The framework and anatomy of shareholders' agreements

It can take months to negotiate a shareholders' agreement. The goal is to protect the interests of all involved.

Shareholders' agreements are written agreements that govern the rights and obligations of shareholders with respect to the management, operation and control of the company, and the transfer of shares.

They are negotiated over a period of weeks to months and usually contain provisions that intend to protect the interests of the new investor. Therefore, founders of startups need to be careful.

On one hand, founders need the financing and the injection of money to be able to pursue the activities of their startup. On the other hand, they will be giving up a large part of the control over the company's affairs. The lawyers' role is to find the best balance between opposing interests and reach a good compromise that serves the best interests of the founders and the investors.

Shareholders' agreements should not be confused with the articles of association, commonly called by-laws. A shareholders' agreement is complementary to the articles of association. It cannot violate the provisions of the articles of association or those of the law.

Here is a brief comparison between the two documents:

A shareholders' agreement is not registered with the Register of Commerce. It is effective between its signatories but not against third parties. Third parties are not made aware of its clauses, which remain confidential.

Articles of association are made public through their registration with the Register of Commerce. They can, therefore, be relied on by third parties. This is why investors usually insist on amending the articles of association further to their acquisition of shares in a startup, in order to reflect the provisions of the shareholders' agreement.

A shareholder's agreement can be signed by some of the shareholders and not necessarily all of them.

Articles of association are signed by the founders of the company, and subsequently apply to all current and future shareholders who shall abide by their provisions.

Shareholder’s agreements cannot be modified without the consent of all signatories.

Shareholders' agreements go back and forth between founders and investors until a compromise that protects all interests is reached. (Image via bloncampus.com)

Articles of association can be modified pursuant to the provisions of the Code of Commerce by a resolution of an Extraordinary General Assembly.

Shareholders’ agreements usually contain provisions relating to the operation of the company and its governance, including milestones, reporting obligations, business plans, confidentiality clauses, exclusivity clauses, clauses relating to intellectual property, how to resolve deadlocks, and more.

Articles of association contain general provisions that address standard matters, such as the name of the company, its registered address, its object, the powers of the company’s respective bodies, the meetings of the company’s bodies, and more. Therefore, they do not enter into details relating to the operation of the company’s business.

Founders often ask: *“Why do we have to sign a shareholders’ agreement on top of the articles of association?”*

Usually upon the entry of a new investor, through an assignment of shares or an increase of capital, such investor feels the need to secure his investment, to retain a certain measure of control over the company’s affairs, to secure his exit, and to benefit from certain priority rights, among other things, especially when the investor is in a minority position. Drafting a shareholder’s agreement therefore becomes a necessity.

A shareholders’ agreement typically contains several clauses governing the management of the company. These clauses can include the designation and resignation of members of the board of directors, the creation of certain committees, reporting obligations, and “reserved matters” which are actions or decisions that require special majorities or the consent of specific individuals, usually the investor. Shareholders’ non-competition and confidentiality clauses, shareholding clauses (pre-emption, preferential, drag-along and tag-along rights, anti-dilution clauses, and more), and clauses that grant priority rights to certain shareholders, mainly the investors (such as a priority upon liquidation or a priority upon the distribution of dividends), are also included in shareholders’ agreements.

Negotiations can take weeks to months, during which several versions of the shareholders’ agreement are circulated back and forth between the parties and their respective lawyers. In a best case scenario, the shareholders agreement leads to a business relationship that is beneficial to all parties involved.

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