In Business with Others? The Benefits of Putting in place a Shareholder Agreement

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Starting a business venture with others is an exciting prospect. However, because owners tend to put their focus (understandably) on getting the company off the ground, they often overlook the important step of putting in place a business agreement between the founding partners.

Such agreements, commonly known as shareholder agreements, are vital and establish an understanding between investors on key matters relating to the company.

"The best thing I ever did in starting Slingshot with my partner was to spend the time to work out a shareholders agreement. This agreement has taken any concern or worry or grey areas out of the equation, so I can focus on our business." Robert Clements, Production Director / Partner, Slingshot Vancouver

While all business partnerships are different, a well-drafted shareholder agreement defines the rules of the game as to a variety of matters that will come up in any company's lifespan. With these rules in place, investors can focus on what is most important; the growth and success of their business.

Here is a list of some general areas that investors may want to cover off in a shareholder agreement.

Who gets to make the decisions?
Without a shareholder agreement, minority investors may find themselves without a voice in company decisions.

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Shareholder decisions (such as the election of directors or a decision to sell or wind-up the business) can generally be made by shareholders with a certain majority of shares, without the input of some minority investors. Minority investors can state in a shareholder agreement which decisions should require the vote of all shareholders or a special majority of shareholders.

Minority investors can also ask that the shareholder agreement allow them to nominate one or more members of the board of directors. Company directors are empowered at law to oversee the affairs of the business, so having some ability to control the board composition will be important for minority investors looking to be more than just a silent partner.

How do I control who I'm in business with?

Without a shareholder agreement, the directors of a private company will generally have the final say as to whether a shareholder can transfer shares to another person.

As a result, an important part of any shareholder agreement is to outline how, when, to whom and for what price shareholders can transfer shares. For example, shareholders can include provisions which allow for or require that a transfer of shares be in made in the following situations:

- Transfers to a related party of a shareholder (for example, for tax or planning purposes)
- Transfers to other shareholders or back to the company if a shareholder dies, ceases being an employee, suffers a disability or breaches the shareholder agreement
- Transfers to third parties to facilitate the sale of the business, including rights allowing or perhaps compelling minority shareholders to sell their shares to a third party if the majority shareholder is proposing to sell its shares to that third party

How do I protect the business?

Given the time and money owners put into a business, they will also want to ensure that their fellow investors continue to put the business first as well.

Investors often include provisions in a shareholder agreement setting out restrictions on the ability of shareholders to compete with the company or entice away customers or employees. To further protect the business, investors can include confidentiality provisions, restricting shareholders from disclosing company information (such as financial results and margins) to outsiders.

For more information on shareholder agreements and other business agreements, as well as any other business law matters, please feel free to contact Jag Shergill. Jag is a business lawyer with a focus on advising companies on all of their business and commercial law needs. He is a partner at the law firm Lawson Lundell LLP and can be reached at jshergill@lawsonlundell.com or by phone at 604.631.6793.