

A Guide to Shareholders' Agreements

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■ Understand the status of a Shareholders' Agreement

■ Understand the function of a Shareholders' Agreement

■ Understand the benefit to your business of a Shareholders' Agreement

This Guide has been designed to assist you with some of the general issues and to answer questions that you may have. This Guide is only intended to be a general overview of the law in relation to the care home funding and home protection schemes and legal advice should always be obtained from Leonard Gray in application to a particular case.

Section

1

What Is A Shareholders' Agreement?

This Section of the Guide explains what a shareholders' agreement is. Shareholders' agreements can vary considerably in terms of content and length and should be specifically tailored to suit the individual requirements of the parties to them.

1. The agreement

A shareholders' agreement is a private contract between members (i.e. shareholders) of a company. Like with any other contract, it is always best for the agreement to be put in writing, preferably in clear, legible wording.

2. The position under the Companies Act 2006

The law relating to companies is governed, by and large, by the above Act. It covers a huge amount of territory, including how companies must be formed, operated and kept in proper order.

Anyone who buys shares in a company will, in the absence of a shareholders' agreement, purchase them subject to the 2006 Act. This has the effect of creating a binding, 'statutory' contract between the shareholders.



3. The difference between the 'statutory' contract and a shareholders' agreement

Most ordinary contracts and agreements can only be amended, in writing, with the agreement of all the parties. However, the statutory contract created by the 2006 Act can be varied more easily. In many cases, all that is required is for 75% of the company's shareholders to agree to the change. This makes the position of a minority shareholder or someone with a small stake in a company particularly vulnerable. It also means that a shareholder or group of shareholders with a majority or larger stake can exercise huge control. Sometimes, that power might be open to abuse.

The next Section of this Guide examines the purpose of having a shareholders' agreement in place.

Section 2

Why Create A Shareholders' Agreement?

In this Section of the Guide we cover the reasons why a shareholders' agreement might be appropriate to shareholders in a company. We also look at the main 'constitutional' documents of a company.

1. Standard company documents

A company's constitution/governing framework is set out, principally, in a key document known as its 'articles of association' ("articles"). These give detailed instructions on how the company is to work. They are, effectively, the 'statutory' contract referred to in Section 1 of this Guide and are where the internal management structure of the company is set out, enabling the company's directors and shareholders to work out whether any action they are proposing to take is, in fact, permitted.

2. If a company's articles govern how it operates, what is the point of having a shareholders' agreement?

It is perfectly true to say that many things a shareholders' agreement might cover can, just as easily, be dealt with in a company's articles. However, there are various, good reasons for preferring to create a shareholders' agreement, including:

- **Privacy**

A company's articles are a public document, available for inspection by enquiring with Companies House (this can be done, subject to the payment of a fee, over the internet at www.companieshouse.gov.uk). A shareholders' agreement, however, is not



accessible to the public, which will suit shareholders who wish to keep their contract with each other private and confidential.

- **Remedies**

As stated above, a company's articles/the 'statutory' contract can, theoretically, be amended merely by a 75% majority vote of its shareholders. This leaves minority shareholders potentially exposed and vulnerable. A shareholders' agreement, on the other hand, can only be altered with the unanimous consent of all the parties to it. In other words, if a shareholders' agreement is altered without the blessing of every shareholder, this will amount to a breach of contract and any dissenting shareholders can make a claim, in the courts, for compensation.

- **Personal aspects of a relationship between shareholders**

Shareholders may want to regulate certain, personal affairs that do not directly relate to the governance of the company. For example, there may be an agreement by one or more shareholders to keep the company's affairs confidential. Alternatively, a shareholder who is also a director of the company may have agreed not to work for a competitor for a certain period of time after their employment comes to an end. Such matters are best dealt with in a shareholders' agreement rather than the company's articles.

3. What other things can a shareholders' agreement cover?

The motivation for creating a shareholders' agreement will frequently be to prevent a minority shareholder from being sidelined or limiting the powers of a controlling shareholder. Shareholders' agreements can, however, cover any number of different issues, from whether a shareholder can sell his shares to whoever he likes, to appointing a particular shareholder to a specific role (e.g. the company's auditor) for a certain period of time.



The next Section of this Guide looks at the question of how a shareholders' agreement might work for you/your business.

Section 3

How Can A Shareholders' Agreement Benefit Me?

This Section of the Guide confirms the reasons why a shareholders' agreement might be relevant to you or your business.

1. Deadlock

One of the most important factors to bear in mind when entering into business with other people, which is, all too often, easily overlooked, is what to do in order to terminate such arrangements. How do a company's shareholders retrieve their initial investment? What happens if the cause of the business ceasing is a breakdown of the relationships between the shareholders?

2. Resolving deadlock

A shareholders' agreement can include provisions that deal with how to value the shares of an outgoing shareholder, whether that person is also an employee/director of the company and is selling their shares because they are retiring or, perhaps, as a result of their having been dismissed for misconduct.

The method of valuing shares can be different, from case to case, since it is not normally considered appropriate for someone who has been dismissed to be given the same amount of money as someone who has worked hard for and devoted their time and attention to the company up to and including their retirement.

A shareholders' agreement can also specify that the shares of a shareholder who dies or becomes permanently unwell must be sold to the other shareholder(s) of the company. This avoids the administrative inconvenience of the outgoing shareholder's family inheriting a stake in the company.

3. Inheritance/Wills

On the other hand, in planning their future affairs, some shareholders might actually want to ensure that those inheriting their assets when they pass away (their 'beneficiaries') also inherit their shares. If those beneficiaries then wish to sell those shares, there will also be concerns, again, about how the shares are to be valued.

A shareholders' agreement can deal with the above concerns by specifying that, in the event of any one or more of the shareholders' death, the surviving shareholders do not get a 'right of first refusal' over the deceased shareholder's shares and that, instead, the shares pass automatically to the deceased shareholder's beneficiaries.

The agreement can also set out specifically a formula for valuing the shares, if they are later sold by the beneficiaries, which may or may not refer to the company's accountants conducting the valuation.

It is not always possible, however, for shareholders of a company to agree to the sorts of terms outlined above. This is usually because, not only might one or more of the shareholders be uncomfortable about another's beneficiaries having involvement in or control over the company's affairs but, also, the beneficiaries may not, in every case, find it particularly easy to find and persuade a buyer to buy their shares.

4. Other matters

As stated above, a shareholders' agreement can also cover all manner of other points, including promises by a company's shareholders to maintain confidentiality and/or not to compete with the company in the event that their employment by it comes to an end. It can also deal with the appointment/assignment of certain shareholders to specific roles, such as the company's auditor or even its solicitor.

A shareholders' agreement, being a private document, can even include a promise to one shareholder by the other(s) to appoint a member of that shareholder's family (e.g. son, daughter) as a director by the time he/she reaches the age of 25 years. This could



be particularly important to shareholders who wish to preserve their family's interest and involvement in the running of a company.

The next Section of this Guide confirms how to make an appointment with one of our specialists.

Section 4

Making an Appointment

If you would like to discuss the issues raised in this Guide further then please contact either **John Appleby** or **Tiah Coles**, our business law specialists.

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We are based in Chelmsford town centre, a two minute walk from Chelmsford Rail Station with car parking and disabled access at the rear of our office for the use of clients.

Open Monday to Friday, 9:00am to 5:30pm. Alternative times by arrangement.

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