LAW MATTERS

LET'S BUY A BAR! THE IMPORTANCE OF SHAREHOLDERS AGREEMENTS

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THERE is something of a recurring joke in the sitcom *How I Met Your Mother*, that Ted and Barney should buy a bar. And why not? Cheap drinks, no last call; it'll be legend… wait for it…

It's with a similar mindset that many people approach starting a business. It's an exciting time: the potential is limitless and both partners are going to be rich. Why wouldn't everyone work together? And why shouldn't each partner get half the profit? The result is often a company with two shareholders, each of whom holds 50 percent of the issued shares.

As fair as this might seem, it can be disastrous for the company if no shareholders agreement is concluded. It can be equally disastrous if a shareholders agreement is concluded, but doesn't cater for situations of deadlock, or where one of the partners is acting against the interests of the business.

We are occasionally approached to give advice on how one shareholder in a company might remove another shareholder. The question might seem reasonable, but is often based on a misunderstanding of the nature of a shareholder's relationship with the company.

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Directors, both in terms of the Companies Act and the common law, owe certain duties of care to the company. They must act in its best interests and can be removed as directors if they fail to do so.

Shareholders, on the other hand, hold no similar duties. They can essentially deal with their shares in any way they see fit, even if it is to their benefit but to the detriment of the company. There is almost nothing that their fellow shareholders can do in these situations. It is important to bear in mind that, unless a company's memorandum of incorporation provides otherwise, ordinary shareholders resolutions must be approved by more than 50 percent of the votes on that resolution. Where two shareholders each hold 50 percent of the shares, this means that either the shareholders must agree on every decision, or there will be a deadlock (which might be grounds to liquidate the company).

It's of no help if the shareholder is also a director. Bad behaviour can see him removed as a director, but this does not automatically require him to sell his shares.

How does one go about addressing the situation? In the first instance, having two shareholders each holding 50 percent of the company's shares should be avoided wherever possible.

Secondly, it is important to have a solid shareholders agreement in place, which regulates how the shareholders deal with each other and the company. This is true even if the shareholding is not equal. There are many issues that might arise between shareholders, equal or otherwise, that cannot sensibly be dealt with without a shareholders agreement.

The good times don't always last. You buy insurance in case the house burns down. You conclude shareholders agreements in case your partner in the bar starts stealing all the liquor.

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