CLIFFORD CHANCE

SHAREHOLDERS' AGREEMENTS

WESLEY TAN & CHRISTIE LONG

12 SEPTEMBER 2023

TYPICAL CONSIDERATIONS

Governance/ Minority Protection

- Rights to appoint directors/commissioners/observers
- Typical veto rights over reserved matters
- Class of shares
- Information/audit rights
- Deadlock

Financials/Funding

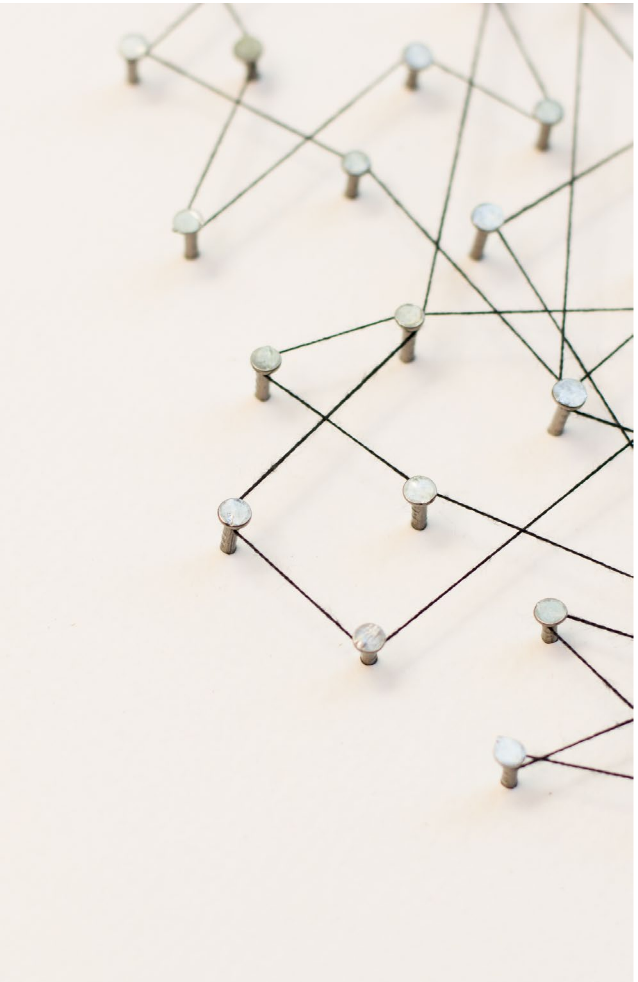
- Debt vs equity funding
- Anti-dilution
- Dividend policy

Termination/Exit

- Transfer of shares/interest
- Termination events
- Options upon termination/exit

GOVERNANCE/MINORITY PROTECTIONS

MINORITY PROTECTIONS
CONTROL RIGHTS



Avenues for control

- Board nominee/observer rights
- Board quorum and voting rights
- Shareholder quorum and voting rights
- Veto special approval rights
- Class rights
- Prohibitions on voting

MINORITY PROTECTIONS
CONTROL RIGHTS – BOARD

Avenues for control

- Board nominee/ observer rights
- Board quorum and voting rights
- Shareholder quorum and voting rights
- Veto special approval rights
- Class rights
- Prohibitions on voting

- Appointment of directors (pegged to shareholding?)
- Appointment of chairman (with casting vote?)
- Observer rights
- Rights may apply at both the board level, at sub-committees and boards of subsidiaries
- Key management positions

MINORITY PROTECTIONS
CONTROL RIGHTS – BOARD

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- **Board meetings**
  - Reasonable notice of board meetings
  - Receipt of board papers
  - Right to be included in the quorum
  - Approval required for certain reserved matters
- **Shareholder meetings**
  - Considerations similar to those for board meetings

MINORITY PROTECTIONS

CONTROL RIGHTS – VETO RIGHTS

Avenues for control

- Board nominee/ observer rights
- Board quorum and voting rights
- Shareholder quorum and voting rights
- Veto special approval rights
- Class rights
- Prohibitions on voting

- Reserved matters
  - Key matters of the business over which shareholders have veto rights
  - Protections for minority investor and operational controls for majority investor.
- Shareholder level or board level
- Varying voting thresholds
  - Simple majority
  - Super majority (for shareholders)
  - Simple/super majority provided it includes specific directors/shareholders
  - Unanimity

MINORITY PROTECTIONS
CONTROL RIGHTS – VETO RIGHTS

Typical veto rights

- Significant changes in the nature of the business/opening of new lines of business/entering new markets.
- Issues of shares including grant of share options (carve out for pro rata issuance).
- Amendments of constitutional documents/changes to the rights/classes of shares.
- Acquisition/sale of major assets/IPOs/JVs.
- Appointment and dismissal of key personnel and directors (and changes to remuneration).
- Appointment/change of auditors/key advisers.
- Liquidation/winding-up.
- Budget/business plan/key group policies.
- Capital expenditure or contractual commitments in excess of pre-agreed limits.
- Debt financing.
- Borrowing limits/giving of guarantees and security.
- Material dealings with intellectual property.
- Dividend policy.
- Management incentive plans.
- Commencing/settling material litigation.
- Contracts with related parties (possible carve out for arms' length and ordinary course transactions).

MINORITY PROTECTIONS
CONTROL RIGHTS – CLASS RIGHTS

Avenues for control

- Board nominee/ observer rights
- Board quorum and voting rights
- Shareholder quorum and voting rights
- Veto special approval rights
- Class rights
- Prohibitions on voting

- Voting/non-voting shares
- Special voting rights
- Special rights to income and distribution (on winding up or otherwise)

MINORITY PROTECTIONS
CONTROL RIGHTS – BOARD

Avenues for control

- Board nominee/ observer rights
- Board quorum and voting rights
- Shareholder quorum and voting rights
- Veto special approval rights
- Class rights
- Prohibitions on voting

- Conflict situations
- Exercising rights against a majority shareholder
- Remedies for conflicts
  - Suspension of voting rights
  - Removal from meetings (or part)
  - Internal information barriers
  - Quorum requirement suspension

GOVERNANCE
INFORMATION / ACCESS RIGHTS

- Financial information
- Board packs
- Compliance/ regulatory requirements
- Information from board appointee/observer
- Material developments
- Right to conduct audit?
- Access to records/ premises?
- Access to management /employees?

GOVERNANCE/MINORITY PROTECTIONS

OTHER RIGHTS

Placing secondees at the target's operations

Upfront agreement on key matters

- Definition of scope of business
- First business plan/budget or ongoing approval and oversight of business plans/budgets (consider "fall back")
- Dividend policy

Non-compete

GOVERNANCE/MINORITY PROTECTIONS

DEADLOCK

No fault – stalemate or disagreement, e.g.:

- Repeated failure to agree on a shareholder/board reserved matter
- Inability to hold board/shareholder meetings due to lack of quorum

Resolution mechanisms

- Escalation to senior management/CEO
- Buy/sell process – "Russian roulette" or "Texas shoot out"
- Winding up
- Independent expert/arbitrator
- Status quo

Mitigants

- Consider if inclusion of 'materiality' thresholds is appropriate
- Include language to fallback on e.g. last year's business plan (if cannot agree on business plan) and operate in ordinary course

FINANCING/FUNDING

FINANCING/FUNDING

Priority of fund raising

Typical: 〉 Internal cash reserves | Third party financing | Shareholders equity

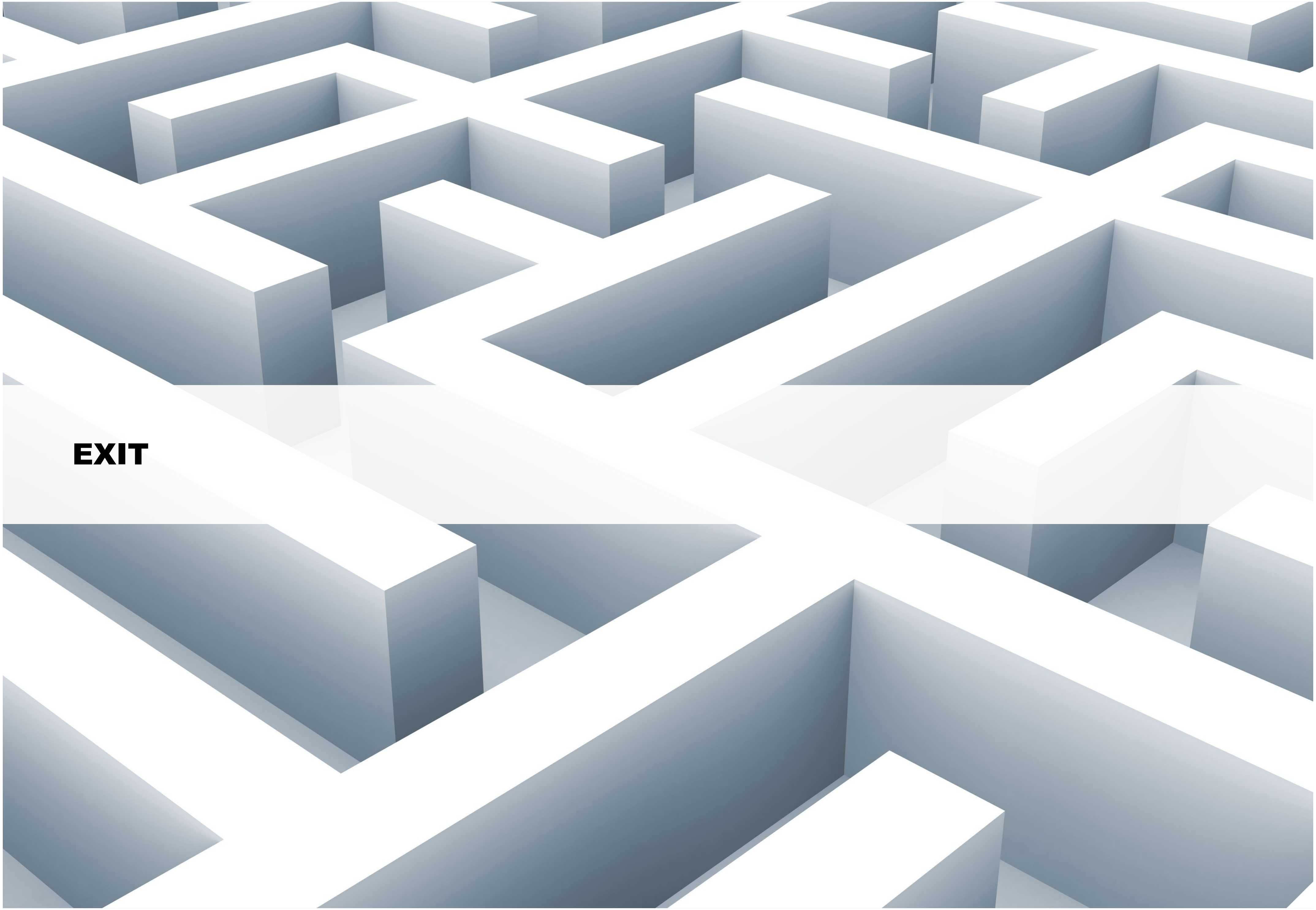
Third party injections

- Subject to agreement of partners
- Restrictions (issuances to competitors?)
- New shareholder to become a party to existing shareholders' agreement – does this work in practice?
- Anti-dilution triggered in the event of a down-round

Anti-dilution

- Rights on issuance of equity and equity-linked instruments
- Consent right or 'put up' (inject capital) or 'shut up' (and get diluted)
- Practical considerations – balance of power may rest with partner who has deepest pockets

EXIT



EXIT

RESTRICTIONS ON TRANSFER

Which transfers are restricted?

- Transfer of an interest (direct/indirect) in shares
- Encumbrances (i.e., pledges, charges, options) over shares
- Change of control of shareholders
- "Blacklist"
- Partial sales

Which transfers are permitted?

- With consent of other shareholders
- Internal restructuring – to "Affiliates"

Restrictions

- Lock-ups
  - On a JV partner or on founders of a portfolio company
  - What is a reasonable lock-up period?
  - Mutual lock-up?
- ROFO / ROFR
- Tag / drag

EXIT

ROFO/ROFR

	Right of First Offer (ROFO)	Right of First Refusal (ROFR)
Offer	Made by non-selling shareholders	Made by selling shareholder
Process	● Selling shareholder informs the other shareholders that it wishes to sell ● Other shareholders may make an offer to acquire the selling shareholder's shares specifying price and key terms ● Selling shareholder may accept offer or sell to a third party at the same/higher price and on no more favourable terms within a defined period	● Selling shareholder offers its shares to non-selling shareholders specifying price and terms, after having identified a third party buyer and negotiated all terms of sale ● If offer not accepted, selling shareholder can sell to a third party at the same/higher price and on no more favourable terms within defined period.
Pricing	Non-selling shareholder sets price	Selling shareholder sets price
Others	● Much easier for selling shareholder ● Encourages non-selling shareholders to make a credible offer ● Preferred by financial investors	● Potential third party buyers may be deterred ● Better for the remaining shareholder

EXIT

ROFO – EXAMPLE CHRONOLOGY

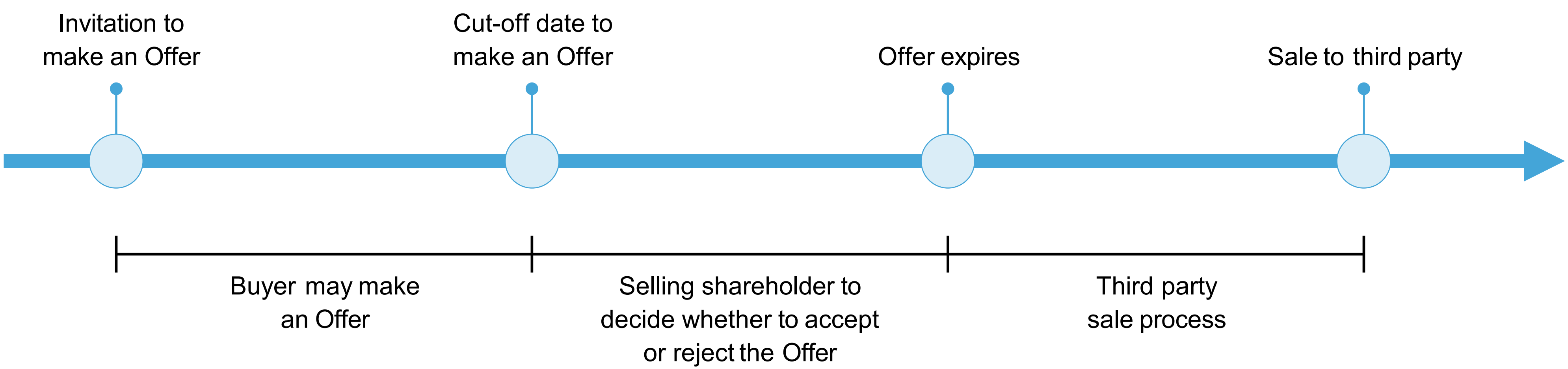
Notice from selling shareholder to non-selling shareholders that have ROFO rights (each a "**Buyer**"):

- stating the number and type of securities to be transferred
- inviting each Buyer to make an offer to buy the securities.

Prior to a set date, the Buyers may make an offer to acquire (some or all of) the securities and specifying price and material terms of the offer (an "**Offer**"). If a Buyer does not make an offer it is deemed to have waived their right to make an Offer

If a Buyer offers to buy all the securities, and not only their equity proportion (although some ROFOs only allow a Buyer to offer to buy all the securities), they typically have to buy the additional securities if other Buyers don't make an Offer

An Offer remains open for a certain period, within which the selling shareholder must decide whether to accept the Offer or to reject it and sell to a third party at the same or higher price and on terms no more favourable to the third party



EXIT

ROFR – EXAMPLE CHRONOLOGY

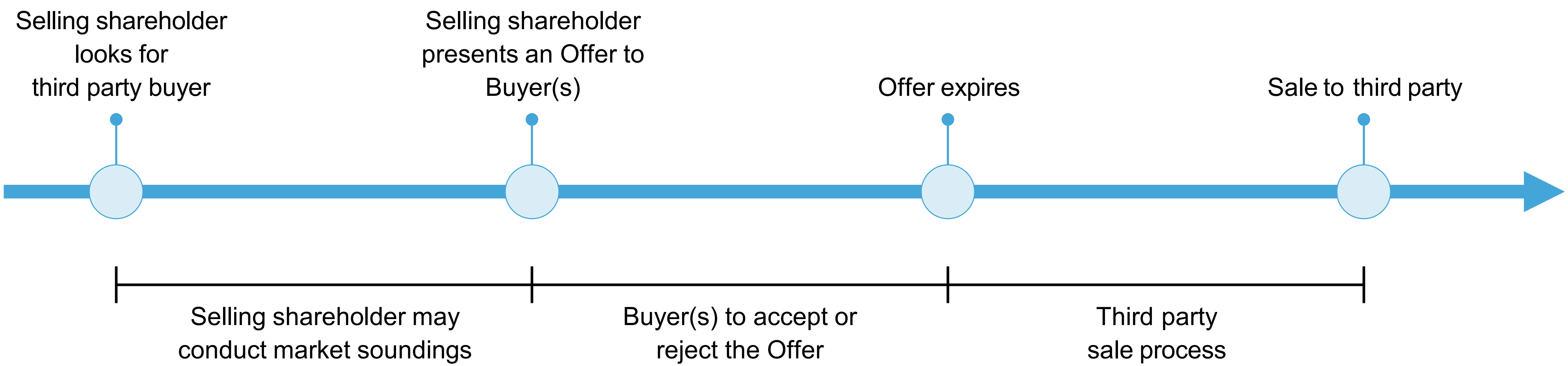
Notice from selling shareholder to other shareholders that have ROFR rights (each a "**Buyer**"), presenting an offer (the "**Offer**") with:

- the number and type of securities to be transferred
- the price and material terms of the transfer

Prior to a set date, notice from each Buyer is given, accepting or declining the Offer. If such notice is not provided, the Buyer is deemed to have declined the Offer. Sometimes called 'kill or fill'

If a Buyer agrees to buy all the securities, and not only their equity proportion (although some ROFRs only allow a Buyer to agree to buy all the securities), they may have to buy the additional securities if other Buyers decline the Offer

If the Buyer declines the Offer or is deemed to have declined the offer, the selling shareholder can sell to a third party at the same or higher price and on terms no more favourable to the third party



EXIT
TAG/DRAG

Tag right

- Valuable “exit option” for a minority shareholder
- Triggered upon any sale – on a pro rata or full basis?
- Tagging seller receives same price/terms as selling shareholder
- Should tag election increase the amount of shares the third party buys or decrease the number of shares sole by the selling shareholder?
- May not be appropriate in 50:50 joint ventures

Drag right

- Valuable right for majority shareholder to deliver 100% stake or a control stake
- Triggered upon sale of all shares or sale of “control” (including indirect)?
- “All or nothing” or proportionate drag?
- Minority may seek protection by agreeing a minimum return below which the drag along cannot be exercised.
- Drag terms/price same as dragging shareholder’s
- May not be appropriate in 50:50 joint ventures

EXIT
TERMINATION

Termination events

- Non-fault situations
  - Termination for convenience
  - On expiry of “fixed term” joint venture or planned exit
  - Deadlock
- Fault situations
  - Material breach of SHA
  - Insolvency
  - Change of control

Options upon termination

- One partner buys the other partner out (default put/call option)
- Third party buys out one party
- Sale of joint venture to third parties
- Winding up of the joint venture (liquidation)

Default put option/call option

- Often seen in fault-based termination events
- Non-defaulter elects to buy or sell
- Price
  - Fair market value (FMV) at time of sale or pre-determined price?
  - Often at a premium/discount to FMV to recognise the impact of the default
- Practical risks, particularly for put options

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QUESTIONS

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