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Appendix 1 - Service agreement checklist

A - Introduction

This checklist is designed to highlight a range of issues which can be covered in a shareholders agreement, a company's articles of association and directors service agreements.

A shareholders agreement will regulate the relationship between shareholders in connection with the company's affairs. The articles of association is the constitutional document of a company, it is a contract between the shareholders and the company and is open to public inspection at Companies House (whilst a shareholders agreement is a private document). The articles of association should be designed to compliment and not conflict with the shareholders agreement.

A service agreement is a contract of employment between the Company and a director.

Please note that not all the issues referred to below will be relevant in all circumstances. The principle aim of this checklist is to help identify issues before commencing the drafting of legal documentation, in order that any arrangements adopted will be specifically tailored to suit individual circumstances.

B - Shares, shareholders and transfer of shares

B1. In what proportions will the shareholders hold shares?

B2. Will there be different classes of shares with different rights or will they all be ordinary shares?

B3. When the company issues new shares, does it have to offer them in the first instance to existing shareholders in the proportion they already hold shares?

B4. Will the directors be given discretion to block the transfer of shares always or just in relation to certain circumstances? For example, is there a right to block a transfer only when shares are not fully paid up or even when fully paid up?

B5. Will transfers be permitted between existing shareholders or to family members or to family trusts or to associated companies? *Please note there may be tax advantages in allowing transfers in these circumstances, particularly for example, when the transferee is a lower rate tax payer.*

B6. Where shares are proposed to be transferred, will they have to be offered in the first instance to existing shareholders in the proportions they already hold shares?

B7. Prohibition for a period of time for the transfer of shares? Do you want to give the directors the right to suspend registration of transfers for a specified period during each year?

B8. Will there be a prohibition on shareholders creating a charge over shares?

C - Directors

C1. In order for an individual or a company to be a director will that person have to meet certain requirements? For example, do you have to have a shareholding to qualify? If so, what amount?

C2. Entitlement to appoint a new director? For example, will each shareholder have the right to appoint new directors according to their shareholding percentage or by general meeting?

C3. Do you wish to impose a maximum number of directors?

D - Directors meetings

D1. What will be the minimum number of directors required in order for a directors meeting (and an adjourned directors meeting) to validly transact business?

D2. How often should directors meetings take place? At least every 3 months?

D3. In circumstances when there is an equality of votes at directors meetings should the chairman be granted a casting vote?

E - Service agreements for directors

E1. Will service agreements be required for the directors? These are recommended in order to regulate the relationship between the Company and each director. See appendix 1 for further information.

F - Shareholders meetings

F1. What will be the minimum number of shareholders required in order for a shareholders meeting (or an adjourned shareholders meeting) to validly transact business?

F2. In circumstances where there is an equality of votes at shareholders meetings should the chairman be granted a casting vote?

G - Shareholders policies

G1. Any policies required in relation to:

- approval of business plans
- dividends
- working capital, long term finance and loan capital
- shareholders guarantees of borrowings.

H - Shareholders consent

H1. Circumstances and situations where consent of all or majority of shareholders required or only one?:

- H1.1 issue of new shares;
- H1.2 introduction of new shareholders;
- H1.3 alterations to share capital;
- H1.4 purchase of company's own shares;
- H1.5 financial assistance for purchase of shares;
- H1.6 change in the nature of the company's business or commencement of a new business by the company;
- H1.7 expansion into a new geographical area;
- H1.8 signing of major contracts;
- H1.9 substantial sale of assets or disposal of business by the company;
- H1.10 amalgamation or merger;
- H1.11 formation, acquisition and disposal of subsidiaries;
- H1.12 charging assets of the company;
- H1.13 borrowings in excess of limit;
- H1.14 capital expenditure in excess of limit;
- H1.15 lending or giving security or financial accommodation;
- H1.16 appointment and dismissal of directors/employees/agents;
- H1.17 directors and other employees remuneration;
- H1.18 acquisition and/or disposal of property;
- H1.19 factoring and/or assignment of debts;
- H1.20 alterations to memorandum and articles;
- H1.21 alterations to company's status as private company;
- H1.22 winding up;
- H1.23 distributions by the company;
- H1.24 change of accounting reference date and/or auditors;
- H1.25 dealings in intellectual property;
- H1.26 acquisition of shares or debentures or participation in any partnership or joint venture by the company;
- H1.27 legal action (except trade debt recovery) in the name of the company;
- H1.28 unusual or long term transactions;
- H1.29 alteration to bank mandate;
- H1.30 transactions with connected persons;
- H1.31 charitable or political donations;
- H1.32 other

I - Non-competition

I1. Non-competition covenants given by shareholders not to compete against the company for a specified period after ceasing to be a shareholder? *Please note, for non-competition covenants to be enforceable they must protect legitimate business interests only, they must also be limited in geographical scope, duration and be confined to the nature of the business in question.*

J - Confidentiality

J1. Confidentiality clauses given by shareholders effective during and after ceasing to be a shareholder?

K - Obligations for shareholders

K1. Positive covenants given by the shareholders in relation to the following:

- K1.1 time to be devoted to the business;
- K1.2 duty to maintain their respective insurance policies;
- K1.3 duty to notify litigation plus other major occurrences to the other shareholders;
- K1.4 duty to maintain control of the company's assets;
- K1.5 right to management information and inspect books of the company at its premises.

L - Breach of Shareholders Agreement

L1. A shareholder can be forced to transfer his or her shares (exit generally) in circumstances of, for example, fraud/dishonesty or for material breach of the shareholders agreement or physical incapacity or bankruptcy or in circumstances where a shareholder ceases to be a director/employee ("Relevant Event")

L2. Consequences of death or Relevant Event?:

- L2.1 the departing shareholder ceases to be a director of the Company;
- L2.2 the departing shareholder offers all his or her shares to the remaining shareholders;
- L2.3 if the remaining shareholders do not take up this offer then the departing shareholder is free to transfer to any third party, alternatively consider liquidation of the Company; or
- L2.4 other

M - Death

M1. On the death of a shareholder the deceased's shares can be dealt with in the same way as a departing shareholder's would be (see paragraph L above).

M2. Alternatively, the personal representatives of a deceased shareholder have an option to demand to be bought out

or the remaining shareholders have an option to demand to buy out the deceased shareholder. This arrangement is commonly referred to as "cross options". This has the advantage of enabling either party in the scenario the ability to take the initiative (and create a legally binding obligation to buy or sell as the case maybe) if he or she chooses to do so, which can be particularly useful to the personal representatives of a deceased shareholder. No such legally binding obligation is created under paragraph M1 where only an offer is made to the remaining shareholders. *Please note, if cross options are to be adopted a separate cross option agreement will need to be prepared and life insurance arrangements put in place (see paragraph Q).*

N - Good/bad leaver

N1. Provision can be made in the documentation so that the departing shareholder's shares are valued on a different basis if he were a 'bad leaver', but this would not apply if he were a 'good leaver'.

For example, a bad leaver could be defined as a shareholder/director who has materially breached the terms of the shareholders agreement or his service contract. A bad leaver's shares could be valued at 50% of their value (as determined pursuant to any arrangement adopted under paragraph O below) or at nominal value. Please note good/bad leaver clauses tend to be controversial. Any provision of this nature will need to be discussed in detail.

O - Valuation of shares

O1. Basis for valuation of shares on departure of a shareholder either:

- O1.1 pro rata (according to the percentage shareholding in the company and the value of the company); or
- O1.2 minority (the shares are discounted to reflect they are a minority holding);

O2. Are there any specific accounting principles which should be applied?

O3. Should the company be valued on an asset basis (i.e. its current assets less its current liabilities) or on an earnings basis (usually a multiple on profits).

O4. Should the future potential of the company be valued? How? (N.B If the company is to be valued at 'fair market value' future prospects would usually be taken into account).

P - Payment for shares

P1. Where a shareholder sells his or her shares to the other shareholder(s) should the purchasing shareholder(s) be granted a period of time to pay (i.e. immediate lump sum, instalments or deferred)?

Q - Life and/or critical illness insurance

Q1. Life and/or critical illness insurance to support cross options (see paragraph M2). This involves taking out insurance over each of the shareholders so that the on the death and/or critical illness of one of the shareholders, the other receives enough money from the policy to buy the deceased or critically ill shareholder's shares.

Q2. Will keyman insurance policies be required? This type of policy is usually aimed at compensating the company for the loss of key personnel.

R - Deadlock

Deadlock provisions are usually only applicable for joint venture arrangements and/or where the company is owned on a 50/50 basis (or similar) and are used as a means to resolve fundamental disagreements (particularly in relation to the future strategy of the company) between the shareholders.

R1. Arrangements in the event of a deadlock:

- R1.1 cooling off period (a few weeks/months in which nothing can happen);
- R1.2 trigger (a specific time deadline whereby the deadlock provisions come into play) then one of the following alternatives:
 - R1.2.1 arbitration (alternative to court resolution);
 - R1.2.2 put/call options over shares (one shareholder demanding to be bought out or demanding to buy out the other shareholder);
 - R1.2.3 competitive bids for shares;
 - R1.2.4 liquidation;
 - R1.2.5 other

S - Sale of a company/business or a listing

S1. Provision can be made in the legal documentation to regulate the circumstances when a controlling interest in the company's shares is proposed to be sold to a third party and/or when the company proposes to sell a substantial part of its business to a third party and/or where the company proposes to be admitted for listing on a recognised investment exchange (e.g. AIM or London Stock Exchange).

For example 'drag along' rights could enable shareholders with a controlling interest in the company the ability to force minority shareholders to join into a sale. Similarly 'tag along' rights would enable shareholders to join with other shareholders who intend to sell to a third party.

T - Costs

T1. Who pays the company's costs and/or each shareholder's costs? The company or the relevant shareholder?

1. Will private health insurance, death in service benefits, permanent health insurance etc be provided?
2. Please provide details of any bonus/commission structure applicable?

APPENDIX 1

Please provide the details identified below:

1. Date of commencement of employment
2. Date of commencement of continuous employment (if different)
3. Job title
4. Is a separate job description provided?
5. Normal hours of work
6. Do normal hours of work include such additional time as required to fulfil duties at no extra payment?
7. Is overtime compulsory/voluntary/not required?
8. Rate of pay (hourly, annual salary etc)
9. When is pay reviewed?
10. Overtime rate(s) if applicable. How many hours have to be worked per day/week before overtime rates apply?
11. Holiday entitlement (including reference to bank holidays)
12. When does the holiday year begin and end?
13. Sickness or injury provisions. Is any payment made over and above statutory sick pay and if so, how much and for how long?
14. Is there a pension scheme or only a stakeholder pension? If so, is it a contributory or non-contributory scheme?
15. Is there a contracting-out certificate in force?
16. Are there any collective agreements in place? If so, give details of the parties to the agreement and provide a copy
17. What is the notice period for employer to employee to employer?
18. In relation to disciplinary rules and procedures, will there be any specific requirements out of the ordinary?
19. Grievance procedure, to whom is a grievance made?
20. Will employee be likely to make any inventions/copyright material in course of employment?
21. Will employee have dealings with customers/clients
22. Will post termination restrictions on employee be required to protect employer's business?
23. Will the employee have access to confidential information?
24. May the employee have a second job without consent of employer?
25. Will the employee be a director of the company?
26. Will a company car be provided, if so, fully expenses or with the employee paying private mileage?
27. Will private health insurance, death in service benefits, permanent health insurance etc be provided?
28. Please provide details of any bonus/commission structure applicable?



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