Shareholders Agreement

Do you have shares in a private company? Do you have an agreed exit strategy when you want to sell your shares? Can your beneficiaries inherit your shares when you die? Can shareholders enter into business in competition with the company? How are disputes between shareholders to be resolved?

A Shareholders' Agreement can be an invaluable tool in ensuring the future viability of a business, giving investors certainty regarding the above questions and many other issues.

What is a Shareholders' Agreement?

A Shareholders' Agreement is a legal contract entered into between a Company's shareholders which sets out the rights and obligations attached to their shares. A Shareholder's Agreement should be worded so that it is consistent with the Company's Constitution and the Corporations Act 2001 (Cth).

Ideally, a Shareholders' Agreement should be entered into when a Company is incorporated or before it starts trading, when all shareholders share the common goal of establishing a successful business. While there are a number of common clauses in Shareholders' Agreements, each business is different. Each Company's Shareholders' Agreement should be carefully fitted to the needs and intentions of the shareholders of that particular Company. This Guide gives a broad overview of some of the common issues that may be addressed in a Shareholders' Agreement.

Setting the Company's Objectives

A Shareholders' Agreement can clearly state what a Company's objectives are.This can give guidance and direction to the Company, by defining what future business activities the Company will engage in. This is a very basic exercise which can be invaluable in avoiding disputes, by setting an agreed direction and purpose for the Company at the outset.

Succession Planning

A Shareholders' Agreement can be a vital succession planning tool, planning for the future of both the Company and individual shareholders. Do the shareholders want to limit who can own shares in the Company? Should it be a requirement that the remaining shareholders have the right to veto new shareholders? Should shareholders only be eligible to hold shares if they are currently involved in working for the Company, either as an employee or a Director?

In small businesses, it is a common requirement that a deceased shareholder's shares must be offered for sale back to the Company or to the remaining shareholders before they are offered for sale to third parties. A Shareholders' Agreement can set out a mechanism for valuing the shares and setting the price for which the shares must be offered for purchase. If the shares can only be transferred to existing shareholders or to the Company, care must be taken to ensure that the terms of shareholders' Wills are consistent with the requirements of the Shareholders' Agreement.

Shareholders in Companies operating small to medium sized businesses commonly possess different levels of experience in diverse fields of expemg shareholders to control the decisions of the Company and to receive the profits from their future endeavours. A Shareholders' Agreement which specifies the rights and obligations of a shareholder who retires or ceases active involvement with the Company can be critically important to enable such issues to be dealt with fairly and transparently, in a way which has the prior written agreement of all shareholders.

A Shareholders' Agreement should state that in order to be eligible to receive shares in the Company all future prospective shareholders must sign a Deed of Accession, binding them to the terms of the Shareholders' Agreement.

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Dispute Resolution

A major advantage of having a Shareholders' Agreement is that it reduces the chances for conflict arising between shareholders in the first place, by reducing investor uncertainty. If conflict does arise, a Shareholders' Agreement should set out methods of resolving any dispute as expeditiously as possible, at the least expense to all parties. The Shareholders' Agreement may require the parties to attempt to resolve the dispute by negotiation and, if that fails, by referring the dispute to a mediator or an arbitrator. Generally, the parties may only issue Court proceedings as a last resort, after the dispute resolution processes specified in the Shareholders' Agreement have failed.

Promoting Fairness among Shareholders

One way to reduce the voting power of particular unwanted shareholders is for a Company to dilute that shareholder's voting rights by issuing shares to the other shareholders. A Shareholders' Agreement can require that the Company offer any new shares issued in the Company to the existing shareholders in proportion to their current shareholdings. This can prevent shareholders' voting power from being diluted, whilst at the same encouraging existing shareholders to reinvest in the Company when the need to raise capital arises.

Promote and Protect the Value in the Business

A Shareholders' Agreement can impose confidentiality obligations on shareholders, prohibiting them from disclosing the Company's private information. It can also restrict shareholders from going into competition with the Company, both while they hold shares in the Company and in the future, if they cease to be a shareholder. These safeguards both help protect the Company by ensuring that shareholders act in the Company's best interests and do not use their knowledge of the Company's affairs for their own personal advantage at the expense of the Company or of other shareholders.

The above are just a few of the things that a Shareholders' Agreement can achieve. Please contact a member of our Commercial Law team to find out whether a Shareholders' Agreement can benefit your business.