10 Reasons why you need a shareholders agreement

This article explains why it is important that business owners consider entering in to a shareholder agreement.

A shareholder agreement is not a requirement, however we strongly recommend it to many of our clients. Such an agreement regulates the relationship between the shareholders. It is private between the parties and there is no requirement to file this at Companies House. There are a number of clauses we can add to protect the shareholder in the future, and I have addressed the top 10 below:

1. **Transferring Shares:** A shareholder agreement will set out how shares are transferred and can include a right for the remaining shareholders to have first refusal on the other party's shares. Most importantly the shareholder agreement can set out how these shares are valued and how much they are worth.

2. **Dealing with death:** the death of a shareholder can cause serious issues for a business and pose difficult questions as to what happens with the deceased's shareholding. A shareholder can set out what happens to the shares and, again, how they are valued to give the parties peace of mind.

3. **Minority protection provisions:** The shareholding in a company is not often a 50/50 basis and there may be minority or majority shareholders. To protect a minority the agreement can be drafted so that certain acts can't happen without the consent of a specific percent of shareholders. There are no hard and fast rules of what is included, but we advise clients based on their individual circumstances. It's a provision put in place to ensure the minority are not excluded from key decisions in the business and are kept abreast of all the relevant day-to-day activities. Alternatively, if acting for the majority, you may want the provisions to be drafted to allow such acts to take place without having to consult the minority shareholders. The key here is finding a balance between all parties and catering for the business's needs.

4. **Restrictions on the shareholders:** Restrictions are key to ensure that client, supplier or employees are not poached by the outgoing party. Such restrictions need to be carefully considered to ensure that they are not so far reaching as to be unenforceable.

5. **Confidentiality:** Many businesses rely on information and leads which, if they were available in the public domain may seriously harm a business's prospects. A simple confidentiality provision can protect the value in the business should the parties part ways in the future.

6. **Dispute resolution:** If communication breaks down among shareholders a dispute resolution provision, also known as deadlock provision, can help the parties find a way to move forwards. The provision can set out a procedure for the parties to follow with a view to allowing them to resolve the issue or, in the event that this can't happen, detail what will happen to the business. This can be anything from winding the company up to settling how one party can buy the other out and how the shares will be valued.

7. **Dividend policies:** A dividend policy can set out how dividends will be paid between the parties – either to reflect an initial uneven investment in the company or simply to allow differing levels of dividends to be payable to each shareholder or differing classes of shareholder.

8. **Sources of finance:** Agreeing at an early stage how the business will be financed can be important to avoid disputes around who has to contribute what going forward. This might be particularly important if one of the shareholders is a 'silent partner' with more of a funding role than a hands-on role.

9. **Linking shareholders with employment:** Shares may be held by employees. In which case, linking the ownership of shares to the individual's employment can resolve a tricky issue should the employee resign, be made redundant or sacked. These provisions are also known as good lever and bad lever provisions. A well drafted provision will deal with how the shares are valued in these differing situations.

10. **Showing you mean business:** It is becoming increasingly common that some funders want to know that a company has a shareholder agreement in place. Such an agreement demonstrates the parties have planned ahead to resolve potential issues quickly.

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