

## **The Advisor – Fall 2015**

### **Shareholder Agreements – Part 2**

In a previous newsletter, we discussed shareholder agreements in the context of institutional investors (such as a pension fund or a private equity firm) investing in privately owned companies and the rights they would expect as a result of their investments. But what about agreements between existing shareholders of privately held entities? What should they look like?

First and foremost, having an agreement is crucial in order to avoid future conflicts or disputes. It should be prepared as soon as the company is established. The so called “honeymoon” phase is an ideal time to flush out the rights each shareholder can expect should circumstances change in the future.

Second, the agreement should be reviewed from time to time and amended as required. Five year anniversaries are ideal for a review, or earlier if a new investor comes on board.

And finally, owners should engage a lawyer with experience in drafting shareholder agreements so that all key points and rights are covered. Although there are cookie cutter agreements available for a fraction of the cost, it is far better to pay a little more to customize the agreement for any special circumstances inherent to your particular situation. The last thing a shareholder would want is a vague or incomplete agreement should a conflict arise.

Shareholder agreements cover a variety of topics but the key issues revolve around management decision making (through board and shareholder rights) and the sale or transfer of shares. These topics are discussed below.

#### **Board and Shareholder Rights**

Board rights are a function of share ownership – whomever owns the majority of the shares controls the board and the day to day management of the company.

A shareholder agreement would outline decisions where board or shareholder approval is required i.e.:

- a. Determining information rights for board members and shareholders;
- b. Amending articles or by-laws;
- c. Compensating management and board members;
- d. Issuing or redeeming shares;

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- e. Borrowing or purchasing assets over pre-determined limits;
- f. Declaring bonuses or dividends;
- g. Acquiring or divesting of a company or business unit; and
- h. Approving the annual business plan.

In order to avoid future challenges to the validity of a shareholders agreement, it is important to ensure that it conforms to the appropriate corporate legislation in the jurisdiction the company was incorporated.

### **Sale, Transfer or Buyout of Shares**

This is a key component of any shareholders agreement and sets out how shares will be bought or sold in the event of a dispute. Some key scenarios that should be addressed in the agreement include:

1. How shares are sold or transferred in the event of an irreconcilable dispute. One method could be by way of a shotgun clause where one shareholder offers to buy the shares of another at a certain price and the offeree can accept the offer or decide instead to buy the shares of the offeror at the same price.
2. What happens if one of the shareholders decides to sell their shares to a third party? The agreement could state they must first offer them to the other shareholders. If the other shareholders do not to accept the offer, the first shareholder can then sell their shares to the third party at the same price.
3. If a majority shareholder decides to sell his shares to a third party, he may be able to force the minority shareholders to sell their shares at the same price to the third party via a drag along right.
4. If a majority shareholder receives an offer to sell his shares from a third party, the minority shareholders would want the right to “tag-along” and sell some or all of their shares to the same third party.
5. How do shares get sold or redeemed upon the death of a shareholder? The agreement should outline if the shares will be bought by the remaining shareholders and how the purchase price will be determined.

Aries Advisory Group has extensive experience in drafting of shareholder agreements. We will work in concert with your legal advisors to ensure that all relevant scenarios are contemplated and all of your rights are protected. Please contact us at [info@ariesag.com](mailto:info@ariesag.com) or at (416) 467-7878 to see how we can help.