IBA Guide on Shareholders' Agreements

New Zealand

Minter Ellison Rudd Watts

1. Are shareholders' agreements frequently used in New Zealand?

Shareholders' agreements are frequently used in New Zealand particularly in closely held companies and joint ventures.

2. What formalities must shareholders' agreements comply with in New Zealand?

New Zealand law does not establish formal requirements for shareholders' agreements beyond the general law applying to contracts.

3. Can shareholders' agreements be brought to bear against third parties such as purchasers of shares or successors?

Generally, shareholders' agreements are only binding upon their signatories. The law does not permit enforceability of a shareholders' agreement by third parties unless the shareholders' agreement confirms specific rights on that particular third party.

4. Can a shareholders' agreement regulate non-company contents?

The law does not prevent shareholders' agreements from regulating non-company matters, in addition to customary corporate issues.

5. Are there limits on the term of shareholders' agreements under the law of New Zealand?

There are no limits as to the term of shareholders' agreements.

6. Are shareholders' agreements relating to actions by directors valid in New Zealand?

New Zealand law places corporate management in the hands of the board of directors. Directors have a duty to act in good faith and in the best interests of the company and must exercise the care, diligence, and skill of a reasonable director. The directors duties are imposed by the Companies Act 1993 ('Companies Act') and cannot be limited by the provisions of a shareholders' agreement. While a shareholders' agreement which prescribes directors' actions will not be invalid, those actions must be consistent with the directors' statutory duties and a director will not comply with those duties simply by acting in accordance with the shareholder's agreement.

7. Does the law of New Zealand permit restrictions on transfer of shares?

Unless stated otherwise in a company's constitution, shares are transferable. However, the Companies Act allows restrictions on the transfer of shares as long as that restriction is contained in the company's constitution. Shareholders' agreements can and often do establish mechanisms to permit the transfer of shares only under certain conditions. Shares transferred in breach of a shareholders' agreement are likely to give rise to an action between shareholders but will not be a breach of the Companies Act or necessarily invalid against the purchaser.

8. What mechanisms does the law of New Zealand permit for regulating share transfers?

Restrictions on the transferability of shares must be clear and unambiguous. There are very few legal restrictions on the types of mechanisms which can be used to regulate share transfers. The most usual mechanisms are:

(a) ***Pre-emptive rights (right of first refusal)***. This is an agreement whereby the shareholder wishing to sell to a third party must first offer the shares to the holder of the pre-emptive right (usually according to a pre-agreed price or formula for calculating price). If the holders of the right do not buy the shares, the shareholder normally can freely sell to a third party. This is the basic structure, but its regulation and mechanisms can be diverse and highly complex. Usually included in a company's constitution so may not be repeated in shareholder agreement.

(b) ***Buy /sell arrangements***. These provisions require other shareholders to purchase the shares of a selling shareholder on the occurrence of certain events (for example death or permanent disability). A variant of this right is to include drag along/tag along rights, under which a shareholder may be required to sell or may require a seller to include their shares in a sale to the third party. There are many possible buy/sell mechanisms available. Some examples include:

- the party offering to buy or sell names a price, and the other party either agrees to sell or buy at the specified price;
- the party offering to buy names a price, and the other party must either accept or make a counter-offer to buy the initiating party's shares at a higher price; or
- a share valuation is established by a neutral appraiser. The party who did not initiate the process has the choice of either selling or buying the initiating party's shares at the appraised value.

(c) ***Put and call options***. A put option allows a shareholder to require another shareholder or the company to purchase his/her shares at a certain price, or a price fixed by a formula, at or after a specified date or event (eg, death of a shareholder, divorce, or failure of the company to achieve specified financial targets). A put option is commonly used by minority shareholders to ensure they have a means of disposing of their shareholding at some time in the future. This gives minority shareholders a level of certainty over their investment. A call option allows a shareholder to require another shareholder to sell their shares to the holder of the option at a predetermined price, or a price calculated in accordance with a predetermined formula, at or after a specified date or event. This is a variation of the right of first refusal in which a fixed price is agreed to from the outset. Options can be a way of resolving deadlock.

(d) ***Drag along and tag along rights***. Tag along rights prevent a shareholder from selling his/her shares to a third party unless the third party also offers to buy the shares held by the remaining shareholders on the same terms. Typically, this right is extended by a controlling shareholder to minority shareholders, thereby permitting them to share in any premium being paid by the third party for buyer control or prevent the introduction of an undesirable shareholder. Drag along rights entitle a shareholder (usually the controlling shareholder) wishing to sell his/her shares to a third party to require certain other shareholders to sell their shares to the third party on the same terms. This enables a shareholder to sell control of a company when he or she does not actually own a controlling interest.

9. In New Zealand do by-laws tend to be tailor-drafted, or do they tend to use standard formats?

In New Zealand all companies are regulated by the Companies Act. A company can also have a 'constitution' which provides rules by which the company will operate and be governed. A company does not have to have a constitution and if it does not certain default provisions in the Companies Act will govern the actions of the company. However, it is common for companies to have a constitution because the provisions of the Companies Act can only be modified by a constitution. Generally, the constitutions of New Zealand companies will follow a standard format, and will commonly include clauses addressing restrictions on the transferability of shares, special voting majorities, voting rights and classes of shares. However each constitution will differ according to the particular circumstance of the company. There are very few limits imposed by law and a constitution may contain any matter which does not conflict with the Companies Act.

10. What are the motives in New Zealand for executing shareholders' agreements?

Shareholders' agreements are more flexible documents than company constitutions and their contractual nature provides the opportunity to tailor terms in addition to the basic requirements of the Companies Act. Because a shareholders' agreement is not a public document, shareholders feel more comfortable in regulating conditions for their business that they do not want to be in the public domain. Unlike a company constitution, a shareholders' agreement can be entered into and binding prior to incorporation.

Shareholders' agreements are common in the context of closely held companies with a small number of shareholders (commonly between two and ten), where there is active participation by the shareholders in the management of the company and concern about the identity of the other shareholders. Shareholders' agreements are commonly used to protect minority shareholders. This is because shareholders' agreements cannot be amended without the consent of all parties unlike a constitution which can be amended by a special resolution (typically 75 per cent). Shareholders' agreements are also useful and to provide a degree of liquidity for the shares of a shareholder wishing to exit.

Shareholders' agreements are commonly entered into to provide (a) protection for minority shareholders to minimise the inequality of different shareholdings or protection for majority shareholders from the minority shareholders who have a full range of rights, (b) an agreement of the parties on how particular matters will be voted on in particular circumstances, (c) who the shareholders will be, both present and future, (d) what will happen when one party exits or wishes to exit, (e) what happens when a group of shareholders no longer want a particular person or entity to remain as a shareholder, (f) a means of dispute resolution.

11. What contents tend to be included in shareholders' agreements in New Zealand?

Many businesses use totally standard constitutions complemented by a shareholders' agreement that includes all the complex elements regulating their relationships (which are not required by the Companies Act to be included in the constitution). Others include certain basic rules in the constitution and leave the more specific conditions for a shareholders' agreement.

12. What determines the content included in shareholders' agreements in New Zealand?

Only a constitution can modify the application of the Companies Act in respect of certain matters. Therefore certain matters must be included in a constitution and may not be repeated in a shareholders' agreement. The main circumstances influencing the decision as to what to include in shareholders' agreements are whether given their complexity it would not make sense to include the matter in the constitution, the need for confidentiality and the need for flexibility.

13. What are the most common types of clauses in shareholders' agreements in New Zealand?

Shareholders' agreements commonly include clauses addressing all or some of the following:

(a) Formation and establishment of the company;

(b) Company business and objects including non-competition and restraint of trade;

(c) Appointment/removal of directors, voting and conduct of meetings;

(d) Management of the company including appointment and removal of the CEO;

(e) Special majority and unanimous voting requirements;

(f) Financing obligations and guarantees;

(g) Distribution policy;

(h) Transfer of shares including permitted and restricted transfers, pre-emptive rights, buybacks, options, tag along and drag along rights; and

(i) New parties and additional shareholders.

14. What mechanisms does the law of New Zealand permit to ensure participation of minorities on the board of directors and its control?

New Zealand law permits division of shares into different classes (which must be provided for in the constitution) and special shareholder voting majorities. A shareholder who votes against a special resolution can require the company to buy their shares. Similarly if a shareholder considers that the company is acting in a manner which is oppressive or unfairly prejudicial to that shareholder's interest the shareholder can apply to the courts for relief including having their shares bought or compensation. Shareholders may question, and pass a resolution relating to, the management of the company at a meeting of shareholders. Unless provided by the constitution, such a resolution is not binding on the board. Typically minority shareholders will require the ability to appoint a director in a shareholders' agreement but this is not a legal requirement.

15. Is it possible in New Zealand to ensure minority shareholder control by means of a shareholders' agreement?

Yes. The division of shares into classes can make it possible to maintain control without the need to hold a majority of shares. Equity and control can be split by having voting (and typically non-dividend bearing) shares and non-voting (typically dividend bearing) shares. In this way the shareholder having a majority of the voting shares can maintain control over the board of directors without necessarily holding a majority of the company's capital.

16. What are the usual valuation mechanisms in connection with rights of first refusal or share transfer regulations?

The most common mechanisms for valuing companies are a third party offer price, versions of the book value, value based on a multiple of EBITDA or EBIT, expert assessment with or without predefined methodological criteria, and advanced fixed price.

17. Is it admissible for a shareholders' agreement clause to refer dispute resolution to the courts other than those of New Zealand and/or under a law other than that of New Zealand?

Yes. It is possible for parties to a contract (such as a shareholders' agreement) to agree that the contract will be governed by the law of a particular country, including the arbitration clause. However, commentary suggests that the courts will not permit New Zealand law to be avoided by the choice of a different system of law where the contract has no foreign element at all.

18. Is it admissible for a shareholders' agreement to include an arbitration clause with seat outside New Zealand and/or under a law other than that of New Zealand?

Yes. See paragraph 17 above.