

Shareholder protection, also known as shareholder agreement protection or shareholder buyout protection, is a set of measures and provisions designed to protect the interests and rights of shareholders in a company in the event of certain triggering events. It provides a framework for addressing situations such as the death, disability, retirement, or exit of a shareholder.



Shareholder protection typically involves creating a legally binding agreement, commonly referred to as a shareholder agreement, which outlines the rights, obligations, and procedures to be followed in these circumstances. The agreement helps ensure a fair and orderly transition of ownership and protects the value and stability of the company.

Co-shareholder protection is insurance specifically for directors, partners or shareholders.

When a business partner or shareholder dies their shares pass to the beneficiaries of their estate. More often than not this will be one or more family members who may have little or no interest in the future of the business or have an immediate need for cash and wish to sell the shares.

For the surviving shareholders this could mean having to work with new business partners who do not have the same experience or vision for the future direction of the business, whether this is a family member of the deceased or potentially a stranger who has purchased the shareholding from the family.

Shareholder protection works to avoid any such disruption.

Some of the key elements typically included in shareholder protection:

Buy-Sell Agreement: A buy-sell agreement is a central component of shareholder protection. It outlines the conditions and procedures for the transfer of shares in the event of a triggering event. The agreement may specify how the shares will be valued, the terms of the buyout, and the rights and obligations of the remaining shareholders.

Cross Option Agreement: A cross-option agreement is a simple contract between shareholders in a company that gives the surviving shareholder(s) an option to buy back the shares of the unwell/deceased shareholder.

Share Valuation: Determining the value of shares is a critical aspect of shareholder protection. Various valuation methods may be employed, such as market-based valuations, book value, or predetermined formulas. The shareholder agreement typically stipulates the method to be used to ensure a fair and consistent approach.

Funding Mechanisms: Shareholder protection often addresses the funding of share buyouts. This can be achieved through mechanisms such as life insurance or critical illness insurance policies, personal savings, external financing, or a combination of these. Insurance policies are commonly used to provide a lump sum to facilitate the purchase of a shareholder's interest.

Rights and Restrictions: The shareholder agreement may define the rights and restrictions associated with share transfers. This can include provisions that give existing shareholders the first right of refusal or restrict share transfers to certain individuals or entities to maintain control and protect the interests of the remaining shareholders.

Dispute Resolution: Shareholder protection agreements may include dispute resolution mechanisms to address conflicts that may arise during the buyout process. This can involve specifying procedures for mediation, arbitration, or other methods of resolving disagreements among shareholders.

Shareholder protection provides several benefits to shareholders and the company as a whole:

Protection of Shareholder Interests: Shareholder protection agreements ensure that the rights and interests of shareholders are safeguarded, particularly in the event of unexpected events or disputes. They provide clarity and certainty regarding share transfers and help prevent potential conflicts among shareholders.

Continuity of Ownership: By establishing procedures for share transfers, shareholder protection agreements help maintain the continuity of ownership and leadership within the company. This ensures stability, minimizes disruptions, and allows the business to continue operating smoothly.

Fair and Consistent Valuation: Shareholder protection agreements provide a predefined method for valuing shares, ensuring a fair and consistent approach. This protects the value of the shares and helps avoid potential disagreements over valuation during a triggering event.

Financial Security: Shareholder protection often involves the use of insurance policies to fund share buyouts. This provides financial security by ensuring that the necessary funds are available to facilitate the purchase of shares from a departing shareholder or their beneficiaries.

Correctly attributing the costs and benefits under a shareholder protection arrangement will ensure that the policy premiums and benefits are not subject to inheritance tax.

Flexibility and Customization: Shareholder protection agreements can be tailored to the specific needs and circumstances of the company and its shareholders. They allow shareholders to define the terms, conditions, and procedures that best align with their objectives and ensure the smooth functioning of the business.

Peace of Mind: Offers peace of mind to the family left behind, as they know they will have a willing buyer of shares they may no longer want, and remaining shareholders can relax in the knowledge that they will have the option to purchase.

It is important for shareholders to seek financial advice to establish a comprehensive shareholder protection agreement that addresses their unique requirements and protects their interests.

Ellis Bates are here to help you both understand the complexities of shareholder protection and to help you select the most appropriate solution for your business.

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