

WHEN SHOULD YOU HAVE A SHAREHOLDERS' AGREEMENT?

What is a shareholders' agreement?

A shareholders' agreement is a contract between the shareholders of a company, providing a procedural framework for the administration of the company and, in particular, for resolving disputes. We recommend that clients have one where the company is a closely held company, in other words a company where there is a small number of shareholders who are actively involved in the management of the company. It is also vital to have a shareholders' agreement where the company is a joint venture between 2 or more shareholders. We also frequently recommend one where a client is a minority shareholder as it can provide the minority shareholder with more protection than he or she would have under the general law.

While both a shareholders' agreement and the company's constitution set out the rules for running the company a shareholders' agreement is not the same as the company's constitution. A company will always have a constitution, whether it is a tailor-made constitution for the company or the "default" constitution provisions contained in the Companies Act 1993. In some cases the company's constitution will suffice and it is not necessary to have a shareholders' agreement, however it is often preferable to have a shareholders' agreement for two main reasons:

1. The constitution is a public document which is registered at the Companies Office and is available for public inspection. Many clients like to keep sensitive arrangements between shareholders confidential.
2. A constitution can be changed by a special resolution of the shareholders, which is generally 75% of the shareholders entitled to vote, whereas a shareholders' agreement will generally provide that changes can only be made with 100% shareholder approval.

What is included in a shareholders' agreement?

The shareholders' agreement can include any matters that the shareholders wish to include but generally deal with the following matters:

- the structure of the company;
- its capital, funding and distribution policy;
- the governance of the company by its directors and the conduct of the company affairs;
- the transfer of shares in the company including the valuation of shares if one shareholder wishes to sell and the process for introducing new shareholders;
- specific matters that will require unanimous shareholder approval, for example: significant contracts; company borrowing; dividend policy and hiring key staff;

- non competition and restraint of trade;
- termination of the shareholding relationship;
- dispute resolution.

We are aware of cases where shareholders have learnt the hard way about the desirability of having a shareholders' agreement. In one case, participants in a 50/50 joint venture company entered into a project but did not have any shareholders' agreement governing the conduct of the joint venture. Unfortunately the project ran over time and was more costly than originally anticipated and the relationship between the shareholders broke down. As they had no contractual framework for dealing with the breakdown in relationships the ensuing dispute took a long time to resolve at significant legal cost. If some fundamental matters had been covered in an agreement at the outset the dispute could have been resolved earlier and at much less cost.

If you would like more information regarding shareholders' agreements please contact Tony Walker, Partner on 303 9916, email: tony@lawworksnz.com or Sarah Edmondson, Associate on 303 9915. email sarah@lawworksnz.com.