

CLIENT MEMORANDUM ON SHAREHOLDER'S AGREEMENT

GENERAL

A shareholder' agreement is very advisable in a small company. It prevents the problem of the shareholder's dispute being resolved through court action. In a court action the results will not be known quickly and during that period proper attention will not likely be given to the company affairs.

If you have not provided for a shareholder's agreement the dispute between shareholders will be resolved by using the majority voting position of the respective shareholders. The shareholder having more than 50 % shares will be able to elect his own board of directors and carry out his wishes subject to minority rights given in the Business Corporations Act.

SHARE OWNERSHIP

Once the shareholders have agreed on the % of shares to be owned by each shareholder the agreement should provide for mechanism to be in place, which will maintain that percentage ratio. The shareholder's agreement will stipulate the number and percentage of shares owned by the shareholders.

The important number for share ownership is the percentage of shares owned by the respective shareholders and not necessarily the actual number. 51% of shares owned permits the holder of those common shares to make decisions on who will be on the Board of Directors and thus determine the policies in the company.

SHOT GUN ARRANGEMENT

In a company which has only two shareholders and there is a dispute it is possible to have a clause which permits one shareholder to send a notice to the other to buy or sell the shares and thus resolve the dispute by a buy out. The initiating shareholder sets the price at which he will ask the other to buy or sell his shares. This enables the parties to have a fair price at which the shares will be sold. This arrangement is sometimes referred to as the "shotgun arrangement" because it finally determines the removal of one or the other shareholder.

This arrangement can also work for 3 shareholders if one or two get together and make the offer to the remaining shareholder. But the arrangement becomes more difficult if there are a lot of shareholders.

Once the shot gun arrangement has been put into effect one shareholder stays in the company and the other one gets paid for the shares and has to leave the company.

FIRST OPTION

In a small company parties usually are related to each other or know each other well. Before a shareholder is allowed to sell his shares to an outsider it is very advisable to give the first chance to an existing shareholder to buy those shares. This is called the first option. It gives the first option to an existing shareholder to buy the shares at a price which is not higher than that offered to an outsider.

To make this arrangement work, it is usual to provide that the offer should be bona fide (genuine) and further that the outsider will not have the right to buy until the existing shareholders have decided not to take the shares. The offer should be shown to the existing shareholders and they should be allowed reasonable time to make up their minds, which is usually 30 days.

DEATH

The shareholder's agreement should provide for the possibility of death of a shareholder. It is common to write a clause in such an agreement in which the survivor will purchase the shares of the deceased shareholder. The price at which the shares of the deceased are purchased is of concern. One possible way to resolve the question of price is to require the shareholders to agree on a price, which will be applicable for about a year, and should any death occur in that year the predetermined price will apply. This price should be determined at the time of each year's shareholder's meeting.

INSURANCE

In the event of the death of a shareholder it is very difficult for the survivor to manage the business on his own. In addition to that if he has to purchase the business it would be even more difficult. Insurance provides a good answer to this problem.

The insurance can be obtained by the corporation as the owner of the insurance policy, which provides for the funds to be given to the company in the event of the death of a shareholder. This is known as the key man insurance. The second variable is the insurance can be owned by each shareholder on the life of the other shareholder(s). Where insurance is purchased by the shareholder on the life of the other one the premium will be paid by him and if the insurance is taken by the company the premium will be paid by the company.

Term policy is usually cheaper and sufficient. Term policies do not contain any savings and comes into pay to pay the benefit only if the shareholder dies. There are no savings under such policy.

TRUSTEE

In large insurance policies a trustee may be necessary to hold the monies in the event of death until the formalities of transfer of shares to the beneficiaries is completed.

DIRECTORS' AND OFFICERS

In a small company it is usual for the shareholders' agreement to state who the directors and officers of the company will be. In a unanimous shareholders agreement this decision is made for a long period and the annual meetings of the company then does not permit change of directors.

NON-COMPETITION

For the corporation to succeed it is important that the shareholders do not compete with the business of the company. It is desirable to provide that the shareholders will not set up competing businesses. Sometimes this obligation is extended to a time period of 2 or 3 years even after the shareholder has left the company.

LOANS

When the new company starts the shareholders usually will have lent some money to their own company. The shareholder' agreement will usually provide for the repayment of the loan to the shareholder's from the company. The loan amounts provided by the shareholders to their corporation will usually correspond proportionately with their share ownership.

REVIEW

A shareholder's agreement should be reviewed annually. The addresses of the parties can change and they should be recorded. If the value of the shares has changed for death provisions it should also be noted. The relationship of parties will change over time and the agreement should reflect the new situation.

If we are doing your annual minutes we will be pleased to review the agreement at the time of preparing the annual minutes.

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