



What is a shareholders agreement and should my company have one?

Author: [Martin Alfonso](#)

Email: martin@ealawyers.com.au

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A shareholders agreement is a company document which sets out what shareholders can and cannot do, together with the rights and obligations of the role of shareholder. It starts as a blank canvas and can cover matters such as the right of the shareholder to appoint a director, funding arrangements for the company and its business, voting rights and setting procedures if a shareholder wishes to sell the shares it holds. In this blog, we look at why you [might consider a shareholders agreement](#).

Isn't the company constitution enough for the shareholders?

A constitution has common provisions about how the company is managed in the way of meetings, share transfers and the like but they are not always satisfactory. The constitution can be amended to make it more appropriate but that is a cumbersome process and is far less flexible as compared to having an agreement among the shareholders which can be regularly reviewed and updated as things change.

The difference between decisions by a shareholder and by directors

It is important to be aware of the distinction between decisions by directors and decisions by shareholders.

Directors have involvement in the day to day running of the company which they can do without conferring with the shareholders. But the shareholders usually expect there to be some limitations as to decision making by directors.

For example, shareholders would not want directors to make decisions which have a significant impact on the company and the shareholders, such as borrowing beyond a small amount of money or selling some or all of the company's assets and business. This can be included in the shareholders agreement.

As for shareholders, the shareholders agreement might also require some of the very significant decisions such as borrowing a large sum or selling assets of the company, will require a special majority (such as 75% of shareholders) or even a unanimous resolution of all shareholders.

What voting rights might be considered?

Voting rights can be the most important issue in a shareholders agreement.

For example, a company may have three shareholders but for various reasons, only one of them acts as the director. In that situation, the shareholders would want to ensure that the sole director cannot make decisions above a certain level of authority (such as not borrowing money or purchasing equipment for more than \$10,000) without the approval of all, or a majority of the shareholders.

Or the company may have an original shareholder who is the "mover and shaker". That shareholder may want any decision to sell all or a part of the company's business or to borrow or raise funds by offering shares, to have their approval.

Should a shareholder have the right to appoint a director?

Sometimes a shareholder might not have the right to appoint a director.

Consider this scenario

- There are three shareholders;
- Two of them hold 45% each of the shares;
- The third holds 10%;
- That minority shareholder might not have the right to appoint a director.

On the other hand, if each of the three shareholders held the same number of shares then, for example, each shareholder might have the right to appoint 2 directors and any decisions need the approval of five directors.

Can the shareholders agreement set out how the company may raise funds?

This is something that should always be included in a shareholders agreement.

The agreement might set out an expectation that if the company cannot borrow funds from a bank, then each shareholder should lend a sum in proportion to their shareholding.

It should also cover what would happen if one shareholder is unable to lend the company money but another shareholder is able to do so exceeding their proportionate share.

For instance, there are two shareholders and the amount required by the company for working capital is \$100,000. One shareholder is able to contribute only \$30,000 and the other shareholder contributes \$70,000. The shareholder who has contributed \$40,000 more than the other shareholder should receive some priority for repayment by the company of that \$40,000 and maybe additional interest would be payable on that larger contribution.

Should there be restrictions on dealing with shares in the company?

This is a fundamental area that should be addressed by the shareholders agreement.

Allotting and issuing new shares

The first issue is how the company might allot further shares. The company will normally want to offer the shares to the existing shareholders before offering them to any third party. And before the company even offers any further shares, the shareholders agreement may require a certain level of approval from shareholders to do so. That is often 75% of shareholders but it can be made a higher level if that was appropriate.

When a shareholder wants to sell their shares

A second issue is what happens if a shareholder wants to sell out their shares. The common provision is that the shares must be offered to the other shareholders initially. However, the agreement might also set a process as to how the shares are offered, and at what price, and what happens if the shares are not purchased by the other shareholders.

A third party seeks to buy all the company shares

It may be appropriate in the agreement to include a process where a third party offers to buy all the shares in the company or a significant number of shares.

If the offer is for all the shares, then the majority of shareholders may wish to require that all the remaining shareholders join in. This is known as a "drag along clause" and allows the majority shareholders to require minority shareholders to sell their shares.

The reciprocal might also apply in that the minority shareholders might insist that if the majority shareholders are proposing to sell their shares to a third party, then the minority shareholders should be able to require that the third party buy their shares on the same terms. This is called a "tag along clause".

Compulsory transfer of shares

Another provision to consider is a compulsory transfer of shares where a shareholder is expelled from the company.

For instance, if the company operated a professional practice (doctors, accountants, lawyers etc), then a shareholder who does not have the requisite licence to act as a professional may be expelled. Or a shareholder who is an employee and who has their employment terminated for reasons of fraud or incompetence might be expelled as a shareholder.

A process for valuing the shares of an expelled shareholder and a process for offering those shares to the other shareholders can be included in the shareholders agreement.

Lastly, the agreement might include that if a shareholder is itself a company, then a change in that company's majority shareholding interests without the consent of all the other shareholders triggers a compulsory transfer event.

Is there anything else that can be included in the agreement?

We have only addressed some of the issues that may be covered in a shareholders agreement. As the agreement is a blank canvas, particular issues may be included such as a requirement that the company not make any donations to a political party!

Another major area that might be addressed but in a separate agreement, is a process for dealing with shares where the shareholder or the principal person behind the shareholder dies or becomes totally and permanently disabled. This is usually accompanied by a method of funding the buyout of those shares using insurance policies.

Get help from a commercial lawyer

If you're [starting a new business](#), addressing your [company structure](#) or reviewing a current shareholders agreement, our commercial lawyers have significant expertise and experience in drafting fair and usable agreements which protect the shareholders and the company.

For more information to arrange a consultation with a lawyer, you can call or email us.

Contacting E&A Lawyers

For more information or to arrange a consultation with a lawyer, you can call or email us.

[02 9997 2111](tel:0299972111)

info@ealawyers.com.au

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