

SHAREHOLDERS AGREEMENTS AND KEEPING THE BUSINESS MARRIAGE TOGETHER

by James Millea



The Chinese have a saying.

"A bad marriage is where you sleep in the same bed but have different dreams" as they say in China
“同床異夢”.

Starting a new business is like a marriage. Common goals and some thought before you take the plunge on how to manage the different dreams and solve disputes will go a long way to maintaining a happy business marriage.

One of the most common vehicles to conduct a business is through a company.

The company may operate in its own right or it may be acting as the trustee of a discretionary trust or unit trust or even be the trustee of a superannuation fund with investments.

Whether acting in its own right or as a trustee, it is important to remember that the company is at law a separate, albeit artificial, legal person from the shareholders.

A company may be seen as two separate parts being the members or shareholders and the directors.

Day to day management and control of a company is usually devolved to a board of directors. The Board of Directors is appointed by the members.

Ownership and control do not however necessarily coincide.

A common way to agree in advance how the company is to be managed, how the profits and losses (if any) are to be distributed, contributions by each of the various parties (whether of capital or labour), exit strategies and dispute resolutions is by way of a Shareholders Agreement.

A Shareholders Agreement is quite simply a contract that the parties can enforce against each other.

Like any good contract it should be clear, simple as possible but cover the most important issues that confront all companies whether conducting a business or a trustee of a trust.

And like all good contracts, it should contribute to reducing potential conflict and where there are disagreements to assist to quickly and cheaply resolving those disputes.

Badly drafted Shareholders Agreements where they do not address important issues, where the provisions are either badly drafted or not thought through may on the other hand exacerbate disagreements.

Before starting the activities of the company, it is always useful to sit down and make a list of issues that are important to the various parties.

The types of issues that need to be addressed in any Shareholders Agreement are:

- The number of directors and how many directors each shareholder (or group of shareholders) may appoint;
- How decisions are made and sometimes providing for special majority or veto rights on crucial decisions;
- Conflicts of interest - for example when one of the shareholders has an interest in a competitor;
- Rights and restrictions on transfers of shares, for example that existing shareholders have a first right of refusal to buy any shares that a shareholder wishes to transfer;
- Protection of minority shareholders. For example if there is a takeover of the company by an outsider, the right of the minority shareholders to insist that their shares be bought on the same terms as the majority shareholders sold their shares to the outsider;

- Dispute settlement procedures such as mediation, arbitration or appointment of experts;
- Deadlock resolution procedures where there is an equal number of parties who simply can't agree;
- Fair and independent method to value the parties' interests;
- Importantly, if the marriage is "on the rocks", how to get a business divorce that is as fair and cheap as possible;
- If the company is a trustee of a trust, the shareholders agreement should include the same provisions for the management of the trust. For example if the company is the trustee of a unit trust, it is usual to "staple" the rights and obligations of the shares and units together so that they must always be dealt with in the same way and at the same time.

There may be other important issues that are important to individual shareholders and it is important that these be clarified and documented so as to avoid misunderstandings.

In my view if the shareholders are friends or family, for example two brothers, it is perhaps even more important to consider the important issues. Unnecessary disputes can disrupt not only a business relationship but an even more important relationship, that of friends or family.

It is never safe to assume that families always cooperate or act fairly. Parties should not feel embarrassed or feel that suggesting a Shareholders Agreement is a declaration that "you don't trust" the other side.

Like pre-nuptial agreements before marriage, a Shareholders Agreement is there to help resolve disputes and if there is to be a separation, to help the parties separate as easily, amicably and cheaply as possible.

As with any important contract that will have an important impact on your future, preparing a robust Shareholders Agreement is not for amateurs.

My grand mother used to say that "an ounce of prevention is always worth more than any cure".

It is important that to obtain competent and experienced legal advice in preparing a Shareholders Agreement.

What it costs in legal fees will be amply saved in providing greater certainty for the future and reducing possible future costly disputes.