**ISSUES CONCERNING SHAREHOLDERS’ AGREEMENTS**

Prior to entering into a Shareholders’ Agreement, the shareholders should consider many issues. The purpose of this memo is to highlight some of those issues for your discussion.

1. **Term of this Agreement:**

What is the intended term of the agreement (perpetual, 10 years, etc.)? Typically, a Shareholders’ Agreement is perpetual.

How is the agreement to be terminated - upon the death of a shareholder, by written agreement of both shareholders?

1. **Provisions for Control:**

How many members will the Board of Directors be comprised of? (e.g. just two, or will each shareholder be entitled to additional nominees on the Board of Directors?)

Who will be the officers of the Corporation?

There must be at least a President and a Secretary, although one person can occupy both offices. Will the directors and officers be paid by the Corporation (separate and apart from any remuneration they earn as employees of the Corporation)? If so, how is their remuneration to be determined

Which officers will be authorized to sign cheques and other banking documents on behalf of the Corporation?

Will two signatures be required for cheques over a certain limit?

Who can sign documents like leases on behalf of the Corporation?

**Operation and Finance of the Corporation:**

Who will be the accountant for the Corporation?

Which bank will the Corporation use?

What will the Corporation’s year end be?

If funds are required by the Corporation, how are those funds to be obtained? Will these funds be obtained by the Corporation borrowing from a financial institution? If the Corporation is unable to otherwise obtain these funds from a financial institution on its own, will the shareholders be required to provide guarantees? If guarantees are provided, will they be limited guarantees and/or will the guarantors’ liability be joint and several (i.e. are both of the guarantors liable for the full amount of the debt separately)?

If the Corporation is unable to obtain the required funds from a financial institution, will the shareholders be required to make personal loans to the Corporation?

If a shareholder is unable or unwilling to advance the funds required by the Corporation, should the other shareholder be entitled to advance funds on behalf of the defaulting shareholder? If so, should the shareholder who has not provided funds have his shareholder’s rights limited (i.e. voting rights, dividends)?

**Restriction on the Transfer of Shares held by Shareholders:**

Will there be a restriction on the transfer of shares? In a private company, there usually is a restriction in place.

If so, will this restriction also restrict the ability of a shareholder to pledge shares to a bank or transfer shares to a family member or related Corporation? Usually, it does.

1. **Death of a Shareholder:**

In the event that a shareholder dies, should his/her estate be bound to sell the deceased’s shares to the other shareholder, or to the Corporation for cancellation, or should the estate be allowed to keep the shares? .

If an estate is required to sell and the Corporation or the remaining shareholder is required to purchase the shares, should there be insurance policies on the lives of both shareholders to ensure that the other shareholder or the Corporation can afford to purchase the shares in the event of death?

If insurance policies are required, should the Corporation pay the insurance premiums?

Upon death, how will the purchase price for the shares be determined, and how should the purchase price be paid (i.e. a percentage at the time of the sale, and the balance paid in equal consecutive monthly instalments over a period of years, with or without interest)?

1. **Events Requiring a Mandatory Sale by the Shareholder:**

Which events should result in a shareholder being required to sell all of his/her shares:

* 1. The death of a shareholder?
  2. The disability of a shareholder which results in the shareholder not being able to devote the time and attention required by the Corporation? If so, after what minimum period of disability? Often, this period is at least six months of continuous disability.
  3. The shareholder reaching a certain age (i.e. 65 years)?
  4. A default by a shareholder under the Shareholders’ Agreement or any related agreement?
  5. The insolvency of a shareholder?
  6. The dismissal or resignation of a shareholder who is employed by the Corporation?
  7. Due to the application of the *Family Law Act*, a spouse becoming entitled to a shareholder’s shares of the Corporation?

How will the purchase price be determined, and should the purchase price for the shares be the same in all situations? (i.e. if a shareholder is required to sell shares as a result of a disability, should the purchase price be the same as if he was required to sell due to insolvency?)

What will the terms be for payment of the purchase price

**Disability of a Shareholder:**

If a shareholder is employed by the Corporation, should the shareholder be entitled to continue receiving employment compensation in the event of a disability? If so, for how long? How should disability be defined?

For example, how severe must an illness be before it is a disability, and what length of time must a shareholder be unable to devote to the Corporation prior to this provision becoming applicable (i.e. number of months)?

Should a shareholder be required or have the option to sell his shares if his disability continues for an extended period of time?

Should a shareholder be required to maintain disability insurance?

**Right of First Refusal:**

If either shareholder receives a *bona fide* third party offer for the purchase of his/her shares, should that shareholder be entitled to sell as long as s/he first offers his/her shares to the other shareholder on the same terms and conditions as the bona fide third party offer?

If the other shareholder does not wish to purchase the first shareholder’s shares, should the second shareholder be entitled to require the third party purchaser to purchase the second shareholder’s shares as well (this is a “piggy back” right)?

If the second shareholder does not wish to purchase the first shareholder’s shares, should the second shareholder be able to be forced by the first shareholder to sell his/her shares to the third party if the third party wishes to purchase all of the Corporation’s outstanding shares (this is a “drag along” right)?

**Right of First Offer**

Similar to the right of first refusal (above), but where the shareholder receives a “soft” offer from a third party, and not necessarily a *bona fide* offer to purchase his/her shares.

This clause is helpful in creating more liquidity, but also may allow the departing shareholder to impose a new shareholder on the remaining shareholders who is not a “good fit”

1. **Buy/Sell:**

Is a buy/sell provision required?

This provision would allow a shareholder to provide notice to the other shareholder, advising him/her of a set price at which the first shareholder is willing to buy all of the other shareholder’s shares or sell all of his/her own shares. Once one party triggers the buy/sell, it is then up to the respondent to determine if s/he wishes to be the buyer or seller.

If a buy/sell provision is included, is the aggregate purchase price to be paid in full at closing, or is it up to the shareholder who triggers the buy/sell to set the terms of payment s/he is willing to give or receive?

What is the time period in which the other shareholder must reply to the buy/sell notice? (Note: It is usually about 30 days.)

1. **Call:**

Should one shareholder or the Corporation be entitled to require a shareholder to sell its shares to the shareholder or Corporation upon notice? If so, should this right be exercisable immediately or only after some period of delay? How will the price be determined? How will the price be paid?

1. **Put:**

Should a clause be included which entitles a shareholder to require the Corporation or another shareholder to purchase its shares? If this clause is included, should it be exercisable immediately or only after some period of delay? How will the price be determined? How will the price be paid?

1. **Pre-Emptive Rights:**

If the Corporation wishes to raise additional funds by issuing and selling new shares from treasury, should the existing shareholders have the first opportunity to purchase the new shares?

If one shareholder does not wish to purchase these new shares, should the remaining shareholder be entitled to purchase additional shares which may result in his holding a disproportionate number of shares (even though this could affect control)?

1. **Dispute Resolution:**

Shareholders’ Agreements often contain a clause which provides for arbitration in the event that a controversy or claim arises which cannot be settled. The agreement can also be drafted so that the parties must attend mediation prior to starting an action if a claim which cannot otherwise be settled arises.

1. **Non-Competition/Non-Solicitation**

A Shareholders’ Agreement should contain a clause requiring the shareholders to (i) not compete with the Corporation in any manner, (ii) not solicit any of the Corporation’s clients, and (iii) keep all confidential information they receive confidential.

Should the terms of this clause be extended so that it applies even when the individual is no longer a shareholder? Typically, it does continue to apply.

If so, how long should the non-competition/non-solicitation clause continue?

1. **Valuation of Shares:**

How will the shares of the Corporation be valued for sale purposes? (I.e. valuation could be by a predetermined formula or by a third party valuator/auditor.)

(Often, the shareholders will agree to appoint a third-party valuator/auditor, as pre-determined formula are tricky to determine in advance, and there are many formulas to select from).

Will the shares be valued annually as the corporation does business?

1. **Employment:**

If either or both of the shareholders are to be employed by the Corporation, there will be some further issues to consider:

* Should typical employment provisions be included in the Shareholders’ Agreement to protect the shareholders, the Corporation or all of them?
  + For instance, should salary levels be agreed upon for some pre-determined period of time?
  + Should notice of termination of employment periods be agreed upon?
  + Should employment automatically terminate if a shareholder sells his shares?

1. **Time to be Spent by the Shareholders in the Business of the Corporation:**

Where either or both shareholders intend to put some of their time and efforts into projects or ventures other than the business of the Corporation, how much time is appropriate? Also, how will a violation of this provision (or a disagreement in respect of this issue) be handled?

1. **Ownership of Products Created by the Shareholders (e.g. Software):**

If a shareholder creates products to be used by, or sold by, the Corporation, will such products automatically belong to the Corporation, whether or not they were produced during “business hours”, on company premises, etc.? Must such a product belong to a defined category of items (e.g. software) or a more specific sub-category in order to qualify as property of the Corporation? .