THE LAWRENCES® LETTER

News and information for clients and friends of Lawrence, Lawrence, Stevenson LLP

FALL 2008

SHAREHOLDER AGREEMENTS

When the Honeymoon Is Over

Avi Goldstein

Beginning a new business venture is somewhat like a marriage: it's a new partnership where each partner brings something to the union. Partners in a business venture might contribute ideas, capital, hard work, skills, or assets. In return, they receive an ownership stake in the business and hope to see tangible returns for their efforts.

As with most relationships, time often changes both the situation and the people. What if the shareholder with the capital decides to spend $100,000 on a new boat instead of investing it in new equipment for the business? What if he wants his spoiled nephew to become a 25% owner of the company, reducing the others' ownership stake? Or what if the computer whiz who wanted only to make the world a better place now wants sole control over the corporate bank accounts? Suppose the hard worker, seeing very little in the way of profit, simply wants out of the company — immediately?

Like prenuptial agreements, shareholder agreements are drafted to minimize problems like these. Such agreements should be put in place at the outset of the business venture, before problems arise. The agreement should address at least three issues:

- *Who owns the company?* The shareholder agreement specifies who holds shares in the company and how those shares can be disposed of. If unfortunate circumstances such as death, disability, or bankruptcy arise, the other owners are at risk of being left with a new business partner that they may neither know nor want. Provisions can be inserted into the shareholder agreement for disposition of shares in these situations, or when an owner simply wants to get out of the business. The best alternative is usually to permit other shareholders to purchase the shares in such circumstances.
- *Who runs the company?* Directors are legally liable for a company's actions. A shareholder agreement identifies the directors and officers of the company and their duties. It sets out the procedures for director and shareholder meetings. It specifies signing authorities, both for banking and for the execution of other documents. It identifies the company's accountants and solicitors. Finally and most importantly, it binds the owners to a duty of confidentiality to the company so that the business is protected.
- *How is the company financed?* If the company needs to borrow money to run the business, a shareholder agreement can outline the procedures to be followed if the company needs to raise debt financing. For example, if the company cannot borrow from a bank, the shareholder agreement may require shareholders to lend money to the company on certain terms and face consequences if they will not do so. A shareholder agreement can also set out provisions to prevent the position of existing shareholders from being diluted. As an incentive bonus for its employees, a company may offer shares that pay dividends while at the same time preserving the ownership structure of the company among the founders. The new shares to be issued would likely be non-voting shares with an entitlement to dividends.

Running a business involves taking risks. The relationship among owners is one risk that can be dramatically reduced by a shareholder agreement, which should be drawn up as close to the commencement of the business venture as possible, before issues arise and grow into irreconcilable differences.

Lawrences' Corporate & Commercial Group has helped many successful businesses grow and prosper, with the shareholders secure in the knowledge that their relationships with their fellow shareholders are protected and controlled.

Avi Goldstein is an associate in Lawrences' Corporate & Commercial Group. He can be reached at (905) 452-6892 or agoldstein@lawrences.com.

In this issue: