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## **SHAREHOLDERS AGREEMENT: CHECKLIST FOR DISCUSSION PURPOSES**

### **Introduction**

There is no such thing as a “simple” shareholders agreement. That does not mean that the agreement should be written in legalese or should be difficult for a business person to understand. What it means is that the issues and contingencies that need to be addressed in a shareholders’ agreement are complex. There is no way around that.

Shareholders agreements are not about trust or acrimony. They are about communication and common understanding. They are about building a strong relationship. They are about doing an agreement today that avoids messy and expensive disputes in the future. Therefore, we do shareholders agreements for four main reasons:

- **The process** you go through in doing the agreement forces you to think and talk through all the major scenarios you may face in your partnership. This assures you have a complete and common understanding, avoids unspoken assumptions, and resolves many potentially contentious issues, at the beginning of your relationship.
- You can not count on your partner always being the person that you will have to deal with. For example, he or she may die and you may have to deal with his or her spouse. You must have a **clear record of what the partners agreed to** for these other people to understand and implement if they come along.
- **No partnership lasts forever.** If it breaks down or one partner wants to end it, we want to unwind it as quickly, as fairly and as cheaply as possible, and without destroying the value in the underlying business.

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- Also, success creates more conflict between partners than failure. A good shareholders agreement is **your success plan**, it addresses how important matters are going to be addressed when you succeed (e.g. distributing profits, cashing in).

Finally, please remember:

- you can always do anything you all agree on, no matter what the agreement says;
- the best shareholder agreements are often put in the drawer and never looked at again because that level of good communication and common understanding that good partnership agreements are based upon has been accomplished in the process of doing your shareholders agreement.

### **The Business**

- what is the business?
- is it existing or a startup?
- if existing, what has each shareholder contributed so far? have they been fairly rewarded? does the existing share structure fairly reflect those contributions?
- What adjustments need to be made?
- what vision do you have for its future?
- what are the key issues related to operating and building the business?
- how or what will each shareholder contribute to the vision, operations and building?
- how is the business going to make money for the shareholders? giving them jobs? paying them profits annually? building a valuable business that can be sold at a later date?
- how long do the shareholders plan to be involved in the business operationally?
- how long to the shareholders plan to be involved in the business as shareholders?
- will the shareholders ultimately sell the business? when? to whom?
- or will they simply wind it up?
- or will they pass it on to their children or other family members?
- is there a business plan? If no, why not/when will there be one? Note: See schedule attached for basic business plan template
- What must the shareholders agreement do to support the business vision/plan set out above?

### **The Legal Entity**

- What is its name?
- Has it been incorporated? When? Where? By Who?
- Has it been organized?
- Is there a Minute book? Where?
- Is there a seal? Where?
- Is it carrying on business already? If yes, how long?
- Where will it be located? Address? Phone number?
- Does it have accountants?
- If yes, who are they, where located? (Name, address, phone number)

### **The Shareholders**

- Their full names, including corporate names if corporations
- Share structure: have types and attributes of shares been agreed to? Has each shareholder consulted his or her accountant in that regard?
- Number of shares each shareholder is to hold, class of shares they hold, amount paid or to be paid for their shares
- Are all shares fully paid for?

### **The Directors**

*There must be at least one director. The directors are elected by the shareholders and direct the affairs of the business. They also hire/appoint/fire/replace the officers of the company.*

- How many?
- How selected?
- Full names and home addresses?
- Citizenship? *If one director, must be a Canadian resident. If two, at least one must be Canadian resident. If more than two, majority must be Canadian residents*

### **The Officers**

*Officers manage the day to day business of the company. There must be at least a President and a Secretary, which can be the same person.*

- How many? What titles?
- How selected?
- Who are they? Esp. President and Secretary?
- Full names and home addresses?

## **Financing the Company**

*How is the company going to be financed?*

- What are the shareholders putting in?
- Is that to be loans or equity?
- Are the loans going to bear interest?
- Are they going to be secured?
- What are the repayment terms?
- What third party financing is going to be used?
- What if more money is needed?

## **Personal Commitment**

- What are shareholders to contribute ways other than financing?
- Who is working in the business?
- On what basis?
- How are responsibilities being divided?
- How are shareholder salaries going to be set?
- What kind of special covenants will apply while you are a shareholder? E.g. non-competition, company owns all inventions
- What kind of special covenants will apply after you cease being a shareholder? E.g. non-solicitation, non-competition

## **Decision Making Generally: Strategic and Operational**

*How will decisions be made? Will there be different kinds of decisions that get made in different ways? Are there things that could deadlock the shareholders?*

*Consider both strategic issues (e.g. new partners, buying new businesses, selling the business) and operational (e.g. signing authorities on contracts and bank accounts, ability to make binding commitments on behalf of the company, hiring and firing, purchasing, selling, etc.).*

- Who will make them?
- How will voting rights be handled?
- What will constitute a quorum of decision makers?
- Are there any general principles for making decisions that you have already discussed amongst yourselves?
- Is the general rule simple majority vote? Or something else?
- Are there things you all have to agree on? I.e. that require unanimous approval?
- Of the things you all have to agree on, are there any that you would be willing to have resolved by arbitration etc. to avoid having a deadlock?
- Of the things you all have to agree on, are there some that you would be willing to resolve by some kind of super majority (e.g. 75%) to avoid a deadlock?
- Which are the things you all have to agree on or we end up in a deadlock situation?

### **Distributing Profits**

- Who will decide when to distribute profits to shareholders and how much to distribute?
- What if they can not agree? Arbitration? Deadlock?
- Are profits distributed based on shares only, or something else too?
- What if you can not agree on splitting profits? Arbitration? Deadlock?

### **Resolving Deadlocks**

*How will deadlocks be resolved, if they arise?*

- Arbitration on some issues? If yes, which ones?
- Second vote by super majority? If yes, which ones?
- Shot gun buy/sell?
- Sale of whole business with any shareholder entitled to match good faith third party offer? (Details to be worked out?)
- Winding up of company?

### **Voluntary Withdrawal**

*Can a shareholder withdraw from the deal if he/she wants out? If yes, how? If no, what do you do with such a shareholder? Consider: they are relocating, the deal is not going the way they planned, or they simply want to cash in?*

- Others forced to buy?
- Shot gun buy/sell?
- Sale of whole business with any shareholder entitled to match good faith third party offer? (Details to be worked out?)
- Winding up of company?
- Shareholder can sell to third party, with others having right of first refusal?
- Some combination of above?
- How will the shares be valued?
- How will the purchase price be determined?
- What will be the payment terms?
- Any restrictions on going this way? E.g. can not withdraw within first two years of starting out?

## **Involuntary Withdrawal**

*What if the other shareholders want to force out a shareholder?*

- Others forced to buy?
- Shotgun buy/sell?
- Sale of whole business with any shareholder entitled to match good faith third party offer? (Details to be worked out?)
- Winding up of company?
- Some combination of above?
- How will the shares be valued?
- How will the purchase price be determined?
- What will be the payment terms?
- Any restrictions on going this way? E.g. can not be forced out within first two years of starting out unless in default?

## **Other Special Considerations Re: Selling Out Etc.**

- Can majority shareholders force the minority to sell to them?
- If yes, what conditions, terms, etc. See above for sample issues to be considered
- Can majority force a sale of the whole company?
- Would that include a carry along provision, whereby minority would be forced to sell on the same terms the majority is selling on?
- What about a piggyback provision, whereby the minority can force any buyer who is buying a majority interest to buy the minority interest at the same terms?

## **How to manage a Shareholder in Default?**

- What do we do if a shareholder defaults in their obligations under this agreement?
- How does it affect their profits? Their shares?
- How do we get them out of the company? What happens to their shares?
- How does this compare to the Involuntary Buyout provisions above?

## **How to manage the Employee Shareholder?**

- What happens if a shareholder of the company who is also an employee gets fired?
- Are they forced to sell? On what terms?
- What if they are not fired for a just cause?
- How does this tie in to the other buyout clauses above?

### **Disability of a Shareholder**

- What if a shareholder becomes sick or disabled for an extended period of time?
- How long can that go on before we must question whether they can stay involved in the company?
- How will we deal with that? Their salary? Profit share? Shareholdings?

### **Death of a Shareholder**

*This is a complex area that may require input from the company accountant and a life insurance representative.*

General Principles:

- Do they have to be bought out?
- Do the other shareholders buy them out, or does the company buy them out?
- How are shares valued?
- How is purchase price calculated?
- What are payment terms?
- Do we minimize tax consequences for estate of deceased shareholder?

Use of Insurance:

- Do we fund this with insurance?
- How much insurance, and how is that updated?
- Who owns the insurance?
- Who pays the premiums?
- How do the funds flow?
- Criss-cross buyout where each shareholder assumes responsibility for maintaining his own insurance with the other shareholders named as beneficiaries so they have funds to buy out the estate?
- Criss-cross buyout where company buys insurance and uses money to provide capital dividend to other shareholders to buy out the estate?
- Company buyout with company buying insurance and using funds to buyout the estate?
- Do we value the company, use insurance and then make up the difference, if any, with other funds?
- If yes, on what terms are the other funds paid?
- Do we set the price at the amount of insurance in place, irrespective of value?
- What do we do if a shareholder is not insurable?
- What if the insurance is expensive?
- How do we determine what is too expensive and therefore won't buy the insurance?

### **Other Considerations**

*What else is important to you and that you want addressed in your agreement?*