

## Share and Share Alike

**When times are tough, it can be tempting to accept financial help from backers who believe they can profit from your business when the recession lifts. But as lawyer Douglas Stewart explains, it's important to consider a shareholders' agreement to regulate the relationship.**

Whether a motor dealership, parts manufacturer or service supplier, bringing in a new investor is likely to entail giving that person shares in the business. Shareholders can decide for themselves what goes into an agreement, but some common provisions include:

- Who can act as a director
- How the business will be managed and run
- A mechanism for dealing with disputes and deadlocks
- When shares can be transferred and to whom
- How shares are valued
- Restrictions on competing with the business
- Dividend, salary and re-investment policies
- Rights to financial information

A shareholders' agreement is not a public document and does not need to be filed at Companies House. Its contents are entirely private and can, therefore, deal with issues that the shareholders may not wish to be seen by their competitors or customers.

Although it is not necessary for all shareholders to be a party to an agreement, it will only have maximum effect if all sign up to it. This may be a problem if there is a large shareholder base or if some shareholders are unwilling to participate.

An agreement is advisable because it helps to plug the gaps where the Law falls short. Company law is often drafted with large companies in mind, where the directors and shareholders are usually different people. When this is applied to smaller companies the results can be less than satisfactory. For example, under company law, shareholders have very few rights to participate or interfere with the management of a company and have no direct right to be appointed as a director.

In smaller companies where there may only be a handful of shareholders, there is more likely to be an expectation that each shareholder should also sit on the board. A shareholders agreement helps to redress the balance by allowing the rights and duties of each shareholder to be set out in a binding contract, as well as documenting how the company is to be run. This, in itself, reduces the likelihood of a dispute and can help to avoid acrimonious and costly stand-offs.

Agreements should be considered not only when a new financial backer is sought, but whenever shares are issued or transferred to new shareholders, such as senior management.

In these financially straitened times, many employers are looking at ways to incentivise and reward employees without having to pay out hard cash. One possibility is to gift shares to employees or to set up a share option scheme. But bear in mind that if an employee or director leaves, the company has no automatic right to reclaim those shares. Often, the only solution is to negotiate a buy back at a greater price than they are worth.

On the whole, it's unsatisfactory for someone no longer active in the business to be holding shares. Notably, they may be looking to make the most of their investment through dividend payments, remaining shareholders are likely to be more concerned with capital growth and reinvesting profits into the business. Worse still are acrimonious departures where retained shares can be used in a disruptive way to express continuing disgruntlement.

A shareholders' agreement can alleviate these problems by forcing a departing shareholder to sell his shares to the remaining shareholders (or back to the company), as well as specifying how those shares are to be valued.

Once an agreement is in place, any new shareholder will need to be persuaded to sign up to it. This could cause problems if he refuses or if the existing shareholders forget to ensure it happens. An agreement should therefore be reviewed on a regular basis to ensure it continues to meet the shareholders' objectives – every few years should suffice, or alternatively at any time when the structure of the company significantly changes.

Even if you're not contemplating taking on board extra shareholders, it's still prudent to have an agreement in place for existing ones to forestall any future upsets.

**First appeared; MIM Motor Industry Magazine, March 2009**

Adams & Remers is a full service law firm with an established reputation for its work in property, private client, family, litigation services, company and commercial, insolvency and employment law. We are a eight partner, 90 strong, firm based in Sussex with offices in Lewes and Brighton and have clients throughout the country.

Legal disclaimer: Although we have taken care over what is said in this information sheet, we have not attempted to give exhaustive statements of law or any opinions on specific legal issues. This information sheet does not provide or offer legal or other advice. You should not rely on it as legal advice. You should consult a suitably qualified lawyer on any specific legal problem or matter.