



AbdulJaami, PLLC

International Commercial Transactions

Negotiating Shareholders Agreements

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Negotiating Shareholders Agreements

- A Rose by Any Other Name...
- Parties and their Interests
- Key Motivations
- Agreement Provisions – Let's Speak Plainly
- Staying in Bounds – Articles and Bylaws
- Mind Your Step – The Long Arm of the Law
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A Rose by Any Other Name...

- Shareholders Agreements – contracts that govern the relationship between equity holders in private ventures
- Some forms of Shareholder Agreements:
 - Shareholders Agreement: private equity/venture capital transaction
 - BuySell Agreement: family/closely-held business
 - Management Agreement: closely-held business
 - Shareholder Voting Agreement
 - Voting Trust
 - Joint Venture



Parties and Their Interests

- Focus on institutional investor transactions, Private Equity and Venture Capital
 - Management Shareholders
 - Participation in upside through Equity participation
 - Maintain voice and some level of control
 - Protect equity interest through shareholders agreement
 - Board of Directors
 - Usually *not* party to the Agreement but impacted by the Agreement
 - Up for Grabs: board presence; right to monitor: management power
 - Investor Shareholder
 - Managing and monitoring investment
 - Return on investment and Exit



Key Motivations

- Return on Investment
 - Management: looking to share in Investor up-side
 - Investor: looking to protect up-side by managing and monitoring
- Management Participation
 - Management
 - Preserve freedom to direct company
 - Protect shareholder and manager interests thru shareholders agreement
 - Investor
 - Incentivize Management to get best results
 - Exercise control through Board rights and voting privileges
- Liquidity
 - Management: prevent hasty/unwise exit; not get left behind; employment
 - Investor: preserve ability to decide when and how to exit



Shareholders Agreement Provisions

- Return on Investment
 - Governance Provisions: seat on board, monitoring rights, voting rights
 - Transactions requiring Supermajority: may need to list in Articles of Inc.
 - Preemptive Rights: participate in future equity offerings; avoid dilution
- Management Participation
 - Vesting Provisions: time/performance vesting; transfer of shares
 - Governance Provisions: officers, board relations, Articles and Bylaws
 - Key man Insurance: permitted transfers; put/call provisions



Shareholders Agreement Provisions

- Liquidity
 - Dealings Amongst Shareholders (Restrictions on Transfer)
 - Right of First Refusal: co. or investor must refuse offer to sell *before* shareholder can approach 3rd parties
 - Right of First Offer: shareholder must first offer to sell to co. or investor *before* approaching 3rd parties
 - Right to “Last Look”: shareholder must present offer to sell to co. or investor *before* closing sale *but after* approaching 3rd parties
 - Put/Call Right: party has option to force the purchase or sale of other party’s equity
 - Third Party Dealings
 - Tag Along Right: if investor or co. sells, shareholder can sell too
 - Drag Along Right: if investor or co. sells, shareholder can be forced to sell too



Staying in Bounds

- Relationship between Shareholders Agreements and Certificate/Articles of Inc. and Bylaws
 - Exists within the confines
 - State Corporate law may require that certain issues be dealt with within the Certificate/Articles of Inc. or the Bylaws
 - E.g. New York and Delaware corporate law suggests that Supermajority voting provisions be disclosed in the Cert. of Inc.
 - Interstitial – fills the Gaps
 - State Corporate law may be silent on an issue, leave it to the shareholders, allow an opt-out, or fail to prohibit
 - E.g. Under NY and DE law, shares are freely transferable, but a shareholders agreement can provide otherwise

Mind Your Step - the Long-Arm of the Law

- State, Common, and Federal law can affect the shape and interpretation of Shareholders Agreements
 - State Law
 - Mainly through state corporation law, but also contract and tort (e.g. fraud) law
 - Common Law
 - Restrictions on the ability to sell or transfer shares are impacted by a negative view of “unreasonable restraints on alienation”
 - Federal Securities Law
 - 1934 Act Rule 10b-5 applies to fraud in the purchase or sale of a security and Repurchase agreements or provisions may fall under its sway



Phantom Presence – External Finance

- Bank Loan, Credit, and Indenture Agreements may indirectly impact your Shareholders Agreement
 - Company’s ability to fund repurchases of shareholder equity
 - Impact of affirmative, negative and financial covenants
 - Governance
 - Impact of housekeeping covenants
 - Exit Strategies
 - Impact of negative and financial covenants



That's...My Half: M&A and IPO

- Investors need to exit to realize ROI goals, but management may have competing interests
 - Employment
 - How will an M&A event impact executives?
 - Vesting of Shares under Shareholders Agreement
 - Are unvested shares lost? Accelerated vesting?
 - Ability to Sell Shares
 - Tag/Drag Along rights? Lock-up period? Dribble-out requirement?
 - Dismissal Prior to Sale or IPO (1 year or less)
 - If shareholder forced to sell shares prior to liquidity event, can shareholder recoup an increase in share price?



Summing Up

- Increased private equity/venture capital activity focuses attention on shareholders agreements
- Management should approach the agreement with a firm grasp of agreements purposes and parties' interests
- Impact of restrictions on transfer and major liquidity events should be carefully thought through
- External influences such as finance and state/common/federal law may have an impact
- For additional information or assistance:
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