Shareholders' Agreement

For companies with more than one shareholder, a shareholders' agreement is vital. Without a shareholders' agreement, the following are examples of scenarios that could potentially be disastrous for a private corporation:

A shareholders' agreement defines the duties and obligations of shareholders in a private corporation. This agreement should be thought of as a set of ground rules which govern shareholders' behavior.

- Deteriorating relationship between shareholders;
- Shareholders wishing to sell their shares to other parties without the knowledge or consent of the other shareholders;
- A shareholder suffering a life threatening illness or dying and how to deal with their interest along with managing business continuity; or
- A major disagreement on how the business is managed can disrupt the day-to-day business operations.

These scenarios illustrate the importance of establishing a set of ground rules to help deal with difficult and complex situations that may arise.

Although shareholders' agreements will vary based on the various complexities that each business faces, the following provisions are examples of what can be included in a typical shareholders' agreement:

Significant Decisions

This provision will stipulate that significant decisions require shareholders' approval. Significant decisions may include a major change in company direction, the sale of the company etc.

Future purchase/sale/transfer of shares

- This provision provides for the future sale of shares (i.e. consent of the shareholders/directors is required for future issue of shares). It might also restrict who can become a shareholder in the company.
- A "right of first refusal" provision stipulates that a shareholder wishing to sell their shares must first offer the shares to existing shareholders before selling them externally.

A "shotgun clause" is an escape mechanism that shareholders can use in the event they cannot resolve a serious dispute. In a "shotgun" arrangement one shareholder may offer to buy the shares of the other shareholder for a price (as determined by a pre-set formula or determined by an arm's length specialist). The shareholder receiving the offer may either sell their shares at that price, or buy the offering shareholder's shares at that same price. This process aims to protect both parties and encourages the shareholders to determine a fair price.

The agreement may also include the rules regarding the transfer of shares which may be triggered by the following events:

- death of a shareholder;
- marriage breakdown of a shareholder;
- bankruptcy/insolvency of a shareholder;
- disability of a shareholder; and
- retirement of a shareholder.

Finally, shareholders' agreements often address the following:

- how shareholder/employee are to be compensated;
- how disputes are to be resolved (i.e. arbitration, mediation);
- how the business is to be valued; and
- how a buyout is to be implemented.

Although a shareholders' agreement is a voluntary agreement, it is an essential tool in laying ground rules for matters of significant impact to corporations. Please note that this article deals strictly with privately held corporations. Public companies are regulated by the various securities regulations.

You should always consult a professional advisor before implementing a shareholder agreement.

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