Curzon Green

<u>Corporate Commercial –</u>
<u>Shareholders' Agreement Checklist – the client guide</u>

A Shareholders' Agreement is a private contract between the shareholders of a company which sets out how they will behave in relation to the company and as such, the Shareholders' Agreement will not usually involve the company itself. The Shareholders' Agreement can cover a range of issues and some will be more relevant than others depending on the nature of the company and the shareholders involved.

Some of the matters dealt with in a Shareholders' Agreement will also (or alternatively) be dealt with in the company's articles. There may, however, be benefits of including these in the Shareholders' Agreement as:

- A Shareholders' Agreement can deal with matters which are private to the shareholders
- A Shareholders' Agreement can help to protect a minority shareholder
- As a Shareholders' Agreement is a private contract, it is generally not made publicly available.

You should note, however, that nothing can be included in the Shareholders' Agreement that fetters the company's power to exercise statutory duty. Also shareholders cannot agree to anything that would bind them as to how they might vote as directors (if that is a position they hold within the company). These 2 limitations can be quite complicated in practice and if you have any queries please do not hesitate to raise them with us.

<u>INDEX:</u>

1. – Shares, shareholders and transfer of shares

A.) Proportions: In what proportions will shares be held by each shareholder?

B.) Class of shares: Who will hold ordinary shares, preference shares, non-voting shares or redeemable shares? Or will all shares be of the same class?

C.) New shares: When new shares are allotted, will they be offered in the first instance to existing shareholders in the same proportion they already hold shares?

D.) Directors Discretion: Will the directors have full discretion to block the transfer of shares or just in relation to particular circumstances?

E.) Transfers: Will transfers be permitted between existing shareholders, between family members, family trusts and/or associated companies? Will the transfers be offered first to existing shareholders in the same proportion they already hold?

F.) Prohibitions: Can directors place a prohibition of time on the transfer of shares? Will the directors be able to suspend the registration of transfer for a specified period during each year?

2. – Directors

A.) Requirements/Eligibility: For an individual or a company to be a director will they have to meet certain requirements?

B.) Entitlement/Ability to Appoint: Will each shareholder have the right to appoint new directors according to their shareholding percentage or by general meeting?

C.) Maximum/Minimum: Will there be a minimum or maximum number of directors?

3. – Directors meetings

A.) Attendance: What will be the minimum number of directors required in order for a directors meeting (and an adjourned directors meeting) to validly transact business?

B.) Frequency: How often do directors meetings take place?

C.) Voting rights: In circumstances when there is an equality of votes at a directors meeting should the chairman be granted a casting vote? Should veto votes be allowed?

4. – Service agreements for directors

Will a service agreement be required for the directors? These are recommended in order to keep a record and regulate the director's actions in relation to the company.

5. – Shareholders meetings

A.) Attendance: What will be the minimum number of shareholders required in order for shareholders meeting to take place (or an adjourned shareholders meeting) to take valid actions for company?

B.) Voting rights: In circumstances when there is an equality of votes at shareholders meeting should the chairman be granted a casting vote? Should veto votes be allowed?

6. – Shareholders policies

Are there any policies required in relation to the approval of business plans, dividends, working capital, long term finance and loan capital shareholders guarantees of borrowings

7. – Shareholders consent

Consider whether consent of all, the majority or only one shareholder will be required for the following:

Issue of new shares	
Introduction of new shareholders	
Alterations to share capital	
Purchase of company's own shares	

Financial Assistance of for purchase of shares	
Change of the nature of the company's new business or commencement of a new business by the company	
Expansion into a new geographical area	
Signing of major contracts	
Substantial sales of assets or disposal of business by the company	
Amalgamation of merger	

Formation, acquisition and disposal of subsidiaries	
Changing assets of the company	
Borrowings in excess of limit	
Capital expenditure in excess of limit	
Lending of giving security or financial accommodation	

Appointment and dismissal of directors/employees/agents	
Directors and other employees' remuneration	
Acquisition and/or disposal of property	
Factoring or assignment of debts	
Alterations to memorandum and articles	

Alterations to company's status as private company	
Winding up	
Distributions by the company	
Change of account reference date and/or auditors	
Dealings in intellectual property	
Acquisitions of shares and debentures or participation in any partnership or joint	

venture by the company	
Legal Action (except trade debt recovery) in the name of the company	
Unusual or long-term transactions	
Alteration to bank mandate	
Transactions with connected persons	
Charitable or political donations	

Other	

8. – Non-competition

Non-competition covenants are given by shareholders not to compete against the company for a specified period of time after they stop being the shareholder*. (These covenants are enforceable if they protect legitimate business interests, they are also limited to a specific geographic place, duration and also a similar type of business).*

9. – Confidentiality

Should confidentiality be contracted between shareholders for the duration of their shareholding or should there be effective after they are no longer acting as shareholder

10. – <u>Obligations for shareholders</u>

Positive covenants are duties that the shareholders enter into. Should these be included in the Shareholder Agreement? Consider the following:

Time to be devoted to the business	
Duty to maintain their respective insurance policies	
Duty to notify litigation plus other major occurrences to the other shareholders	
Duty to maintain control of the company's assets	

Right to management information and inspect books of the company at its premises	

11. – <u>Breach of Shareholders' Agreement</u>

A.) <u>Compelled Transfer:</u> A shareholder can be forced to transfer his or her shares (exit) in some circumstances. Consider:

Fraud or dishonesty	
Material breach of shareholders agreement	
Physical Incapacity	
Bankruptcy	

No longer a director/employee of the company	

B.) <u>Death or Relevant Event:</u> Consequences of such an occurrence can be:

Departing shareholder ceases to be a director of the Company	
Departing shareholders offers all his or her shares to the remaining shareholder	
The remaining shareholders do not take up this offer and then the departing shareholder is free to transfer to a third party, or consider liquidation of the company	

Other	

12. – Death

A.) Shares: On death, the deceased shareholder's shares can be dealt with similar to how a departed shareholder would be (see section 11 above)

B.) Cross Options: Depending on circumstances, the personal representatives of the deceased shareholder have an option to demand to be bought out. Alternatively, the remaining shareholders have an option to demand to buy out the deceased shareholder.

These cross-option agreements need to be prepared separately	
Also life insurance arrangements need to be put into place	

13. – <u>Good/Bad Leaver</u>

<u>Valuation:</u> These are provisions allowing departing shareholder's shares to be valued lower depending on whether they were a "bad leaver

14. – <u>Valuation of shares</u>

A.) <u>Basis for valuation:</u> The value of shares on the departure of the shareholder can either be pro rata (according to the percentage of shareholding in the value of the company) or minority (when the shares are discounted to reflect that they are a minority holding.

B.) Accounting: Are there any specific account principles which should be applied.

C.) Company Valuation: Will the Company be valued on an asset basis (current assets minus current liabilities) or an earnings basis (usually a multiple on profits)

D.) Future Potential: Should the future potential of the company be valued? If so, how?

15. – **Payment of shares**

Time Period for selling shares: When a shareholder sells his or her shares to the other shareholder, should the purchasing shareholder be granted a period of time to pay? Consider the following:

Immediate lump sum	
Instalments	
Deferred payment	

16. – <u>Life and/or critical illness insurance</u>

A.) <u>Insurance Policies:</u> These support cross options and involve taking out insurance over each of the shareholders so that the on death and/or critical illnesses of one of the shareholders, the other receives enough money from the policy to buy the deceased or critically ill shareholder's shares.

B.) <u>Keyman Insurance:</u> These policies are usually aimed at compensating the company for the loss of key personnel.

17. – <u>Deadlock</u>

This would apply only to joint venture agreements and/or where the company is owned on a 50/50 basis with the aim of resolving major disagreements between the shareholders, these arrangements can include:

Cooling off period (few weeks/months in which nothing can happen)	

Arbitration	
Put/call options – when one shareholder is bought out or buys out the other	
Competitive bids for shares	
Liquidation	
Other	

18. – <u>Sale of a company/business or a listing</u>

These are to regulate circumstances when a controlling interest in the company's shares is proposed to be sold to a third party and/or when the company proposes to sell a substantial part of its business to a third party and/or where the company proposes to be admitted for a listing on a recognised investment exchange.

19. – <u>Costs</u>

A.) <u>Payment:</u> Who pays the company's costs and/or each shareholder's costs?

B.) <u>Benefits:</u> Will private health insurance, death in service benefits, permanent health insurance be provided?

C.) <u>Bonus/Commission:</u> How will bonus/commission be structured, if applicable.

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