SHAREHOLDERS AGREEMENT

How should a shareholder protect his/her interests in the company?

Would every shareholder, notwithstanding his/her proportion of shareholding, be entitled to a seat on the board?

INTRODUCTION

Drafting a well thought through and comprehensive shareholders' agreement is an often neglected but an extremely important step when parties / entities come together to strike deals.

In this article, we explore both the legal underpinnings of such an agreement and some possible practical options available to parties to apportion their rights and liabilities in various circumstances.

This is a joint article between our Joint Managing Director, Mr Mark Lee and Ms Melissa Lee, Director of Sales, Manulife Financial Advisers.

Shareholders Agreement V. Company Constitution

A shareholders agreement can feature in the context when individuals come together to invest and co-own a company, in a joint venture between corporate shareholders and even where new investors come on board with the promise of capital injection in exchange for shareholding.

A well drafted shareholders agreement ought to carefully consider and calibrate the interests of the various shareholders but also address issues of board representation, voting mechanisms, deadlock situations, etc.

How would a shareholder protect his/her interests in the company? Would every shareholder, notwithstanding his/her proportion of shareholding, be entitled to a seat on the board? Are there matters / decisions that the shareholders would like the company to reserve to the shareholders only? These questions (and more) have to be addressed in the course of parties navigating the drafting of a shareholders agreement.

Is a shareholders agreement really necessary given that a company would have to in any event prepare a constitution?

The High Court in BTY v BUA and other matters [2018] SGHC 213 makes clear the foundational differences between a shareholders agreement and a company's constitution. A shareholders agreement is a private contract. "It derives its contractual force purely from the private law of obligations. The law of contract, which is a branch of the law of obligations, provides that the coincidence of offer, acceptance and consideration gives rise to obligations which are legally binding. At common law, nobody who is not a party to the contract can be bound by its provisions or can claim any rights under its provisions."

On the other hand, a constitution "derives its contractual force from company law, not private law. Section 39(1) of the Companies Act provides that the constitution of a company binds the company and its members as if the constitution had been signed and sealed by each member and contained covenants on the part of each member to observe its provisions. The constitution is therefore a deemed contract which binds immediately by force of statute upon and by virtue of registration. As such, it binds without any need for offer, acceptance or consideration."

Operating on separate planes

As a result of the fundamental different legal character of a shareholders agreement and constitution, it also means that the two contracts "operate on separate planes". "A company's constitution operates on the company law plane ... . A shareholders' agreement operates on the private law plane."

As such, amongst other practical consequences, it is important for shareholders to note the following, including:-

- the provisions of a shareholders' agreement can be modified only with the consent of all of the parties to the agreement. On the other hand, on the company law plane, in general, any provision of a company's constitution may be amended by special resolution. Thus, a shareholder who holds under 25% of a company's shares can find himself bound against his will by a modification of a provision in the company's constitution.

- no person can be bound by a shareholders' agreement unless he accedes to it expressly and separately by contract. On the company law plane, however, an incoming shareholder is, by force of company law, immediately and automatically bound by the company's constitution. No expressed consent is required from the incoming shareholder.

- company law subordinates a private agreement. This has practical consequences for shareholders to a shareholders agreement because "Any obligation which a company or a shareholder undertakes privately in a shareholders' agreement which is contrary to a mandatory provision of company law must yield to company law." Simply, if there are inconsistencies between the terms of a shareholders agreement and the articles of the company's constitution, the articles of the company's constitution would prevail.

Finally, the consequences stemming from the breach of a company's constitution and a shareholders' agreement carry deep differences as well. Where the company has acted in breach of its constitution, shareholders may argue that such act by the company was "ultra vires" and be deemed void and/or may be set aside. Whereas, if a term of a shareholders agreement is breached, that act constituting the breach is not per se ultra vires but merely a breach of a contractual obligation where a shareholder's recourse is for one of civil liability for a breach of contract.

Simply put, a shareholders agreement and one's appreciation of its significance is crucial to the longevity of any deal/transaction between serious commercial parties.

In the next section of this article, Ms Melissa Lee weighs in on various mechanisms and/or policies that are available for parties to consider weaving into the fabric of their envisioned shareholder arrangements to further safeguard their interests.

Ms Melissa Lee, Director of Sales, Manulife Financial Advisers:-

A shareholders agreement can play an important role in business succession planning when it provides a framework for the transfer of ownership interests to ensure a smooth transition of the business using one or more of the following methods.

Buy-sell provisions

Buy-sell provisions set pre-established rules for transferring the owners' interest in the business in the event of their death, disability, or retirement. These provisions can help ensure that the remaining owners could buy the departing owner's interest at a fair price and prevent the sale of the interest to an outside party who may not be in the best interest of the business.

Transfer restrictions

Transfer restrictions limit the ability of shareholders to transfer their ownership interests to third parties without the consent of the other shareholders. This can help ensure that the remaining owners have control over the ownership of the business and prevent the business from being sold to outside parties without their approval.

To enhance financial protection and reduce risk for the shareholders of a company, here are some strategies that employ the use of insurance as a cost-effective means of financing succession events.

Key person insurance

Key person insurance is a type of life insurance policy that is taken out on a key employee or shareholder of a business. In the event of that person's death, the insurance pay out can be used to fund the purchase of their shares under the terms of a buy-sell agreement. This can help ensure that the remaining owners have the funds needed to buy out the deceased owner's interest in the business.

Cross-purchase plan

A cross-purchase plan is a type of buy-sell agreement where each owner agrees to purchase the other owners' interests in the event of their death or disability. In this type of plan, each owner takes out a life insurance policy on the other owners, with the pay out used to fund the purchase of their shares.

Entity purchase plan

In an entity purchase plan, the business itself agrees to purchase the shares of a deceased or disabled owner. The business takes out a life insurance policy on each owner, with the pay out used to fund the purchase of their shares.

Thus, by incorporating insurance into business succession planning, business owners can ensure that funds will be available to purchase another owner's interest in the event of their death critical illness or disability. This can help provide financial security for the remaining owners and ensure the continuity of the business.

Mr. Mark Lee is the Joint Managing Director of WMH Law Corporation.

Mr. Lee's practice includes a particular emphasis on corporate, shareholder boardroom disputes and he routinely advises high valued companies, shareholders and directors in complex, multi-party shareholder disputes, breach of director duties claims and minority oppression claims.

Amongst others, Mr. Lee has earned the following accolades for his work and deals handled, finalist for Thomson Reuters' Asian Legal Business South East Asia Awards:-

- Young Lawyer of the Year Award
- Managing Partner of the Year Award
- Transactional Boutique Law Firm of the Year Award

Contact Information:-
DID: (+65) 6514 6352
HP: (+65) 9182 9643
EMAIL: mark.lee@wmhlaw.com.sg

Ms Melissa Lee is Director of Sales, Financial Services with DNA Branch, representing Manulife Financial Advisers.

Ms. Lee is a is a licensed financial practitioner, estate planning professional, AEPP® designee, and CFA® charter holder.

She previously represented top tier international private banks serving and advising ultra-high net worth clients across Asia in Wealth Management.

Her experience spans across advising business owners, individual investors, and families in key areas of business continuity & succession, wealth, estate and legacy planning.

She specializes in the comprehensive planning and structuring of customized financial solutions for clients.

Contact Information:-
HP: (+65) 9362 3223
EMAIL: melissa.lee@manulifefa.com.sg