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Why draw up a shareholders’ agreement?

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Shareholders’ agreements set out shareholders’ rights and obligations in various situations that may occur during a corporation’s existence. While it is true that corporate laws generally establish a common structure for all business corporations, they don’t do so in great detail. A shareholders’ agreement is thus an invaluable tool for preventing conflicts and settling those that do arise.

A shareholders’ agreement is essential to the proper functioning of a corporation and helps to solidify the commitment of its shareholders. A shareholders’ agreement also serves to:

1. Maintain proportional shareholding between shareholders;
2. Maintain the “private” nature of a corporation by preventing third parties from becoming shareholders without the consent of the parties;
3. Ensure a market for the shares;
4. Prevent a minority shareholder from being prejudiced by a majority shareholder’s decisions or actions;
5. Settle in advance certain potentially contentious issues in the administration of a corporation; and finally
6. Give the shareholders the power to decide on some of the corporation in question’s activities.

The main provisions of a shareholders’ agreement

The clauses that can be included in a shareholders’ agreement are many, and they make it possible to apprehend and prevent difficult situations. Here are some examples.

1. **Share transfers**

   Some clauses in shareholders’ agreements govern the transfer of shares, such as:

   Clauses imposing an obligation to sell or an option to purchase the shares of other shareholders in specific situations (disability, personal bankruptcy, retirement at a certain age, death, voluntary withdrawal from the corporation, misappropriation of corporate funds or breach of a non-competition or non-solicitation clause).
   A right of first refusal clause. This type of clause aims to oblige a selling shareholder to offer their shares to co-shareholders, in proportion to their shareholding, before the selling shareholder can sell them to a third party or another co-shareholder.
   A drag-along clause. This type of clause is required in agreements between a majority shareholder and one or more minority shareholders. By availing themselves of a drag-along clause, minority shareholders will be entitled to demand, as a condition of the majority shareholder's right to sell their shares to a third party, that the third party also purchase the minority shareholders’ shares on the same terms as those offered for the majority shareholder's shares.

A shotgun clause. This type of clause allows any shareholder to initiate a process to purchase a co-shareholder's interest, whereby the co-shareholder must either (i) accept the offeror's offer to purchase; or (ii) make a counter-offer to purchase on the same terms and conditions as those contained in the offeror's offer to purchase.

2. **Terms and conditions for share purchases**

   A shareholders' agreement can also serve to resolve issues arising from share purchase and sale clauses, by determining:

   Who will purchase the shares—the corporation, the shareholders or third parties.
   Payment terms (cash, deferred payments, etc.).
   Life insurance or other insurances to guarantee payment of the shares.

3. **Share valuation**

   A shareholders' agreement may determine various methods of valuing shares, which may vary depending on the circumstances leading to redemption, such as:

   Valuation at book value.
   Valuation at adjusted book value.
   Valuation at liquidation value.
   Valuation at capital value.
   Valuation by a third-party, etc.

4. **Voting clauses**

   Shareholders may determine a variety of voting arrangements by setting out clauses relating to:

   The election of directors.
   The need for a special majority vote in certain situations.
   The creation of a pooling agreement (transfer of shares to a custodian agent who undertakes to vote and administer the shares in accordance with the instructions of the shareholders who signed the shareholders' agreement).
   The creation of a trust agreement (transfer of shares to a custodian agent who undertakes to vote and administer the shares at their discretion).

5. **Management clauses**

   Through management clauses, shareholders may:

   Determine each shareholder's contribution.
   Share revenues.
   Provide for the reimbursement of expenses.
   Allocate the duties of the shareholders.
   Provide for terms should one of the shareholders become disabled.
   • Ensure that a departing shareholder will abide by exclusivity, confidentiality and non-competition undertakings.
   Govern vacation times.

It may be tempting to think that shareholders' agreements contain more or less the same clauses and that it would be easy to draft one on one's own. While the concepts are easy to grasp, there are multiple factors that make their application much more complex. Each corporation has a different business reality, and a shareholders' agreement must be adapted to such specific reality.

For example, what if one of the shareholders cannot be insured because they are older or have a serious illness? Or what if shareholders' life insurance is worth $500,000, but the value of a share is deemed to be $200,000? Who will benefit from the extra $300,000, the corporation or the estate?

It's best to consult a lawyer and a tax specialist to understand your corporation's needs and all the risks associated with the clauses in a shareholders' agreement. The experts at Lavery Lawyers advise you to draw up a shareholders' agreement from the outset, when everything is going well, and to update it should the corporation undergo major changes or new shareholders arrive.