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An Overview of Shareholders' Agreement

A shareholders agreement is a contract to govern the affairs of the shareholders as well as to establish a relationship between the shareholders and to govern how the company is to be run which is not covered, or different from the existing Articles of Association of the company. Shareholders' agreement may be entered into between the members or shareholders of a company or in some cases, together with the said company. Sometimes, a shareholders' agreement can also be entered into between only some of shareholders, for example, the holders of a particular class of shares.

When do you need a Shareholders' Agreement?

A shareholders' agreement is not necessary for all companies. It is very common that the importance of a shareholder agreement is ignored. In fact, most of the companies do not have a proper shareholders' agreement among its shareholders.

There is no legal requirement that a company must have a formal shareholders agreement. However, if a company has more than one shareholder, it is advisable to have a shareholders' agreement. A well drafted shareholder agreement should define each party's expectations with clarity to describe the relationship amongst the shareholders and outline, inter alia, how the business should be managed and it will assist in pro-actively pre-empting problems among shareholder in the future.

Under the new Companies Bill 2015[1] regime, companies will no longer have a Memorandum and Articles of Association as the new Companies Act 2015 aims to capture all necessary provisions for running of a company. However, a company may vary certain provisions of the new Companies Act 2015 for itself by entering into a shareholders agreement to agree on the variation and it can then adopt the agreed variations into a constitution.

[1] The Dewan Rakyat has passed the Companies Bill 2015 on 4 April 2016 and the Dewan Negara has passed the Companies Bill 2015 on 28 April 2016. The Companies Bill 2015 has yet to be enforced as Royal Assent has not been obtained.

The importance

Shareholder agreement is a tool to ensure that the running of the company and the responsibilities of the shareholders are properly thought through, there is clarity and certainty as to what can or cannot be done and decisions may be taken by consensus and discussion. As a result, it will reduce the potential for conflict between shareholders and help the company to be run smoothly and profitably. Now that we have the new Companies Act 2015, a shareholders agreement becomes more important if the shareholders want to have their own set of rules in the running of a company.

Matters to be considered

Below are some important matters which are usually considered for inclusion in a shareholders' agreement:

1. Board of directors: to decide how many directors can a particular shareholder appoints to represent the shareholder in the board. It is very common that the number of directors representing a shareholder corresponds commensurately with the equity the shareholder has in a company. For example, if shareholder A owns 60% stake in a company and shareholder B owns 40% in a company, it is usual for a shareholders agreement to provide that shareholder A is entitled to appoint 3 directors and shareholder B is entitled to appoint 2 directors.

2. Chairman of the board of directors: to determine in advance who can appoint the chairman of the board of directors and whether a chairman has a casting vote.

3. Board meeting: an important provision in a shareholders agreement to ensure that at least one representative of a shareholder has to be present in all board meetings.

4. Management of the company: In the case of a joint venture company, it is common to spell out who can appoint the chief executive officer, the chief operating officer and the chief finance officer.

5. Shareholders' Approval: if one shareholder owns majority of shares, it is important to set out a list of reserved matters which require ¾ or unanimous shareholder's approval to ensure that the majority stakeholder is not able to make unilateral decisions without first involving all shareholders.

6. Share Transfer: A shareholders agreement will normally have a primary rule that no shares can be transferred without prior approval of the directors. This can be supplemented with a number of additional mechanisms to promote liquidity of the shares. For example, a right of first refusal is commonly used to avoid the shares of the company falling into the hands of an unfavourable third party.

7. Dispute Resolution: a shareholders' agreement should also have provisions of how deadlocks amongst shareholders can be resolved. A common mechanism in a shareholder agreement is to limit the dispute resolution process to mediation or binding arbitration which is a considerably less expensive alternative than seeking restitution through the courts.

8. Funding Considerations: Every company requires capital upon incorporation and subsequently for operations. It is very important to agree upfront how such capital will be funded. It is also very important that each shareholder contributes the requisite amount corresponding to his or her stake in the company. In the event that a company requires financing, a shareholders agreement can provide how future capital injection is to be managed among the shareholders or with new investors.

Conclusion

While there are companies in which the shareholders do not have a shareholders agreement, however, when the relationship between the shareholders breaks down, the company without a shareholders' agreement will then face difficulties to resolve the issues among themselves and in worst case scenario, winding-up of the company becomes the best resort.

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