

## **Know How to Share with a Shareholder Agreement**

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Small- and medium-size businesses form the foundation of the Canadian economy. The majority of small- and medium-size businesses are operated by private corporations formed by business partners and/or family members.

In a multi-shareholder corporation, a Shareholder Agreement (SA) is perhaps the most important contract for incorporation. This contract describes the relationships between the shareholders (SHs), and between the SHs and the corporation. As a SH with an interest in the company, you want to ensure that the value of your shares is not diluted by unnecessary loans or sale of the corporation's assets. You would also want to limit the transfer of shares to third parties to preserve the nature of the business. A well-drafted SA will minimize internal conflicts among the SHs by clearly setting out the rights and obligations of the SHs.

The SA addresses issues such as voting rights, powers of the directors in managing the business and affairs of the corporation, limitations in share transfers, mandatory transfer in the event of disability or death, and dispute resolution in the event of conflict. The SA may also restrict and mandate certain matters and certain actions to be taken only with the consent of the SHs or a particular majority of the SHs, such as loans and/or sale of assets.

The principal objective of most SAs, however, is to control the issuance and transfer of shares within the corporation and among its SHs. Such controls act to maintain the share structure of a corporation. Certain SA provisions specifically address the issuance and transfer of shares. For example:

- 1) A Shotgun (also known as "Buy-Sell") clause provides a mechanism whereby any SH can attempt to sell the SH's shares or acquire the shares of any other SH.
- 2) A Coattail (also known as "Piggyback" or "Tag-along") provision protects the rights of a minority shareholder in case a group of shareholders, constituting majority of shares, want to sell their shares; the Coattail provision allows the minority shareholder to tag along or piggyback on the transaction.
- 3) Rights of first refusal are often used in SAs to provide a SH with the right to purchase the shares of another SH before being offered to an outsider. This is significant in most corporations to limit dilution of the shares and to preserve the nature of the business.

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Death can often disrupt share structures within a corporation. It is often a recognized practice that upon the death of a SH, the remaining SHs of the corporation have the obligation to purchase the shares of the deceased SH while the estate of the deceased SH has the obligation to sell the shares. Under some SAs, life insurance on each SH may be advisable in order to fund the purchase.

Following the incorporation of the company, SHs need to address the above issues and ensure the interests of each SH and the corporation are dealt with in a satisfactory manner to ensure a successful business relationship. Note, however, that the above provisions should be customized in accordance with your particular situation; there is no such thing as a “standard” agreement.