

Short notes on:

## **WHY EVERY COMPANY NEEDS A TAILORED SHAREHOLDERS' AGREEMENT**

### ***Introduction***

A Shareholders' Agreement is just that – an agreement between the shareholders of a company. This agreement is an invaluable resource for any business as it structures the relationship between the shareholders and provides the foundation for how they will interact with each other.

A Shareholders' Agreement is drafted in order to protect the interests/investments of all the shareholders of the company. It further sets out the duties and rights of the shareholders and regulates the process surrounding the sale of shares by one or more of the company's shareholders. The Companies Act No. 71 of 2008 ("the Act") does not regulate buy-out of shares. Therefore, unlike the Memorandum of Incorporation ("MOI"), it is a confidential agreement not filed in public office.

Without this agreement, possible disputes that are looming in the future between shareholders will not be regulated in a constructive manner. These unregulated disputes will have a negative effect, not only on the company, but also on the relationship between shareholders.

### ***We have a Memorandum of Incorporation***

This is a falsehood that a lot of company owners rely on when asked why there is no Shareholders' Agreement in place. Although the company's MOI (previously known as articles of association) will help to some extent, a fully considered and well-drafted Shareholders' Agreement will act as a much needed safeguard where the MOI lacks protection.

A clear distinction should be made between your MOI and Shareholders' Agreement but they should be read together. The MOI should deal with directors' duties and responsibilities, and the general day to day management of the company, while the Shareholders' Agreement should set out the right and obligations of the shareholders; how shares can be bought, sold, and transferred, and how disputes are to be handled.

## ***What is dealt with in a Shareholders' Agreement?***

How are shares valued? How do you sell shares? Do your fellow shareholders have a right of first refusal to purchase your shares? These are the types of scenarios you think you will be able to sort out between shareholders, but when it comes to this, it is quite a different story in practice.

This agreement should contain specific, important and practical rules relating to the company and the relationship between the shareholders which would be beneficial both to minority and majority shareholders.

For example:

- shareholders' rights and obligations;
- regulate the sale of shares in the company;
- provide protection for minority shareholders and the company;
- define how important decisions are to be made;
- paying dividends'; and
- dispute resolution procedures.

## ***Advantages of a Shareholders' Agreement***

It is general knowledge that the one constant in business, is change. Regardless of how well developed your business plan is, changes both externally (including relationships with clients and competitors) and internally (relationships among the shareholders, directors and employees) are inevitable. A Shareholders' Agreement will enable the company and the owners to adapt to these changes.

Here are some of the advantages of having a properly drafted Shareholders' Agreement in place:

- It can be used to protect the position of minority shareholders by requiring unanimous approval for important company decisions;
- It regulates what should happen if a shareholder passes away or becomes ill;
- It avoids issues when creditors wish to attach shares etc.;
- It sets out clear valuation methods It can regulate the raising of capital to avoid the dilution of shareholdings; and

- It can also provide for the resolution of disputes where a deadlock occurs, through mediation and/or arbitration.

## **Conclusion**

In reality, some shareholders of a company in possession of a well drafted Shareholders' Agreement will never need to rely on its provisions, but more often than not, shareholders, especially when a dispute arises, wish they had taken the time to meet with an attorney to ensure that each of the shareholders' rights were protected in a regulated manner.

It is of the utmost importance to ensure your Shareholders' Agreement is tailored to your company's specific needs while still being in line with the provisions of the Act, and that it aligns with its MOI. At SchoemanLaw Inc., we can assist you in the negotiating and drafting of the relevant incorporation documentation for your company.

