

SHAREHOLDERS AGREEMENTS CRITICAL QUESTIONS



Prepared by

**Jackie
Atchison,
Principal
Lawyer.
Founder**

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7 Critical Questions Before Finalising Your Shareholders Agreement

Essential Considerations for Business Owners &
Co-Founders

Starting a business with co-founders or bringing in shareholders creates exciting opportunities for growth and shared success. It also creates the need for clear agreements about how the business will be owned, governed, and managed.

Most shareholder disputes don't start from hostility. They emerge from genuinely different understandings about rights, obligations, or processes that weren't documented clearly at the outset.

These seven questions help you assess whether your shareholders agreement addresses the essential protections and processes your business needs. Use them before finalizing your agreement to identify gaps that could cause problems later.

QUESTION 1

Have we clearly defined ownership percentages and share class rights?

Ownership structure goes beyond simple percentage holdings. Different share classes can carry different rights - some shareholders might hold ordinary shares with full voting rights, while others hold preference shares with priority for dividends but limited voting.

Consider whether your agreement documents not just who owns what percentage, but also what rights attach to each share class. Can shares be converted between classes? What triggers conversion rights? How might new shares be issued, and what protections exist against excessive dilution of existing holdings?

For businesses where shareholders contribute different things - some provide capital while others contribute expertise or intellectual property - clear documentation of these contributions and how they translate to ownership prevents future disputes about who deserves what share of the business.

Why this matters: Ownership disputes typically arise years after formation when the business has value. Vague ownership documentation creates expensive legal conflicts when shareholders disagree about who owns what or what rights their shares carry.

QUESTION 2

What decisions require unanimous consent versus majority vote?

Decision-making authority determines whether your business can act quickly on opportunities or gets paralyzed by disagreement. Your agreement should distinguish between routine business decisions that management or directors can make independently, and major decisions requiring shareholder approval.

Major decisions typically include taking on significant debt, selling major assets, entering new business lines, changing the company's structure, or issuing new shares. But what constitutes "significant" or "major" for your specific business? A \$50,000 decision might be routine for one business but transformational for another.

Consider also whether all major decisions require the same approval threshold, or whether some fundamental changes (like selling the entire business) require unanimous consent while others (like approving annual budgets) need only majority approval.

Why this matters: *Unclear decision authority creates paralysis when action is needed, or resentment when some shareholders feel excluded from important decisions. Documenting clear thresholds prevents both problems.*

QUESTION 3

What happens if one shareholder can't or won't contribute additional capital?

Most businesses eventually need additional capital beyond initial contributions. Shareholders may have different financial capacity or willingness to provide that capital, creating tension about obligations and consequences.

Does your agreement create binding obligations to participate in future capital raises, or are additional contributions voluntary? If voluntary, what happens when some shareholders participate but others don't? Does the non-participating shareholder's ownership get diluted? Do participating shareholders receive preference rights as compensation for providing needed capital?

Consider also whether shareholders might loan money to the company rather than making equity contributions. If so, what interest rates apply, what repayment terms, and whether loans are secured?

Why this matters: Capital contribution disputes damage relationships and can prevent the business from accessing needed funding. Clear frameworks for capital requirements and consequences protect both the business and shareholders who do contribute.

QUESTION 4

How does a shareholder exit the business - and what valuation method applies?

Exit strategies matter from day one, even when everyone intends to stay with the business long-term. Life changes - people want to retire, pursue other opportunities, or simply need liquidity. Without clear exit mechanisms, these natural transitions become contentious disputes.

Valuation methodology causes particular friction. The exiting shareholder typically wants maximum value, while remaining shareholders prefer lower valuations to reduce buyout costs. Your agreement should specify the valuation approach - independent professional valuation, agreed formulas (such as multiple of earnings), or negotiated price between parties.

Address also who can purchase the exiting shareholder's shares - the company itself, remaining shareholders, or both. Specify payment terms (lump sum or instalments), timeframes for completion, and what happens if buyers can't raise the required funds within the specified period.

Why this matters: *Exit disputes are among the most expensive and relationship-damaging shareholder conflicts. Most could be prevented with clear processes agreed when relationships are strong rather than negotiated after someone wants out.*

QUESTION 5

What process addresses deadlocks between equal shareholders?

Equal ownership structures (50/50 partnerships or equal splits among multiple shareholders) carry inherent deadlock risks. When equal shareholders fundamentally disagree on major decisions, the business can become paralyzed with neither party having authority to proceed.

Deadlock resolution mechanisms provide pathways forward when agreement proves impossible. These might include mandatory mediation before triggering more drastic measures, casting votes for certain decision types to break ties, or buy-sell mechanisms that allow shareholders to exit when continued co-ownership becomes unworkable.

Buy-sell clauses (sometimes called "shotgun" clauses) allow one shareholder to make an offer to buy the other shareholder's shares at a specified price. The receiving shareholder must either accept and sell at that price, or buy the offering shareholder's shares at the same price - forcing realistic pricing since the offerer risks having to sell at their own offered price.

Why this matters: Equal ownership without deadlock resolution creates business paralysis when disagreement occurs. Clear mechanisms prevent deadlock from destroying both the business and shareholder relationships.

QUESTION 6

What restraints protect the business from shareholder competition?

Shareholders often have access to business information, relationships, and operations that could be used to compete with the company. Restraint provisions address whether shareholders can operate competing businesses, approach company clients, or solicit company employees.

These provisions must be reasonable in scope, duration, and geographic area to be enforceable under Australian law. Courts won't enforce restraints that go beyond protecting legitimate business interests.

Consider whether restraints should differ between active shareholders (those working in the business with full access to operations) and passive investors. Active shareholders typically face stricter restraints given their deeper involvement and knowledge.

Confidentiality provisions complement restraints by preventing shareholders from using or disclosing company confidential information, typically continuing even after a shareholder exits the business.

Why this matters: *Without reasonable restraints, shareholders can use their inside knowledge to compete against the business they partially own, damaging company value and relationships with remaining shareholders.*

QUESTION 7

What happens if a shareholder dies, becomes incapacitated, or goes through divorce?

Life events create ownership complications that most shareholders don't consider when forming the business. Death, incapacity, bankruptcy, or divorce can all trigger forced ownership changes or bring new people into the shareholder group.

Does your agreement address what happens to shares when a shareholder dies? Can remaining shareholders purchase the shares from the estate? Must they? What valuation applies, and what payment terms? Insurance funding for these buyouts can make them practical rather than theoretical.

Incapacity provisions address what happens if a shareholder can't participate in the business due to illness or injury. Can their shares be purchased? Who makes decisions about their shareholding during incapacity?

Divorce often requires selling or dividing assets including business interests. Without clear provisions, a shareholder's ex-spouse might become a co-owner - creating complications most shareholders would prefer to avoid.

Why this matters: Life events happen regardless of business planning. Clear mechanisms for handling these situations protect both the affected shareholder's interests and the business continuity for remaining owners.

IMPORTANT NOTE

These questions highlight key considerations that shareholders agreements should address. Every business situation has unique elements requiring professional legal guidance to structure provisions that protect your specific circumstances and objectives.

READY TO FINALISE YOUR SHAREHOLDERS AGREEMENT?

These questions help you identify what your shareholders agreement needs to address. But answering them effectively requires understanding both the legal frameworks and the commercial realities of your specific business situation.

I work with business owners and co-founders to structure shareholders agreements that protect the business while supporting long-term success. We can discuss how these considerations apply to your circumstances and ensure your agreement addresses the provisions that matter for your situation.

Ready to discuss your shareholders agreement with expert guidance? Contact Jackie Atchison at LexAlia Property & Commercial Law to explore how your specific situation can be handled effectively.

LexAlia Property & Commercial Law | Northern Beaches, Sydney

Email: hello@lexalia.au | Web: lexalia.au

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