

Shareholders' Agreement

Checklist

Guide for Temple Heelis Clients

INTRODUCTION

This checklist is designed to highlight a range of issues which can be covered in a shareholders agreement and a company's articles of association.

A shareholders agreement will regulate the relationship between shareholders in connection with the company's affairs. The articles of association is the constitutional document of a company, it is a contract between the shareholders and the company and is open to public inspection at Companies House (whilst a shareholders agreement is a private document). The articles of association should be designed to complement and not conflict with the shareholders agreement.

The principle aim of this checklist is to help identify issues before commencing the drafting of legal documentation, in order that any arrangements adopted will be specifically tailored to suit individual circumstances.

1 SHARES, SHAREHOLDERS AND TRANSFER OF SHARES

- 1.1 In what proportions will the shareholders hold shares?
- 1.2 Will there be different classes of shares with different rights or will they all be ordinary shares?
- 1.3 When the company issues new shares, does it have to offer them in the first instance to existing shareholders in the proportions they already hold shares?
- 1.4 Will the directors or remaining shareholders be given discretion to block the transfer of shares always or just in certain circumstances? For example, is there a right to block a transfer only when shares are not fully paid up; can any transfer to a competitor be blocked?
- 1.5 Will transfers be permitted between existing shareholders, to family members, to family trusts or to associated companies? *Please note there may be tax advantages in allowing transfers in these circumstances, particularly for example, when the transferee is a lower rate tax payer.*
- 1.6 Where shares are proposed to be transferred, will they have to be offered in the first instance to existing shareholders in the proportions they already hold shares? Will the price for such shares being transferred need to be agreed by the company accountant (or other accountant)?
- 1.7 Will there be a prohibition on shareholders creating a charge over shares?

2 OBLIGATIONS OF SHAREHOLDERS

2.1 What time to be devoted to the business. Will it be full time/part time?

3 DIRECTORS

3.1 Do any directors have to meet certain requirements to be a director? For example, do you have to have a shareholding to qualify? If so, what amount?

3.2 Entitlement to appoint a new director? For example, will each shareholder have the right to appoint new directors according to their shareholding percentage or by general meeting?

3.3 Do you wish to impose a maximum number of directors?

3.4 If a director's employment is terminated, will they have to sell their shares?

3.5 Will the shareholders be the same people as the directors always?

4 DIRECTORS MEETINGS

4.1 What will be the minimum number of directors required in order for a directors meeting (and an adjourned directors meeting) to validly transact business?

4.2 How often should directors meetings take place? At least every 3 months?

4.3 In circumstances when there is an equality of votes at directors meetings should the chairman be granted a casting vote? Will each director be entitled to one vote only on any decision?

4.4 Can directors appoint alternative directors to attend and vote at Board Meetings in their place?

5 SERVICE AGREEMENTS FOR DIRECTORS

5.1 Will service agreements be required for the directors? These are recommended in order to regulate the relationship between the Company and each director.

6 SHAREHOLDERS MEETINGS

6.1 What will be the minimum number of shareholders required in order for a shareholders meeting (or an adjourned shareholders meeting) to validly transact business?

6.2 In circumstances where there is an equality of votes at shareholders meetings should the chairman be granted a casting vote?

6.3 What is to be the company dividend policy?

7 SHAREHOLDERS POLICIES

7.1 How will the shareholders finance: working capital; will there be any long term finance or loan capital; and how will and in what proportions will shareholders guarantees of borrowings?

7.2 Will all shareholders have access to all financial information eg management accounts; bank accounts?

8 SHAREHOLDERS CONSENT

8.1 Will there be circumstances and situations where consent of all or majority of shareholders is required (eg 100%, 75%, 51%) eg

- (a) Issue of new shares
- (b) Introduction of new shareholders
- (c) Alterations to share capital
- (d) Purchase of company's own shares
- (e) Any financial assistance for purchase of shares
- (f) Any change in the nature of the company's business or commencement of a new business by the company
- (g) Expansion into a new geographical area
- (h) Signing of "major" contracts eg over a certain amount.
- (i) Any substantial sale of assets or disposal of business by the company
- (j) An amalgamation or merger
- (k) The formation, acquisition and disposal of subsidiaries
- (l) The charging of any assets of the company
- (m) Any borrowings in excess of financial limit
- (n) Capital expenditure in excess of financial limit
- (o) The lending or giving security or financial accommodation (such as guarantee; indemnity; mortgage; debenture; overdraft security)

- (p) The appointment and dismissal of directors/employees/agents
- (q) The changing of any directors and other employees remuneration or varying any of the terms of their contracts
- (r) Lease; hire; hire purchase; acquisition and/or disposal of property or any other material asset
- (s) Factoring and/or assignment of debts
- (t) Alterations to memorandum and articles
- (u) Alterations to company's status as private company
- (v) Any winding up or any other act of insolvency or arrangement with creditors
- (w) The making of any financial distributions by the company
- (x) The acquisition of shares or assets or participation in any partnership or joint venture by the company
- (y) The entering into of unusual or long term transactions
- (z) The entering into transactions with connected persons

9 NON-COMPETITION

9.1 Are there to be any non-competition covenants given by shareholders not to compete against the company for a specified period after ceasing to be a shareholder? *Please note, for non-competition covenants to be enforceable they must protect legitimate business interests only, and they must also be limited in geographical scope, duration and be confined to the nature of the business in question.*

10 CONFIDENTIALITY

10.1 Are there to be any confidentiality clauses given by shareholders effective during and after ceasing to be a shareholder? (For instance, to ensure protection for intellectual property; major customers; processes and methods used by the company).

11 TERMINATION AND/OR DEATH

11.1 What are to be the circumstances in which the Agreement ends: eg termination of the shareholders agreement for material breach of its terms, physical incapacity, bankruptcy or in circumstances where that shareholder is also a director/employee and he or she leaves the company or any other reason ("**Termination Event**")?

11.2 What are the consequences of death or Termination Event (see 11.1)?:

- 11.2.1 Will each shareholder have the right to demand to be bought out or demands to buy out the other shareholder (put/call option);
- 11.2.2 Will there be a compulsory sale of shares (shareholder remaining must be allowed to purchase outgoing shareholders shares; outgoing shareholder must sell his shares to remaining shareholder or other person);

12 GOOD/BAD LEAVER

- 12.1 Provision can be made in the documentation so that the departing shareholder's shares are valued on a different basis if he were a "bad leaver", but this would not apply if he were a 'good leaver'.

For example, a bad leaver could be defined as a shareholder/director who has materially breached the terms of the shareholders agreement or his service contract. A bad leaver's shares could be valued at 50% of their value (as determined pursuant to any arrangement adopted under paragraph N below) or at nominal value. Please note good/bad leaver clauses tend to be controversial. Any provision of this nature will need to be discussed in detail.

Commonly, if a shareholder is also a director and/or an employee he will be under an obligation to transfer his shares in the company if he ceases to be a director and/or an employee.

13 VALUATION OF SHARES

- 13.1 What will be the basis for valuation of shares on departure of a shareholder either:
 - 13.1.1 pro rata (according to the percentage shareholding in the company and the value of the company) or
 - 13.1.2 minority (the shares are discounted to reflect they are a minority holding)
 - 13.1.3 Are there any specific accounting principles which should be applied?
 - 13.1.4 Should the company be valued on an assets basis (i.e. its current assets less its current liabilities) or on an earnings basis (usually a multiple on profits).
 - 13.1.5 Should the future potential of the company be valued and if so, how? (N.B. If the company is to be valued at 'fair market value' future prospects would usually be taken into account).
 - 13.1.6 Should the valuation be carried out by a specific accountant – if so who?

14 PAYMENT FOR SHARES

- 14.1 Where a shareholder sells his or her shares to the other shareholder(s) should the purchasing shareholder(s) be granted a period of time to pay (i.e. immediate lump sum, instalments or deferred)?

15 LIFE INSURANCE

- 15.1 Is there a requirement for life insurance to cover cross options (insuring the life of both shareholders so that on the death of one of the shareholders, the other receives enough money from the policy to buy the deceased shareholders shares from the widow or family or if the money is not utilised for this purpose, the widow or family obtain a lump sum payment)
- 15.2 Should there be Keyman Insurance (Policies insuring against death, injury, ill health of directors/executives)?

16 DEADLOCK

Deadlock provisions are usually only applicable for joint venture arrangements and/or where the company is owned on a 50/50 basis (or similar) and are used as a means to resolve usually fundamental disagreements (particularly in relation to the future strategy of the company) between the shareholders

- 16.1 Arrangements in the event of a deadlock:
- 16.1.1 cooling off period (a few weeks/months in which nothing can happen)
- 16.1.2 trigger (a specific time deadline whereby the deadlock provisions come into play) then one of the following alternatives:
- 16.1.2.1 arbitration (alternative to court resolution)
- 16.1.2.2 put/call options over shares (one shareholder demanding to be bought out or demanding to buy out the other shareholder)
- 16.1.3 competitive bids for shares
- 16.1.4 liquidation
- 16.1.5 Other

17 SALE OF COMPANY/BUSINESS OR A LISTING

- 17.1 Provision can be made in the legal documentation to cover the circumstances when a controlling interest in the company's shares is to be sold to a third party and/or where the company is to sell a substantial part of its business to a third party and/or where the company is admitted for listing to a recognised investment exchange.

For example 'drag along' rights could enable shareholders with a controlling interest in the company the ability to join minority shareholders into a sale. Similarly 'tag along' rights would enable shareholders to join with other shareholders who intend to sell to a third party.

Thus in the event of an offer for a shareholding of 50% or more, will the requirement be that 100% of the shares must be bought on exactly the same terms, failing which no sale of 50% will be recognised by the company?