



## **Shareholder Agreement Considerations**

The following list of questions should be considered in connection with the preparation of a new shareholder agreement governing the business and affairs of a subject corporation and the relationship of its founder/new shareholders to each other.

### ***Shareholder Matters***

- confirm identity and relative shareholdings of the founder/new shareholders
- confirm if all shareholders are to participate in this business on a full time basis
- consider what consequences, if any, should result from a shareholder ceasing to devote his full time and attention to the business

### ***Shareholder Meetings***

- consider quorum requirements for shareholder meetings
- consider approval thresholds for shareholder meetings
- consider if the chairman of shareholder meetings shall have any second or casting vote
- consider the frequency of formal shareholder meetings

### ***Director Matters***

- confirm number and identity of existing/new directors
- consider if each shareholder to have a right to nominate a director
- if less than all of the shareholders will serve as corporate directors, consider what decision-making should take place at the shareholder level (see “*Approval Thresholds/Veto Rights*” below)

### ***Director Meetings***

- consider quorum requirements for director meetings
- consider approval thresholds for director meetings
- consider if the chairman of board meetings shall have any second or casting vote
- consider the frequency of formal directors meetings

### ***Officers***

- identify all corporate officers (i.e., the offices of President, Secretary and Treasurer should, at a minimum, be filled)
- consider what approval thresholds are needed to add/remove officers (i.e., unanimous)

### ***Equity Financing Matters***

- detail the initial capital contributions of the founder/new shareholders and the use of proceeds relating to same

- consider any mandatory future equity “capital calls”
- to the extent that additional shares will be issued (other than stock dividends or stock issued under any ESOPs), consider if founder/new shareholders desire “pre-emptive rights” to avoid subsequent equity dilution

### ***Debt Financing Matters***

- consider if “bank only” future debt financing is desired without capital calls upon founder shareholders for new debt
- if bank debt is unavailable, consider if “debt calls” will be mandatory or optional
- if debt calls are optional, consider repayment terms, interest rates and security issues, etc.
- if debt calls are mandatory, consider consequences for failure to comply
- if bank debt requires personal guarantees from the founder/new shareholders, consider if all shareholders will be required to provide same
- if “joint” personal guarantees are provided, consider contribution issues among the joint guarantors

### ***Signing Authorities***

- consider who will have authority to sign contracts and commitments binding the new company
- consider who will have authority to sign company cheques and what thresholds will apply (e.g., 1 signature for amounts less than \$x and 2 signatures for amounts equal to or greater than \$x)

### ***Distribution of Funds***

- consider what level of shareholder approval is required to declare and pay dividends or other corporate distributions
- if shareholder loans are outstanding, confirm if shareholder loans must be repaid first before dividends/distributions can be declared
- consider to what extent the new company should be required to maintain a minimum level of capital/retained earnings during its first few years (i.e., a “moratorium on distributions” until retained earnings reaches a prescribed threshold)

### ***Financial/Other Disclosure Matters***

- consider the type and frequency of financial/operational information to be provided to the shareholders in each fiscal year
- will annual business plans and capital/operating budgets be subject to shareholder approval?

### ***Approval Thresholds/Veto Rights***

- assuming that all fundamental decisions will be made by the shareholders, consider (a) the appropriate percentage approval threshold for same and (b) the list of matters requiring such approval

### ***Non-Competition/Non-Solicitation Issues***

- are there any permitted exceptions to the general prohibition on shareholders/officers/directors competing with the corporation while they remain shareholders, officers and directors?

- once a shareholder ceases to remain a shareholder of the new company, consider what time/geographic restrictions (if any) apply to restrict such departing shareholder from (a) competing with the company and/or (b) soliciting the company's employees and clients

#### ***Restrictions on Share Transfers***

- generally, no share transfers or share pledges are permitted without majority or unanimous approval
- consider what types of "permitted transfers" are acceptable without unanimous approval (e.g., transfers to wholly owned corporations/controlled family trusts, share pledges to commercial banks to obtain personal loans, etc.)

#### ***Liquidity Event Considerations***

- "ordinary course" liquidity: (a) shotgun provisions, (b) 1<sup>st</sup> refusal rights and (c) piggy-back and drag-along rights
- "special event" liquidity: (a) specific call/put rights at predetermined dates and values, (b) call options in favour of the non-affected shareholders arising upon bankruptcy, default, disability, termination of employment or family law events

#### ***Death***

- upon the death of any shareholder, consider whether the sale of his shares is optional or mandatory in light of all tax implications arising to each of the estate, the deceased and the company upon such death
- consider the use of call/put options to provide maximum flexibility
- will life insurance be utilized as a means of funding the purchase of shares on death?

#### ***Valuation Upon Liquidity Events***

- consider what valuation will apply if liquidity arises as a result of bankruptcy, default, disability, family law events, termination of employment or death
- will fair market valuations apply in all cases or will discount factors be applicable (e.g., buyout due to termination "for cause" or uncured defaults, etc.)?
- in determining fair market valuation, is 3<sup>rd</sup> party advice from an independent valuator with experience in your industry desired if negotiations among the parties fail?
- will any special valuation rules/principles apply?

#### ***Payment Terms Upon Liquidity Events***

- consider applicable payment terms where no insurance proceeds are available to fund buyouts
- for example, consider 25% paid on closing and 25% paid on the next 3 anniversary dates (this will depend on the vendor's need for immediate cash and the purchaser's ability to pay)
- consider interest and security issues relating to any unpaid amounts following closing

#### ***Termination/Amendment of Agreement***

- consider the shareholder approval threshold required to terminate or amend the shareholder agreement

