

Shareholders Agreement

Many private company shareholders have a significant part of their wealth tied up in those company shares. As a result, they would be wise to consider the benefits of a shareholders agreement in order to protect that investment when they are not the sole shareholder.

A shareholders agreement is a written agreement between the shareholders of a company defining each shareholders rights and obligations. The following are some of the benefits of such an agreement:

1. Define how the company will be managed, how decisions will be made, as well as how disputes will be resolved. This will help the business operate successfully and maintain the value of the company despite acrimony at the shareholder level. Larger decisions, such as electing the board of directors, selling the business and shareholder compensation, may require unanimous agreement at the shareholder level whereas other operating decisions might be based on a majority decision.
2. Determine shareholder compensation. Those shareholders active in the day-to-day operation of the business may expect to receive a salary in addition to a return on the shares themselves. The shareholders agreement might, for instance, tie the salary to the operating success of the business. The agreement might provide for the payment of dividends to ensure that minority shareholders earn a return on their investment.
3. Establish a non-competition clause and confidentiality agreement. This would prevent a shareholder from disposing of his or shares and opening up a new company that would operate as a direct competitor.
4. Set out policy for when shareholders are required to lend monies to company or make additional capital contributions. The company may not have further access to institutional lenders at reasonable rates. The shareholders agreement should define the shareholders obligations, the return expected on their investment and the ramifications of not complying with the obligation.
5. Sets out the circumstances under which a shareholder can purchase shares or dispose of his or her shares. This maintains a market for the shares of the shareholders and, at the same time, ensures that the shareholders have a choice before new shareholders are introduced.

The agreement could provide the remaining shareholders with a “right of first refusal” before shares are sold to an outside party. The agreement might provide for a “shotgun clause”. This involves one shareholder offering his or her shares to another shareholder at a certain price per share. The other shareholder has the option of tendering his or her shares or buying the shares of that person for the same price.

The agreement might provide for a buyout of a person’s shares on retirement, disability, divorce or death. The buy-sell provisions of the shareholders agreement should set out a formula for determining the buyout price. Using “fair market value” as the buyout price may not be desired because of the various assumptions that are used in the determination and the impact of factors such as minority and marketability discounts. The shareholders will have to consider the various avenues available for funding the buyout. This might include life insurance, company operations or borrowings.