



CANADIAN CORPORATE LAW

Shareholders' Agreements: Essential or Superfluous?

Even though many disregard their necessity at the time of a company's inception or when a new shareholder arrives, it is undeniable that a shareholders' agreement is no longer a luxury, only becoming essential when a conflict or deadlock arises between the shareholders. There are two types of shareholders' agreement: 1) an ordinary agreement to govern the shareholders' relationship with each other; and 2) a unanimous agreement which, although it can also govern shareholder relations, has for primary objective the restriction of all or part of the directors' powers of business administration and internal administration in regard to the corporation. Furthermore, a unanimous agreement is valid if, and only if, all shareholders grant their consent at the moment of the agreement's signature, as opposed to an ordinary agreement which can include only a partial group of the shareholders.

Ordinary Shareholders' Agreement

The main goals of this type of agreement are as follows:

1. Maintaining proportional shares ownership between the shareholders ;
2. Maintaining the "closed" nature of the corporation by preventing third parties from buying into the corporation without the other shareholders' assent;
3. Protecting minority shareholders from prejudice caused by the decisions and actions of the majority shareholder;
4. Preventing conflict between the shareholders by providing for conflict-resolution mechanisms;

In order to reach these various goals, the same shareholders' agreement can address these various issues.

Share Transfer Restrictions

In general, a shareholders' agreement provides from free disposal of shares by shareholders. By example, it could be foreseen that shareholders be granted a *right of first refusal* therefore enforcing a selling shareholder to offer his shares to the other shareholders prior to a third party. A certain mechanism, called the *shot gun* clause, can also be set forth in a shareholders' agreement to avoid possible conflicts between two (2) shareholders. The *shot gun* clause may be exercised, in certain circumstances, by a shareholder-offeror wishing to put an end to his partnership with the other shareholder (shareholder-offeree). In that case, the shareholder-offeror initiates an aggressive buy-out process enforcing the shareholder-offeree to sell his shares. If a counter-offer is made by the shareholder-offeree to buy the shareholder-offeror's shares instead of selling his own, the shareholder-offeror then has no choice but to accept such counter-offer and sell his shares.

The Evaluation of the Shares

A shareholders' agreement generally contains some provisions regarding the evaluation mode of shares in any a particular scenario. For example, if a shareholder has been charged with criminal accusations and the corporation has to redeem his participation in the capital-stock of the corporation. In this case, it would be more worth it for the corporation to

redeem such shares at a lower price than their real market value in order to impose a penalty to the offending shareholder. The same reasoning should also apply to a shareholder in breach of a non-competition clause. However, redeeming shares at their good market value may be a more equitable evaluation method in case of a shareholder's death.

Votation Clauses

Shareholders may also foresee in their joint agreement how their vote would be managed within the corporation. Thus, the shareholders' agreement may contain a special clause providing that each shareholder has the right to vote for his own representative at the Board of Directors. It is also conceivable to foresee different vote categories (unanimous, special majority, etc.) when major decisions are to be taken.

Other Various Clauses

A shareholders' agreement may also deal with many other subjects, notably: circumstances leading to the end of the shareholders' agreement or the corporation's dissolution, various non-competition and confidentiality clauses, the possibility to submit litigation to arbitration to the exclusion or not of other civil courts of justice.

The Unanimous Shareholders' Agreement

The **Business Corporations Act** (federal) as well as the **Companies Act** (Quebec) allow corporations and shareholders to enter into a unanimous shareholders' agreement. More than simply managing the relationship between shareholders as does the ordinary shareholders' agreement, the unanimous agreement allows shareholders to limit, in whole or in part, the Board of Directors' powers by transferring some of the directors' powers, duties and responsibilities directly to shareholders.

Many of the following directors' duties are generally transferred to shareholders in the scope of a unanimous agreement: declaration of dividends, issuance and redemption of shares, directors' and officers' remuneration, election of officers, decision to enter into a deed of loan, amendment to the corporation's general by-laws, etc. However, as a requirement for its validity, a unanimous shareholders' agreement must be signed by all shareholders of the corporation.

Another aspect of the unanimous agreement is its capacity to bind any future shareholder without needing the unanimous agreement to be signed by that new shareholder, granted that every share certificate acquired bears a notice of the existence of a unanimous shareholders' agreement.

Conclusion

In conclusion, in order to respond to their specific needs, shareholders need to have their shareholders' agreement drafted accordingly. Unlike other type of contracts, such as sale and offer to buy agreements, it is not recommended to simply adopt a generic, existing model while amending a few clauses, since these models may not correspond to shareholders' exact needs; hence, it is better to draft a specific shareholders' agreement "from the ground up". If the shareholders are unwilling to invest time and effort in such a precaution, it might be wiser to reconsider the opportunity of the shareholders' agreement rather than settling for a generic agreement which could prove to be wholly inadequate to the shareholders' specific needs.

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