisions by which they wish to be governed now and in the future. As a result, there are numerous reasons why shareholders should have a shareholders agreement in place, many of which are set out in the rest of this Guide. But the reasons which are typically the most relevant to our clients are:

- You can build into your shareholders agreement rights of first refusal, so if any shareholder wants to sell their shares they must offer them to the other shareholders (or the company) first. This helps try to keep the shares within the existing parties. After all, you have all gone into business together for a reason and do not want to one day suddenly find that you have a different business partner.
- Shareholders agreements can set out a list of key decisions which cannot be made without your consent. These are particularly important for shareholders who have a minority holding and/or who are not also directors.
- Typically in private companies, the shareholders are the directors or other managers who are actively involved in the business. A shareholders agreement can provide a mechanism for getting shares back off any shareholder who ceases to be involved in the business. Without such a provision, an exiting shareholder can keep hold of their shares and therefore continue to benefit from the hard work of those who remain within the business.
- Shareholders agreements are handy tools for dictating what would happen to shares when a shareholder dies and commonly contain cross option provisions which complement the terms of any life insurance policies which are taken out for this purpose.

What follows is a list of matters which shareholders should consider when contemplating having a shareholders agreement prepared for them.

Matters to Consider

1. Management of the company

A shareholders agreement could include terms relating to the management of the company. This is of course left to the board of directors and some of these issues may already be suitably covered by the company's articles of association.

However, you may wish to consider including provisions such as:

- (a) whether each shareholder will have the right to be appointed as a director to the board
- (b) the quorum for director meetings
- (c) the frequency at which such meetings are to be held
- (d) whether there will be a chairman.

There is no ultimate right for a shareholder to also be a director, unless such a provision is set out in a shareholders agreement.

2. Reserving important decisions

As mentioned above, the general running of the company is left to the board of directors. However, every so often a decision needs to be made which is beyond the scope of what is classed as the ordinary day-to-day running of a business. These decisions may require a formal board meeting to be held so board approval can be obtained, or may even require shareholder approval.

A shareholders agreement would usually contain a list of decisions that are deemed important enough that they cannot simply be made by the board or by the passing of a 'normal' shareholders resolution but instead require the unanimous consent of all of the shareholders.

These provisions are generally included as a way of protecting the minority shareholders.

Such provisions would include matters such as changing the company name, changing the nature of the business, issuing new shares, purchasing assets that have a value of over a set limit and employing people whose salary is over a certain figure, to name but a few.

3. Pre-emption of Transfer Provisions

Pre-emption provisions that apply to the transfer of shares effectively give the other shareholders or the company (as the case may be) a **right of first refusal** over any shares that are proposed to be sold.

Such provisions are used to protect the ongoing shareholders in the company and it is common that a shareholders agreement would contain pre-emption provisions so that if one shareholder wishes to sell or otherwise dispose of their shares they must offer those shares to:

- (a) the ongoing shareholders
- (b) any shares that are not purchased by the ongoing shareholders are offered to the company who may wish to perform a company own share purchase (provided the provisions of the Companies Act 2006 are complied with)
- (c) any unpurchased shares can then be offered to a third party.

Such provisions would normally contain an agreed mechanism for how the shares are to be valued, which is commonly at their **fair value** as determined by the company accountant.

You may also wish to include provisions which cover the sale of shares from one shareholder to another, i.e. when there is no third party involved. These provisions can be used to agree what valuation mechanism will be used to value the shares. Generally, if the shares are offered to the other shareholders first, but they do not take up the offer, the selling shareholder has a set time period during which they can sell to a third party (on substantially the same terms) otherwise they are required to keep the shares themselves.



4. Transfers to Family Members and Family Trusts

The shareholders agreement could contain the ability to transfer shares to an immediate family member or members, or to a family trust (all generally for the purpose of tax planning) without having to go through the pre-emption procedure referred to above. This is on the basis that any person to whom shares are transferred enters into a deed of adherence agreeing to be bound by the terms of any shareholders agreement and would have no ability to appoint a director to the board.

5. Trigger Events

Shareholders agreements also usually contain provisions that if certain events occur the shareholder in question is obliged to offer their shares for sale under the pre-emption provisions mentioned above. Such “trigger events” would include where there is a material breach of the shareholders agreement that is not capable of being remedied, or upon the insolvency/ bankruptcy of any of the parties.

Such events might also include the concepts of **Good Leaver** and **Bad Leaver**. These concepts are linked to the directorship/employment of the shareholders by the company and create a situation where upon a shareholder ceasing to be a director and employee is obliged to offer their shares for sale under the pre-emption provisions.

Bad Leaver provisions set out the circumstances under which the exiting shareholder would only be paid a discounted price for their shares (e.g. if they are dismissed for misconduct) and the **Good Leaver** provisions set out circumstances where the shareholder will get ‘market value’ or ‘fair value’ for their shares.

Alternatively, if you do not want to distinguish between the two, we can prepare **Leaver** provisions whereby the shareholder who is leaving is obliged to offer their shares for sale under the pre-emption provisions.



6. Transfers on Death

The Trigger Event provisions mentioned above may also include the death of one of the shareholders – in such circumstances they would normally be considered a **Good Leaver**.

However, you may wish for the shareholders agreement to contain specific provisions regarding the transfer of shares on death in order to provide more certainty as to where those shares would end up.

Therefore, if the shareholders are looking into taking out life insurance over their respective lives it is possible to draft into the shareholders agreement a **cross option** where upon the death of a shareholder the surviving shareholders are obliged to use the proceeds of the insurance policy that is maintained over the deceased shareholder's life to purchase the shares from the deceased's estate.

It is also important to ensure that each shareholder has a Will and that the provisions of the shareholders agreement complement the provisions of those Wills and vice versa. Where the Will specifies that the shares themselves, as opposed to the cash value of them, are to be passed to a specific individual, the shareholders agreement can make it clear that the shares are to follow the provisions of the deceased shareholder's Will.

7. Drag and Tag

The shareholders agreement could contain **Drag Along** and **Tag Along** provisions.

Drag Along rights would usually operate where an offer is received to buy all of the shares in a company and a majority (or set percentage) of the 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.

Tag Along rights (also known as piggyback rights) would usually operate where a majority of the shareholders wish to sell just their shares to a third party and enables the minority shareholders to force the majority shareholders to obtain an offer for their shares on the same terms. The tag along rights act as protection for the minority holders in case the majority look to sell only their shares rather than obtaining an offer for the entire issued capital.

8. Dividends

A shareholders agreement could include a **dividend policy**. This might be as straightforward as "dividends shall be declared by the directors exercising their powers from time to time" or a more complicated dividend policy could be included.

9. Non Competition Restrictions

Non competition restrictions can be placed on the shareholders who would agree that whilst they are shareholders, and for a set period after they cease to be a shareholder, they will not do certain things like set up in competition, poach staff, poach customers etc.

10. Deadlock provisions

These would be used in circumstances where the shareholders cannot agree on something that is reserved for unanimous consent (as mentioned above).

Where there are just two shareholders, the shareholders agreement can contain provisions allowing for one of the shareholders to offer to buy the shares from the other shareholder for a given price. However, the offer to purchase also acts as an offer from that shareholder to sell their shares to the other for that same price (this stops people putting in frivolous offers).

Alternatively, the shareholders agreement can provide that any disputes are to be settled through some form of mediation. This type of provision is more common when there are more than two shareholders but can be used in all circumstances.

11. Guarantees given by shareholders

The shareholders agreement could state that where shareholders have given, or are to give, personal guarantees on behalf of the company all the shareholders agree between themselves that if those guarantees are called in, the liability under those guarantees is split between the shareholders in proportion to their shareholdings.

Shareholder agreement checklist

Set out below is a checklist of the questions for you to use to agree the terms of the shareholders agreement. As every shareholders agreement is different, depending on the nature of the company and the needs of the shareholders', the list of questions below is not exhaustive. Not all of the following matters are required to be dealt with in every shareholders agreement, but they are matters that you may like to consider:

- 1** What is the name of the company in which the shares are held?
- 2** Who are the current shareholders and how many shares do each of them hold?
- 3** What is the business of the company?
- 4** Do you want each of the shareholders to have the right to appoint a director to the board?
- 5** How often are you going to meet as a board?
- 6** How many days notice do you envisage giving a board meeting?
- 7** What is the agreed quorum at board meetings?
- 8** Is one of you going to be chairman of the board?
If so, will the chairman have a casting vote in the event of a deadlock?
- 9** Can a director who is absent from a board meeting appoint an alternate to attend and vote in their place?
- 10** Do you wish the shareholders agreement to include a list of key decisions which require the unanimous consent (or other majority threshold) of the shareholders?
- 11** Do you want pre-emption provisions to apply to share transfers?

If so, should the shareholders be able to transfer their shares to family members/family trusts for tax planning purposes without being subject to the pre-emption provisions?
- 12** Would you like the shareholders agreement to include "trigger event" provisions?

If so, would you like the trigger event provisions to include the concepts of good leaver and bad leaver, or just leaver?
- 13** Upon the death of a shareholder, are the shares to follow the deceased shareholder's Will, are they to be offered up for sale under the "trigger event" provisions or do you intend to take out life insurance cover and require the necessary cross option clauses?
- 14** Will the company have a specific dividend policy?
- 15** Would you like drag-along and tag-along rights to be included in the agreement?
- 16** Would you like deadlock provisions like those referred to above included in the agreement or should any disputes be sent to mediation?
- 17** Where the shareholders have given or are to give personal guarantees on behalf of the company, do all the shareholders agree between themselves that if those guarantees are called in, the liability under those guarantees are split between them in proportion to their shareholdings?
- 18** Are the shareholders to be subject to non competition restrictions?

What to do next

Drafting a Shareholders Agreement

When preparing a shareholders agreement we generally act for the company. As such, we are unable to advise any individual shareholder on the shareholders agreement and therefore if any of the shareholders feel it necessary they should seek their own independent advice.

There may be a benefit to incorporating some of the provisions mentioned above into the Articles of Association of your company. This can be complicated and costly, and for most companies incorporated since 2009 it is probably not necessary. We would be happy to discuss this with you.

Regardless of whether we are making any amendments to them, we will always review your Articles of Association to ensure that they do not prevent any of the above provisions being enforceable, particularly in relation to the transfer of shares.

What do I do now?

By providing us with the answers to those questions, you are providing us with the information we need in order to have a clear understanding of what matters you are looking for your shareholders agreement to deal with and how.

When we have received the answers from you, one of our team will give you a call or arrange to meet with you to discuss your answers and to clarify any issues you may have.

We shall then provide you with a tailored quote for preparing your shareholders agreement. We will usually do this on the basis of a fixed fee so that there is no uncertainty.

Once our quote has been accepted, we will produce a first draft of the shareholders agreement and this will be sent to you for consideration. You will then need to discuss the first draft with the other shareholders, following which we can discuss any questions and agree any proposed changes with you, either at a meeting or over the telephone.

After any necessary changes have been made a final version of the shareholders agreement would be sent to you for signature.

If you are unsure about of the matters set out in this Guide, any of the questions in the Checklist or if you have any specific requirements which are not dealt with by this Guide, please do give us a call.

More information

To discuss how we can help you, please contact us:

E: enquiry@ashtonslegal.co.uk

T: 0800 915 6037

