HOPE FOR THE BEST, PREPARE FOR THE WORST – THE ADVANTAGES OF HAVING IN PLACE A WELL DRAFTED SHAREHOLDERS' AGREEMENT

A shareholders' agreement ('SHA') is a private agreement entered into between the shareholders of a company. Some of the main purposes of a SHA are to regulate the management of the company, understand the position in relation to the shares and ultimately, to protect the shareholders positions.

Why is a shareholders' agreement important?

When starting a new business, the last thing parties want to think about is the idea that something could go wrong, so protections are rarely put in place for such a scenario. Taking steps to enter a SHA could not only help to protect the shareholders' position if something were to go wrong, but it could also detail how any dispute should be resolved.

What does a shareholders' agreement do?

A SHA will deal with numerous aspects of the business operation. Some of the key provisions are summarised below:

Management - A SHA can help to regulate the management of the company. Typically, the day-to-day running of any business will be handled by the Directors, however, there will be certain aspects of the decision making which may require shareholder approval. It may be prudent to agree a list of those specific matters. Such consent matters can include approval of capital expenditure or borrowings above set de minimis levels, material changes to the nature of the business, the rights to appoint or remove senior employees, amongst many others. Agreeing this list, together with the level of shareholder consent required (50%, 70%, 75%?) can assist with striking the appropriate balance between board and shareholder control.

Transfer of Shares - Secondly, a SHA can control the transfer and/or sale of shares. It is often the case that shareholders want to have a say in who is admitted as a shareholder in the company. A SHA can include the right of pre-emption whereby any shareholder who wishes to sell their shares must firstly give the remaining shareholders or the company, the right of first refusal of those shares.

Protection for Minority Shareholders - One of the key reasons why shareholders enter a SHA is because it can afford protection for both minority and majority shareholders.

For minority shareholders, a carefully drafted SHA can provide protection by, for example, preventing an allotment of new shares, without unanimous consent, which would otherwise dilute their shareholding.

A SHA could also contain a "tag-along" provision. This is relevant for when a majority shareholder attempts to sell their shares and it allows the minority shareholder to participate in the sale, at the same time, for the same price for the shares.

Future Sale of the Company - For majority shareholders, a SHA could contain a "drag-along" provision which would permit majority shareholders to force minority shareholders to join the sale of a company on the same terms. This is essentially to prevent a situation whereby a minority shareholder tries to stop or stall the proposed sale going through.

Dispute Resolution - As mentioned above, parties rarely focus on potential negatives when starting a business, however, disputes do happen. A SHA can include specific requirements as to how a dispute should be resolved, including at what stage a third party, such as a mediator or arbitrator should be engaged. Not only does this provide guidance for the shareholders, but it saves significant time and costs by having this agreed at the outset.

Remuneration & Dividend Policy - Finally, a SHA can set out a remuneration policy for the Company. SHA's will regularly include different types of shares, with different rights attached to them. Having a carefully drafted SHA can provide clarification as to what value attaches to each specific share, and in turn, can allow for different dividends to be paid, depending on the share.

The drafting of a SHA needs to be bespoke, tailored to suit the nature of the business and the commercial position of the parties involved. Whether it is an owner managed business, or two distinct groups of shareholders and directors/managers, there are many key areas which can be addressed within a shareholder agreement - a worthwhile document for every company to have!

Key Contacts

Des Kelly

Partner

Des.Kelly@CavanaghKelly.com

Claire Daly

Senior Manager

Claire. Daly@CavanaghKelly.com

Caoimhe Lowe

Manager

Caoimhe.Lowe@CavanaghKelly.com

Rebecca Kirkpatrick

Legal Consultant

Rebecca.Kirkpatrick@CavanaghKelly.com