

# HOW DO YOU PROTECT YOUR SHAREHOLDING? PART I

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A large proportion of inventors and innovators are establishing companies, without giving much thought to the protection of their shareholding in these companies, writes Dr Rosanna Cooper. Equally, parties to a joint venture (JV) would need to establish their rights and obligations in relation to the JV, in a joint venture or shareholders agreement. This three-part series focuses on the duties/responsibilities and liabilities of directors and protecting the position of shareholders. This article gives an overview of the position of a shareholder in a company whether as an inventor or part of a JV.

## Apportioning Shares

It is often the case that a new venture comprises a number of individuals/organisations who may have contributed time and resources including funding to getting a company established or there might be one or more companies coming together to form a JV. Once the company is set up, no further attention might be paid to documenting any details. For example, if the company is unable to pay for professional services, the company can in some cases offer shares in lieu of fees to the firm. At RT Coopers we accept equity in lieu of fees for the right venture.

Furthermore, if an individual is working in the company without receiving any remuneration, that individual might be expecting to be rewarded with a percentage shareholding.

## Shareholders Agreement

We strongly recommend that if there is more than one shareholder in the company that you enter into a shareholders agreement. In the event that things do not go according to plan, a well-drafted shareholders agreement would provide the basis for dealing with any disputes that may arise (see next month's article for some of the common disputes that you might encounter). It should be noted that in a smaller company the directors and shareholders may be the same individuals. They tend to be known as director-shareholders. In a JV, you would most probably have two separate companies forming the JV. The separate companies would become the shareholders of the JV and the individual shareholders of the companies might also become shareholders.

Unlike the articles of association ("articles") of your company, a shareholders agreement is a private document between the shareholders and/or directors-shareholders. It sets out the issues that cannot be dealt with in the articles of the company. The shareholders agreement is governed by contract, whereas the articles are governed by statute. One of the main

You might also find that you have a number of people who have assisted in some way with your invention/innovation, or setting up of the JV and are expecting shares in the company. However, you might not have agreed the value of their shareholdings or even whether they are entitled to shares.

You should also decide what shareholding you are going to retain personally (if you are the founder of the business) because the level of your shareholding determines your position as a shareholder. In the next article we would explain the varying levels of shareholding and protecting your shareholding if you happen to be a minority shareholder.

problems tend to be identifying and agreeing on the roles and responsibilities of the directors and/or shareholders. Another major problem tends to be that certain individuals may only be able to devote a proportion of their time to the company, so how would you ensure that sufficient time is devoted to your business? As an inventor/innovator, you may need to bring in certain expertise, especially in the early stages of your business, such as legal or financial advisers.

In reality, if a shareholders agreement is not in place, any shareholder with a fifty one percent shareholding can largely control the company. A director-shareholder with fifty one (51%) percent shareholding can remove a director if the shareholders agreement does not deal with the removal of directors. It is usual practice once the shareholders agreement has been signed, to revise the articles accordingly. The articles may be amended by special resolution, by shareholders holding seventy five (75%) percent or more of the voting rights. The shareholders agreement may be amended by mutual consent.

What issues should a shareholders agreement address? Broadly, a shareholders agreement should cover the following:

## Shareholdings

- Apportionment of shareholding – how are shares to be divided between the shareholders?
- Who is going to own the majority shareholding?
- The capitalisation and financing of the company.
- Transfer and allocation of shares - When and how will the decision to allocate new shares be taken?
- How much shares should be given up in lieu of fees for the necessary professional services, if any?
- What percentage shareholding would be reserved for external investors? There are certain times when, due to the extent of an investor's commitment to your venture both financially and otherwise, the investor would justifiably receive a sizeable shareholding. However, the company must be extremely careful not to give up control to an external investor. At RT Coopers we would advise you on how to keep control of your company, when seeking external investment.

## Joint Venture

- If you are in a JV, the objects and scope of the JV.
- The capitalisation and financing of the company.
- Provisions for unwinding a deadlock if you have a 50/50 JV (see below).
- Termination of the JV.
- Any restrictive covenants on the company or participants.

## Shareholders

- The powers of the shareholders of the company – What shareholders are able to do and whether this is dependent on their shareholdings in the company.
- Limits and procedures for the operation of the company.
- How are minority shareholders to be protected? It is crucial that minority shareholders are protected from the effects of the introduction of new shareholders, so that their shareholdings do not diminish substantially in value.
- Changes to a shareholder's circumstances that might affect the company and its shareholders.

## Board of Directors

- What are the roles and responsibilities of the directors of the company? Such roles and responsibilities must be clearly defined and agreed by the directors.
- Are there any targets that the board will have to meet on a periodical basis?
- What happens if the board is deadlocked? Does the chairman have a casting vote?
- How are directors to be appointed and dismissed?
- What about appointing non-executive directors? In most cases, investors tend to place non-executive directors on the board to represent their interest. What voting rights would the non-executive directors be given?

## Conclusion

There are a host of considerations that must be taken into account by the shareholders and directors of a company. Many of the problems that arise can be comprehensively dealt with in a shareholders

agreement. However, once there are disputes, these problems can cause irreparable damage to the company and shareholder relations. In some cases, the company will have to be dissolved.

In next month's article we will focus on the key areas of dispute between shareholders, which a timely shareholders agreement can prevent. We will also begin to look at directors' responsibilities and liabilities.

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