Little Black Book of

SHAREHOLDER AGREEMENTS

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Note *From The Author*

Running a business is like building a home; you'll want to start with a solid foundation. Shareholder Agreements are just that - a solid foundation built in the form of a contract among all the shareholders of a business. I commonly receive inquiries from business owners who disagree with their business partners on each others' rights and obligations in the company. I understand how challenging it can be to run a business, so it is my hope that this "Little Black Book of Shareholder Agreements" can help lay the foundation for business owners to avoid expensive litigation with their business partners.

"An ounce of prevention is worth a pound of cure."

--- Benjamin Franklin

Question:
What is a “Shareholders’ Agreement”?

Answer:
A Shareholders’ Agreement is a custom-tailored contract among the shareholders of a company. The contract addresses matters such as the rights and obligations of each shareholder when it comes to the management of the company, the process for dispute resolution, sale/transfer of shares, valuation of shares, etc.

Question:
Is having a Shareholders’ Agreement a legal requirement for Ontario/Canadian companies?

Answer:
No. Shareholders’ Agreements are not a legal requirement for Ontario/Canadian companies. However, if a company issues voting shares to a new shareholder, all shareholders should consider preparing a Shareholders’ Agreement in advance before those shares are issued.

Definition: *“shares” refer to the ownership a shareholder has in a company. For example, if two shareholders own an equal amount of shares, and those shares are all the issued shares of the company, those shareholders own 100% of the company.*

Question:
What are the types of Shareholder Agreements?

Answer:
There are two types of Shareholder Agreements:

1. General Shareholders' Agreement; and
2. Unanimous Shareholders' Agreement

Unlike a General Shareholders' Agreement, a Unanimous Shareholders' Agreement transfers all or most of the authority from directors of the company to the shareholders of the company.

Question:
If a company has one shareholder, will that shareholder need a Shareholders' Agreement?

Answer:
No. However, if the company wishes to issue shares to a new shareholder, those shareholders should consider preparing a Shareholders' Agreement.

Question:
What happens if two or more shareholders don't have a Shareholders' Agreement?

Answer:
Those shareholders can continue to run the company, but they are at risk of running into uncertainty. For example, if one shareholder dies, who gets the deceased shareholder's shares - That deceased shareholder's spouse, or the other shareholders? Similarly, what happens if one shareholder gets divorced - Will the former spouse of that shareholder become the new shareholder of the company? Without a carefully-drafted Shareholders' Agreement to address those situations, the shareholders can find themselves dealing with unintended consequences.

Question:
If a company already has articles and by-laws, do the company's shareholders need a Shareholders' Agreement?

Answer:
A company's articles set out the rights and restrictions attached to each class of shares. The by-laws of a company typically address the rights and obligations of the company's directors and officers. The articles and by-laws may be silent on the management issues and shareholder issues that may arise when running the company.

Question:
What are some management-related issues that are addressed in a Shareholders' Agreement?

Answer:
Issues related to the management of a company can include filling vacancies on the board of directors; financing of the company; the declaration of dividends; hiring or firing key employees; and the meetings of directors

Question:
What are some shareholder-related disagreements that are addressed in a Shareholders' Agreement?

Answer:
Issues related to the shareholders of a company can include voting on dissolution of the company; the rights of shareholders in the sale or transfer of their shares; corporate-owned life insurance on the life of the shareholders; and the voting rights of each shareholder.

***Definition:** "dissolution" refers to the ending of a company after it ceases to carry on its business. Voluntary dissolution happens when the voting shareholders of a company, or the company's incorporators (or their personal representatives), authorize the dissolution. Involuntary dissolution can be initiated by court order when a company is wound up.*

Question:
How can shareholders sell or transfer their shares using a Shareholders' Agreement?

Answer:
The following are a number of ways for shareholders to dispose of their shares using a Shareholders' Agreement. For example, if a shareholder intends to sell their shares to a third-party, the shareholders' agreement can require them to first offer those shares to the other shareholders in the company. Another example would be where the shareholders' agreement provides for a right to existing shareholders to have the first opportunity to purchase newly-issued shares in the company in order to avoid diluting their shares.

Question:
What if the shareholders of a company have a dispute among themselves and the articles and by-laws of the company are silent on the resolution?

Answer:
Each shareholder in the dispute should carefully consider their options, and be prepared to negotiate with one another. It can be difficult for shareholders to come to an agreement, especially where a Shareholders' Agreement doesn't exist. In some cases, each shareholder may retain legal counsel to aid in the negotiations, or engage in litigation.

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Jonathan regularly advises his Business Law clients as they jump-start their businesses, sell their existing businesses, and navigate through the complexities of business disputes and negotiations. His Business Law services include Provincial and Federal incorporation, corporate organization and reorganization, corporate restructuring, shareholder agreements, partnership agreements, franchise agreements, non-disclosure agreements, amalgamation, dissolution, and purchases and sales of a business.

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