NZ CHAMBERS OF COMMERCE
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Business Vitality

## Why you need a Shareholders Agreement

Often, two or more '*partners*' will form a company to own and operate a business. However, if those partners fall out, then it can be a very difficult and expensive process to try and sort out the problem/dispute if there is no shareholders agreement in place.

A shareholders agreement is a contract between the shareholders regulating how the company is to be operated. The reasons for having a shareholders agreement as well as a constitution include:

- The constitution may be an inadequate record of the full understanding between the parties. A shareholders agreement gives certainty about shareholders rights and obligations to each other.
- There may be some issues which the parties wish to keep confidential – the constitution is a public record.
- It may be necessary to include further methods of dispute resolution e.g. to require mediation to be used.
- It can set out clear rules for how major change events are to be dealt with, such as the introduction of new investors, the exit or death of a shareholder, or the sale of all or part of a company's assets.
- Negotiating a shareholders agreement at the start of a business relationship can highlight issues that the partners may not have previously thought about, and avoid misunderstandings in the future.

A shareholders agreement will cover issues such as:

- Who has the right to appoint directors, and how many each shareholder can appoint
- The quorum for directors and shareholders meetings
- The company's dividend policy – when dividends will be paid, and how they are calculated.
- How many votes are needed to approve key decisions.
- How funding is to be arranged – how much shareholders will have to contribute, md whether they will have to give guarantees.
- Whether budgets and business plans have to be prepared, and how frequently.
- What pre-emptive rights apply to a transfer of shares. The problem facing shareholders in small unlisted companies is the ability to sell their shares. On the other side of the coin, as there are only a small number of shareholders, the introduction of any new shareholder is extremely important. If a shareholder leaves, existing relationships are broken, and the remaining shareholders may have no information about the new shareholder, or his or her intentions, character, or credit worthiness.

  A pre-emptive rights clause will usually require an exiting shareholder to offer to sell to the remaining shareholders first, will say whether a shareholder can sell some only of his or her shares, and will set out a mechanism for setting the sale price, amongst other things. There are a number of different types of pre-emptive rights clauses, to cover situations where a majority shareholder wants to sell and wants the ability to require the minority shareholder to sell at the same time, or where a minority shareholder wants to prevent the majority shareholder from selling without also including the minority shareholders' shares in the sale.

If you are going into business with someone else, and you are setting up a company to do that, you should have a shareholders agreement in place to avoid costly and lengthy disputes in the future.

***Article provided by Mike Toepfer from Aspiring Law***