

A shareholders' agreement is a written agreement between the shareholders of a corporation to define their rights and obligations with respect to the management and operation of the corporation and the purchase and sale of shares in the capital stock of the corporation. Generally such an agreement is entered into between shareholders of a closely-held corporation. The principal provisions of a shareholders' agreement relate to control, management and operation of a corporation, funding of a corporation's capital needs, transfer of shares to third parties and mandatory and optional transfer of shares. These provisions are discussed more fully below.

1. Provisions relating to Management and Control

These provisions of a shareholders' agreement address the sharing of control and management of a corporation among shareholders (especially shareholders who are actively involved in the business of the Corporation), the rights of shareholders with respect to material changes and significant transactions and the interests, expectations and contributions of shareholders. Some of the more important matters relating to these issues include:

- (a) voting in elections of the directors of the board of directors, filling of vacancies on the board of directors and compensation of directors;
- (b) issues relating to meetings of the board of directors and shareholders such as the quorum required to hold such meetings;
- (c) appointment and compensation of officers;
- (d) authorization for execution of contracts and other documents binding the corporation;
- (e) circumstances in which the approval of shareholders will be required and the degree of approval required (e.g. unanimous or majority approval), such circumstances include:
 - (i) declaration and payment of dividends,
 - (ii) issuance of shares by the corporation or the redemption or purchase by the corporation of issued shares,
 - (iii) borrowing,
 - (iv) making amendments to Articles or by-laws of the corporation,
 - (v) providing financial assistance to shareholders or related parties, and
 - (vi) making of business decisions outside the normal course of business such as the making of significant capital expenditures, commencing a new business or disposing of assets; and
- (f) matters relating to operation and financing of the corporation, including:
 - (i) books and records of the corporation,
 - (ii) accountants of the corporation,
 - (iii) banking arrangements,
 - (iv) obligations of shareholders to provide funds to the corporation, and
 - (v) provision of bank guarantees by shareholders for corporate borrowings.

2. Share Transfer Restrictions

It is usual to include provisions prohibiting the corporation from issuing additional shares and the shareholders from transferring shares without the consent of the shareholders, except in certain circumstances as provided in the agreement. A shareholder may be permitted to transfer shares to related entities such as a holding company controlled by the shareholder. If any of the shares are held by a holding company, similar restrictions may be imposed on that corporation and its capital stock.

3. Transfers to Third Parties

These provisions address two competing interests; the desire of the shareholders of a closely held corporation to control the shareholdings of the corporation and the expectation of shareholders to be able to sell their shares to a third party and realize their investment in appropriate circumstances. It is, therefore, usual to include the right of first refusal clause in a shareholders' agreement.

Under such a clause, a shareholder usually must first obtain a bona fide third party offer to purchase such shareholder's shares. The other shareholders are then given the option to purchase the selling shareholder's shares at the same price and on the same terms as provided in the third party offer. Where a corporation has a majority or dominant shareholder, it is not unusual to provide minority shareholders with a "piggy-back" right. This right gives the minority shareholders the option to require a third party purchaser who wishes to purchase the shares of the majority shareholder to also purchase the shares of the minority shareholders. It is also common in such circumstances to include a "drag-along" right in the agreement. This provision allows the majority shareholder to accept a third party offer and require the minority shareholders to sell their shares to the third party on the same terms.

4. Transfers upon Occurrence of Certain Events

For liquidity and other reasons, it is usual to provide an option or obligation to buy and sell shares on the occurrence of certain events. The circumstances in which such rights may be given are as follows:

- (a) the death of an individual shareholder who is active in the management and operation of the corporation;
- (b) the disability or incapacity of an individual shareholder who is actively involved in the management and operation of the corporation;
- (c) the bankruptcy or insolvency of a shareholder;
- (d) in connection with certain family law related claims (such as in a case of separation or divorce) where the ownership or voting shares by the shareholders will be interfered with; and
- (e) in certain cases, upon termination of the employment or retirement of a shareholder.

With respect to each of the above-described circumstances, consideration must be given as to whether the obligation should be optional or mandatory, whether the purchase will be by the corporation, the majority shareholder or all the shareholders pro rata, or in some combination of the foregoing alternatives. In each case, consideration must also be given to the relevant tax consequences.

5. Mandatory Buy-Sell Provisions

It is also common to include a mechanism to deal with an impasse among shareholders. A common approach is the "shotgun" clause. Such a clause requires a shareholder to offer to sell his or her shares to the other shareholders and to offer to purchase the other shareholders' shares at a specified price. The other shareholders then have the option of choosing whether to buy or sell shares. If there is a majority or dominant shareholder, it may not be advisable to provide this option to minority shareholders.

6. Valuation

A shareholders' agreement would also include a methodology for valuing shares in connection with mandatory and optional share purchases under the agreement (other than the shotgun clause and the right of first refusal clause). Such a provision may require the shareholders to agree on a value of the shares on a periodic basis. If such valuation becomes stale dated, then some other methodology is provided to determine the value.

Alternatively, a formula based methodology can be used. The formula can be asset-based, earnings-based or revenue-based. A further alternative is to have a competent third party determine the value of shares.

7. Other Clauses

A shareholders agreement would also include non-competition, confidentiality and arbitration provisions as well as a provision setting out the general sale provisions with respect to a purchase and sale of shares under various provisions of the shareholders' agreement.

8. Conclusion

This document has provided a brief explanation of the purposes of a shareholders' agreement and its main provisions.

SPECIMEN