

AGREEMENTS

Shareholders' Agreements

How a shareholders' agreement works alongside the articles, covering reserved matters, pre-emption, drag and tag rights, and good and bad leaver provisions.

Articles and agreement: two different documents

The articles of association are the company's constitution. They bind the company and its members, and they are filed at Companies House, so anyone can read them. A shareholders' agreement is a private contract between some or all of the shareholders, usually with the company as a party. It is not filed and stays confidential.

Most owner-managed companies run on the Model Articles, which say nothing about what shareholders owe each other. The agreement fills that gap. It records how the business will be run, how shares may be sold, and what happens when the shareholders fall out or one of them leaves.

What the agreement usually covers

- **Reserved matters.** Decisions that need the consent of a stated shareholder, or a stated majority, before the directors can act. Typical examples are new borrowing above a limit, issuing shares, changing the business, and hiring or dismissing senior people.
- **Pre-emption on transfers.** A shareholder who wants to sell must first offer the shares to the others, usually at a price set by an agreed method.
- **Drag-along.** If holders of a stated percentage accept an offer for the company, they can require the rest to sell on the same terms.
- **Tag-along.** If a majority sells, the minority may join the sale on the same terms.
- **Leaver provisions.** What happens to a person's shares when they stop working in the business, covered below.
- **Restrictive covenants.** Limits on competing with the company or approaching its customers and staff after exit.

Making it bite

A contract between shareholders does not by itself change the company's constitution. Where a protection matters, such as a veto or a rule on transfers, it is usually safest to mirror it in the articles, so that the company is bound as well as the people. The agreement should say that, if the two conflict, the shareholders will vote to amend the articles to match. Shareholders also keep their statutory powers, such as removing a director by ordinary resolution under the Companies Act 2006 (section 168). An agreement can bind how they vote, but the usual way to protect a minority director is through share rights in the articles.

Key points

- Articles are public and bind the company. The agreement is private and binds the people who sign it.
- Reserved matters give a minority real protection. Keep the list short and workable.
- Pre-emption, drag and tag rights should work together, not pull against each other.
- Leaver terms are the hardest part to agree later. Settle them while everyone is on good terms.
- Mirror key protections in the articles.
- New shareholders should sign a deed of adherence before they are registered.

Good and bad leavers

A leaver clause answers one question: when someone stops working in the business, what happens to their shares and at what price? It usually divides leavers into two groups.

- **Good leaver.** Death, serious illness, retirement at an agreed age, or dismissal without cause. The person usually keeps their shares or sells them at full market value.
- **Bad leaver.** Resignation within an agreed early period, dismissal for misconduct, or breach of the agreement. The shares must usually be offered for sale at a discount, sometimes at the lower of cost and market value.

The definitions matter more than the price. Vague wording such as serious misconduct invites a dispute about whether the trigger has been met. Decide who values the shares, whether minority and illiquidity discounts apply, and over what period the price is paid. Check how the clause interacts with any employment contract. Leaver terms may also affect the tax treatment of shares acquired through employment, which is for the shareholder's tax adviser.

Deadlock and exit

Equal or closely balanced shareholdings can stall. The agreement should say how a deadlock is declared and what follows: a cooling-off period, then mediation, then a buy-sell or sale process. Our separate guide on deadlock and exit planning covers these mechanisms.

Practical points

- All shareholders, including those who join later, should sign. A shareholder who is not a party is not bound.
- Agree what happens on death, divorce and bankruptcy, as these often bring shares to someone who was never part of the business.
- Review the agreement when the shareholders or the business change. An agreement signed years ago may no longer fit.
- Keep a signed copy with the company's records, and tell the accountant, since shares and tax positions can depend on its terms.

Keeping it working

An agreement is only as good as the company's habits. Check that the board follows the reserved matters list, that a record is kept of consents given, and that new shares are issued only after the new holder has signed up. Build a yearly review into the diary: the shareholders, their roles and the company's value will all have moved since the agreement was signed.

Before you start

- Who is to be a party, and does the company sign?
- What decisions must need consent?
- What price applies on a sale, and who sets it?
- Who counts as a good or bad leaver?
- What happens on death or divorce?
- What changes need to be made to the articles?
- Is there an existing agreement or a set of articles that must be reviewed first?

How MTM can help

0161 835 2080
client@mtmlp.co.uk

Practices usually bring shareholders' agreements to us when a client takes on a partner, an investor or a family member. We draft the agreement and any matching changes to the articles, prepare the resolutions and filings, and update the statutory registers, working through you or directly with your client. The commercial and tax advice stays with you and your client's tax adviser.