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Introduction to Shareholder Agreements:

The functioning of a company depends on its financing. As a result, shareholders, as owners of shares in a company, help to fund companies when they buy and sell shares. To structure the relationship between shareholders and govern the management of the company, it is important to put in place a shareholder agreement.

1) **What is a Shareholder Agreement (SHA)?** An SHA regulates the relationship between shareholders and the company itself. The agreement sits alongside articles of association of the company, but unlike the articles, it is a private document, confidential to the parties to it. An SHA sets out the rights and obligations of shareholders, describes how the company is going to be run and creates protections/ground rules for both shareholders and the company.

- **Why are Shareholder Agreements necessary?** SHA's are necessary to protect an individual's interest in a company and create rules to deal with disputes between both types of shareholders (majority and minority), but also between shareholders and companies. An SHA is a private document between the parties to the SHA, whereas articles of association are public; because it is a private document, an SHA keeps confidential information such as director remuneration and private contact details.

2) Key clauses to include in a Shareholder Agreement:

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Clauses in an SHA are essential in order to develop the structure of the SHA. They also give shareholders the opportunity to be aware of and understand their rights.

1. EXIT PROVISION: Provides a fair protection to shareholders by giving them the opportunity to walk away from the agreement and sell their shares.

The exit provision can include different clauses such as:

- **The tag-along clause** which serves to protect a minority investor in a startup or company. Through the mechanism of the tag-along clause, the minority shareholders are entitled to the same price and conditions as the majority shareholders when the shares are sold. Without this clause, minority shareholders run the risk of being left behind when the majority shareholders liquidate their investment and consequently being locked in a joint venture.

- **The drag-along clause** protects the majority shareholders by forcing the minority shareholders to sell 100% of the shares of the company. Buyers most often seek complete control of a company for the operation to go smoothly. The aim of drag along rights is to provide liquidity, flexibility and an easy exit route for a majority shareholder. Whereas a 'tag along' clause provides protection to minority shareholders, a 'drag along' provision protects the interests of the major shareholder(s).

- **The put-option clause**, gives to shareholders the right to sell their shares at either a fixed sum or an amount determined by a formula, at some specified time in the future. The advantage of a put option is to give shareholders an option to exit during a set period of time or upon a certain event occurring without losing out on the share value.

2. CONFIDENTIALITY CLAUSE: Prevents the release of confidential and commercial information of the company (such as the customer list) and of each of the shareholders. The disclosure can still be authorized under certain circumstances, such as a request from a court or a regulatory authority.

3. VOTING RIGHTS CLAUSE: With voting rights, shareholders have control over the company and thus, have decision-making powers that are only applicable if they have the consent of all shareholders. The SHA needs to specify what those decision-making powers are. Furthermore, it is important to bear in mind that while shareholders have the right to vote, the default position under the Companies Act of 2006 is that each shareholder only gets one vote if voting in person or on a written resolution one vote per share.

3) How can Shareholder Agreements be made more attractive to investors?

When drafting an SHA, it is important to determine whether the primary aim of the agreement is to protect existing shareholders or to attract and protect new shareholders. To add new investors, it is important to sell or transfer existing shares to them or issue new shares. The terms of the SHA explain how and when a new investor becomes a shareholder. When a new investor receives shares in a company, either through a new issue of shares to them or a transfer of existing shares held by another shareholder, the new investor must agree to be bound by the SHA.

Different clauses will ensure that investors' shares are protected after they receive a share in the company, these clauses include:

- **ADDITIONAL EQUITY FINANCING CLAUSE:** It is the collection of funds from investors for equity financing. In other words, equity financing is the raising of new capital. The aim is to raise funds for start-ups or businesses that want to grow but do not have capital. Additional equity financing can either be provided by existing shareholders putting more money in for new shares or by bringing in new investors who again would receive new shares. These rights below protect existing shareholders when new equity (i.e. new shares) are issued:

- **PRE-EMPTION RIGHTS:** These rights provide the existing shareholder with the right to buy the new share before it is sold to the new investor. In this way, the share can be sold to the new investor only as long as the existing shareholder does not want to buy it.

- **ANTI-DILUTION CLAUSE**: This clause protects the rights of existing shareholders vis-à-vis new investors. Existing shareholders will not want their shareholding percentage to be reduced by new investors coming in. ANTI-DILUTION is the concept that the share ratio remains constant without adding capital in capital increases. Essentially ANTI-DILUTION clauses are mechanisms to allow existing shareholders to maintain their ownership percentage when a new investor subscribes for shares, by issuing additional shares to those existing shareholders. It is also attractive for investors because it protects the value of their investment and their level of involvement in the company. Existing investors may be more willing to allow new investors to come in.

- **GREATER INFORMATION RIGHTS:** These rights ensure that shareholders can request information from the board of directors on the company's operation and from the auditors in terms of the way of auditing at the general assembly. If the right is exercised in this way, the shareholder can reach more satisfactory results since information can be obtained not only about financial statements and reports but also about the company's strategy (e.g. monthly management accounts and financial statements, business plan, budget, board minutes). The greater the information rights, the better for investors as they can more accurately monitor how the company is being run and how their investment is performing.

- **CONTROL RIGHTS: These rights provide** shareholders control depending on their level of investment. The SHA usually sets out the corporate governance through for instance the appointment or removal of directors. Directors of a company control daily basis decisions for running the company. For new investors, the control rights ensures them the right to have a director present at all board meetings or to have control over the appointment of a majority of the board. Besides, they can have an 'observer', who cannot vote or speak during the meeting to affect the decision, but who can attend all meetings. At a minimum, shareholders can get more information about how decisions are being made.

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