

Unitholder agreements



Embarking on a new business venture or enterprise can be an exciting time for business proprietors. Often during the formative stages of a new business the participants can be insulated by a “honeymoon period” in which participants fail to consider or are unable to foresee a possible breakdown in the business relationship. In such circumstances very little time and resources are allocated to considering potential issues which may arise between the participants or to ensuring that appropriate contingencies are put in place. Stakeholder agreements are without a doubt the most valuable tool and best mechanism by which this trap can be avoided yet they are all too often overlooked by parties embarking on new ventures with a “she’ll be right” approach. Unfortunately, for many of these participants the value and importance of a stakeholder agreement is not realised until circumstances are not as the parties had thought or intended and by this stage it is too late. In the absence of a stakeholder agreement the resulting disputes can be as messy, irrational and emotional as the worst marital breakdown and bring what would otherwise be a successful business to its knees. This article focuses on the role of stakeholder agreements in the context of unit trusts but many of the issues raised apply equally to other structures involving the participation of multiple stakeholders such as shareholders in a company or partners in a partnership.

Prior to discussing the role and importance of unitholder agreements to a unit trust structure it is important to be aware of the nature of the structure being utilised and the default position governing the relationships within that structure.

A unit trust structure incorporates a number of levels of control. Day to day control of the trust lies with the trustee but ultimate control lies with the unitholders as they have the power to remove and appoint the trustee. The trustee may consist of an individual/s or a corporate entity but irrespective of whether the trustee is a company or not, the rights and obligations of the trustee and unitholders are determined by the terms of the trust deed and the law of trusts, not by reference to company law principles. This means that company law principles such as oppression and fraud on the minority play no part in relation to unit trusts. So what level of protection is afforded to a unitholder under the terms of the trust deed and the law of trusts?

Obviously the terms of the trust deed itself need to be considered on a case by case basis but generally speaking a unit trust deed will not incorporate a dispute resolution procedure, will not address the issue of succession and will only make basic provision in relation to decision making and the transfer of units. Overriding the provisions of the trust deed are the basic principles of trust law. Trustees of trusts are subject to broad sweeping, general fiduciary obligations to the unitholders of a trust. These obligations require the trustee to promote the interests of unitholders generally as opposed to promoting the interests of any one unit holder individually and thus little protection or assistance is afforded to an aggrieved minority unitholder or disputing unitholders. The extent to which the terms of the trust deed and the law of trusts governs the rights, roles and responsibilities of the various participants in a unit trust structure is far from comprehensive.

In circumstances where aggrieved or

disputing parties seek to rely or are forced to rely solely on these avenues the process inevitably becomes drawn out, messy and results in the parties incurring excessive costs for what is often an unsatisfactory result for all concerned.

By underpinning the unit trust structure with an appropriately drafted unitholders agreement from the outset it is possible to comprehensively set out the rights, roles and responsibilities of the participants so that disputes and grievances are avoided, or alternatively if not avoided, dealt with in a timely and cost effective manner.

Unitholder agreements simply document the agreed terms upon which the relationship between the participating unitholders is to be governed. As such, there are no hard and fast rules as to what issues agreements of this nature must address. Identification of the issues which are relevant to any particular trust structure is an exercise which the participants themselves must undertake in conjunction with and under the guidance of their advisors. The success of this exercise and the subsequent utility of the end agreement will ultimately be determined by the ability of the parties to identify those issues which are fundamental to their participation in the venture. This requires the parties to think laterally and foresee issues which could arise both in the short term and long term life of the venture.

Following identification of the issues which need to be addressed the unitholders need to reach an agreed position in relation to the mechanism to be adopted to address each of these issues. Often this process may expose fundamental differences between the underlying intentions or

understandings of the parties which can be fatal to the venture. Some may argue that this is counterproductive in that what was an otherwise amicable and potentially fruitful relationship has now broken down on the basis of hypothetical issues which may have never arisen between the parties. However, where this occurs has not the objective of undertaking this process been achieved? If the process has exposed a potential underlying conflict of such magnitude that the parties no longer wish to proceed then I would think this is clear evidence in support of the value of undertaking this process. Surely it is far more desirable and cost effective to identify a potentially unworkable relationship prior to engagement than it is to try and untangle a broken down relationship at some point in the future - particularly where the relationship between the parties is not governed by a unitholder agreement.

The benefits to be derived from unitholder agreements are not constrained to avoiding and dealing with disputes and grievances. Unitholder agreements have the ability to address issues in relation to succession, business development and expansion and they can encapsulate and clarify the goals and objectives of the parties. They are not merely a "safety blanket" for the participants but rather can form a positive tool through which the resources of a venture can be focussed in pursuit of a common goal or objective. Whilst the potential negative consequences of failing to put in place a unitholder agreement are alone justification for their necessity the potential positive benefits which can be derived and achieved through the agreement development process and the agreement itself

are often over looked and under utilised.

The benefits obtained by regulating the roles and the relationships of the participants also flow through to new participants in the venture and greatly increase the marketability of interests to these prospective buyers. An interest in a venture is far more appealing to prospective investors when they know the terms upon which they can enter and exit the structure and when their rights, roles and responsibilities and the rights, roles and responsibilities of the other participants are clearly spelt out and locked in.

Although there are no hard and fast rules as to what issues must be addressed in a unitholder agreement there are obviously core issues which should be addressed. The following is a summary of key issues which participants should at the least turn their minds to when entering into a unitholders agreement or embarking on a new venture:

DECISION MAKING

Who will be responsible for making certain decisions and at what level i.e. at the unitholder level or the trustee level? Are certain important decisions to be subject to more onerous voting thresholds such as requiring unanimous agreement.

THE BUSINESS

Are limitations to be imposed in respect of the nature of the proposed business activities the trust is to undertake?

FINANCE / CAPITAL

How is the structure to undertake revenue raising? Can participants be called upon to contribute capital and if so on what terms and what are the consequences of failing to do so? Does capital raising require the

unanimous consent of all participants or a simple majority?

TRANSFER OF PARTICIPANT'S INTEREST

A mechanism needs to be developed by which a participant can sell its interest in the trust. Will this mechanism permit the transfer of units to unrelated third parties? How are the units to be valued? Do the continuing unitholders have a pre-emptive right to acquire the units being sold? How do new participants enter the structure? What happens if the other parties refuse to acquire the units of a party wishing to exit?

BREACH AND DEFAULT

The participants must consider what consequences are to flow from the failure of a participant to fulfil its obligations to the business or other participants.

DISPUTE RESOLUTION

The participants should agree upon a mandatory, binding mechanism for the resolution of disputes that will enable disputes to be resolved in a fast and cost effective manner without interfering with the conduct of the business.

Unitholder agreements are fundamental to any unit trust structure involving multiple unrelated participants. Parties who embark on a venture utilising a unit trust structure without putting in place a unitholders agreement do so at their own peril. •

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