



SHAREHOLDERS' AGREEMENTS

Approximately 95% of Companies currently registered in New Zealand are believed to have fewer than 5 shareholders. These Companies are commonly referred to as "closely held Companies". Closely held Companies usually emerge from small business operations with the shareholders often relatives, friends or business associates who have invested a large percentage of their overall wealth in the company and derive their main source of income from it. Closely held Companies therefore rely heavily on harmonious relationships between shareholders to ensure their success. However, careful consideration and structuring of shareholder relations is an often neglected area of business affairs.

When things go wrong, where do you turn?

Reliance on the provisions of the Companies Act 1993 will provide you merely with an ambulance at the bottom of the cliff. The Act is not regarded as a good fit for closely held Companies with its focus more on Companies with many shareholders.

What if your Company has a constitution; will it help? A Company constitution is the principal vehicle used by Companies to adjust the statutory provisions of the Companies Act 1993 to better suit a Company's particular needs. A constitution is certainly an important document. However, there are good reasons to have a Shareholders' Agreement in addition to a constitution.

- A Shareholders' Agreement is tailored to meet the particular needs of your Company and its shareholders and has a more personal focus than a constitution which tends to be more procedural in nature.
- A Shareholders' Agreement is a confidential document, whereas a constitution must be registered with the Companies Office and available for public inspection. Sensitive matters such as the roles of shareholders, or rights attaching to shares are better placed in a confidential Shareholders' Agreement.
- A Shareholders' Agreement can cover events prior to incorporation whereas a constitution only comes into effect on incorporation of the Company.
- A constitution can usually be altered by special resolution (75% agreement of shareholders) whereas a Shareholders' Agreement can be drafted to provide higher protection of shareholders' rights from alteration. This is very important for minority shareholders.

Even the strongest business relationships are tested by personality differences, changes in personal lives and direction and shifting economic climates. And legal cases have too often shown that, with closely held Companies, family relationships as well as business relationships can irretrievably break down and be destroyed when shareholders fall out. While a Shareholders' Agreement is not a panacea for all business problems, the mere process of preparing a Shareholders' Agreement is highly valuable as it forces shareholders to give careful thought to a wide range of issues that might not have otherwise been considered. This process provides your Company with a personalised framework that can be turned to in times of dispute and uncertainty.

A Shareholders' Agreement would commonly include details of:-

1. The Business objectives of the company.
2. Share Structure and Funding
 - Formation and organisation of the Company.
 - Initial capital structure and issue of shares.
 - Payment for shares.

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- Dividend policy
 - How the business is to be funded
 - How profits and losses will be allocated.
3. Control and Management
- Whether power is to be held equally.
 - Voting rights
 - Entitlement to appoint directors
 - Need for independent directors
 - What matters require a special resolution (75% agreement of shareholders) or unanimous approval of directors
 - Entry and exit of shareholders
 - Transfer of shares
 - Introduction of new shareholders
 - Exit strategies for existing shareholders
 - Pre-emptive rights (remaining shareholders to have first option to purchase outgoing shareholder's shares)
 - Further share issues
 - The death of a shareholder.
4. General
- How assets are to be brought into the business
 - Need for restraint of trade clauses to restrict shareholders from engaging in a similar business whilst a shareholder or afterwards
 - Intellectual property rights e.g. trademark/patent protection
 - Need for confidentiality clauses to restrict shareholders from divulging sensitive information
 - Mechanisms for resolving dispute and deadlock situations.

There are two main benefits in having a Shareholders' Agreement in place at the outset of a business venture. First, the agreement establishes a sound operating platform for your business and equips it with a procedural framework covering those issues most commonly faced in the management of a business. Secondly, the risk of shareholder conflict is minimised as shareholders are required to consider and agree on issues from the outset and to air their intentions and expectations.

Here lies the rub: a Shareholders' Agreement is best entered into at the outset of a business venture and not when things start to go wrong. We are aware that this is a time when resources are often limited and shareholders would (understandably) rather spend these resources on the business itself than professional fees. However, a Shareholders' Agreement is a very sensible investment in your business's future success and in protecting crucial shareholder relationships often involving your family and friends. If you wish to discuss in more detail whether a Shareholders' Agreement would benefit you and your company, please contact us.

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