



# Your Word Against Mine

The importance of shareholders' agreements in running your business

BY PINAR OZYTETIS

A shareholders' agreement is one of the single most important agreements that you will need to govern the ownership of a business. A shareholders' agreement is simply a contract among a company and its shareholders.

A common situation that shareholders (or partners in a partnership) find themselves in is to have a "handshake deal" where one person's recollection of a business deal is different than their business part-

ners. This can lead to disputes, distrust, inefficiency in the performance of the business, and sometimes lengthy and expensive lawsuits. strategies for a shareholder to leave the business. While this article does not exhaustively list all of the provisions for you to consider, a shareholders' agreement may contain clauses providing for some of the situations described below.

Different shareholders may have different objectives, which will necessari-



If you have not yet incorporated your business, but conduct business by way of a partnership, you should consider entering into a partnership agreement to include some of the concepts described above. You may want to consider incorporating to take advantage of certain legal and tax matters that are available to corporations, but not to sole proprietors or partnerships.

At the very least, a shareholders' agreement should address issues of control and management, limits on decision-making authority, and exit

ly affect how a business is run. By having a written agreement signed by all of the shareholders of a company, all shareholders can negotiate to determine their common expectations and ground rules about how the business should be run. For example, do you have a minority interest or a majority interest in a company? Are

you one of three shareholders, each of whom has an equal interest? Are you a "silent investor" who makes capital contributions, but leaves operational matters in the hands of another shareholder or shareholders? In each of these situations, unique provisions need to be included in the shareholders' agreement to ensure that your interests are protected.

Control of a company is straightforward where there is only one shareholder involved. You make all of the decisions, and reap the benefits and suffer the consequences of those decisions. The introduction of one or more business partners as shareholders means that you have to give some thought to who gets to make decisions for the company. If you have two or more shareholders, you may have one shareholder who is entitled to a casting vote in the event of deadlock. One shareholder may have a veto right for important issues. If controlling shareholders are not involved in the day-to-day operations of the business, they may want



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to have clauses about the selection and compensation of employee-managers of the company. This will provide controlling shareholders with the comfort that the business is being run properly.

There are numerous ways of handling a sale of shares or "exit strategies" in a shareholders' agreement in the event that you or one of your business partners no longer wants to be involved in the business. Common provisions are:

- (1) Rights about sales of shares between existing shareholders;
- (2) Rights in the event of an offer to buy shares by a third party;
- (3) Rights to join such third party offers or situations in which a shareholder can be compelled to sell to a third party.

A shareholders' agreement must also contemplate a procedure in the event that the relationship among shareholders starts to sour. Often, clauses are included to resolve dis-

putes among the shareholders by arbitration. If the arbitration clause is well-drafted, it may be possible to avoid a lawsuit in the event of a dispute.

There are many different variations that a shareholders' agreement

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may take, each of which is unique to the specific business and concerns of the shareholders of a company. If you have not yet incorporated your business, but conduct business by way of a partnership, you should consider entering into a partnership agreement to include some of the

concepts described above. You may want to consider incorporating to take advantage of certain legal and tax matters that are available to corporations, but not to sole proprietors or partnerships.

To ensure that you, your business and/or your investment is adequately protected, consult a lawyer to prepare a shareholders' agreement for you.

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