

Issues to be considered in a Shareholders Agreement - Information Guide

Some of the issues normally dealt with in Shareholders Agreements are summarised below. The various issues require a degree of negotiation between the shareholders to ensure they satisfactorily reflect the understanding between them.

Involvement in the business

A Shareholders Agreement should contain a provision requiring all shareholders to co-operate with each other to ensure that the business remains successful.

The agreement can set out the minimum involvement that each shareholder is to have in the business and how any remuneration is calculated.

Management of the company

The issues in relation to management of the company include:

- What rights will each shareholder have to nominate their own director?
- In what situation can a director be removed?
- How often must board meetings and shareholder meetings be held and what will be the quorum?
- What are the voting rights of the directors – equal votes, or based on shareholding?
- Who is the chairman and does the chairman have the casting vote?
- How many signatures are required for the signing of the cheques or other large expenditure?

Management of the company

A pre-emption clause usually provides that a shareholder cannot sell their shares to an outside party without first offering them for sale to the other shareholders. This raises the following issues:

- What restrictions will there be on the transfer of shares?
- How much notice needs to be given of an upcoming retirement?
- Must the shares being sold be offered to remaining shareholders in proportion to their current shareholding?
- At what price are they offered to the remaining shareholders (for example, this price could be agreed between the shareholders, the fair market value of the shares as determined by an independent third party or calculated in accordance with a formula)?
- If the remaining shareholders do not buy all of the shares, at what price can the unsold shares be offered for sale to an outside party (for example, at the same price or higher)?
- Must the outgoing shareholder disclose who they intend to sell their shares to? Must the outside buyer be someone approved by the remaining shareholders?
- How long do the remaining shareholders/outside buyer have to accept the offer?

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The pre-emption arrangements can also set out the circumstances in which further shares in relevant companies can be allotted to an existing shareholder or to an outside party.

Unanimous or special agreement

The shareholders agreement should set out:

- Those decisions that require simple majority consent, those that require a special resolution (typically 75% approval) and those that require unanimous consent of the directors, and
- Which decisions should be referred to a shareholders' meeting for approval.

Examples of decisions which may require unanimous consent may relate to:

- The allotment of further shares
- A proposed change to the direction of the business
- The winding up of any group company, and
- Purchases by a group company over a set dollar value.

Deadlock

How are disputes between directors or shareholders to be resolved? Should they be referred to mediation or arbitration? Or should there be some other mechanism to force one of two disputing shareholders to buy out the other shareholder?

Restraint of Trade

We recommend inserting a clause in the agreement which prevents a shareholder from competing with the business while they are still a shareholder. Some consideration should be given to restraining shareholders from competing with the business within a certain time frame and within a certain area after selling out of the business. The restraint clause should be drafted to ensure as far as possible that it can be enforced.

The agreement can also contain a confidentiality clause preventing shareholders from disclosing 'trade secrets' to outsiders. Consideration needs to be given to what type of information/know-how this clause should cover, and how long should the clause bind a shareholder after they have left the business.

Termination of agreement

Under what circumstances will the agreement be terminated? And where one shareholder sells out of the business, are any clauses still to apply to them, e.g. confidentiality, restraint of trade etc.

What happens if one of the shareholders breaches the agreement? Should they be required to sell their shares to the remaining shareholders? Should the selling price be discounted to dissuade a shareholder from defaulting or take into account the effect the breach may have on the value of the business?