A Brief Introduction to Unanimous Shareholder Agreements

By Shanlee von Vegesack

Background

Every corporation is governed by corporate legislation (such as the *Business Corporations Act* (Alberta)), articles of incorporation and by-laws. These documents cover the basic rules and procedures by which a corporation is governed. However, there may be instances where shareholders will want to agree on matters beyond the scope of the legislation and constating documents of the corporation. A shareholder agreement will allow shareholders to do this – it is an agreement in which the shareholders define their obligations between themselves and it governs shareholders' behavior in certain circumstances. A unanimous shareholder agreement ("**USA**") is a specific type of shareholder agreement that (i) is signed by all shareholders at the time it is first signed; (ii) binds future shareholders whether or not they sign; and (iii) removes, in whole or in part, the duties and powers from the directors of the corporation to the extent shareholders assume them.

Why Adopt a Unanimous Shareholder Agreement?

Share ownership in a corporation brings about certain risks to shareholders; a USA can help to minimize and manage these risks. In addition to numerous other considerations, if there is a significant shareholder in a corporation, then it may be advantageous to smaller shareholders to negotiate a USA. For example a minority shareholder investing significant capital may want certain protections from the significant or majority shareholder. A USA can be a useful mechanism in preventing disputes between shareholders in the future. If a dispute does arise, a USA may drastically reduce the costs of such dispute.

Key Provisions

- *Governance, Management & Control Provisions:* The governance section of the USA will set out provisions dealing with various matters related to the board of directors and its committees, as well as shareholder approvals of certain actions. USAs may dictate specific guidelines for the selection of the board of directors as well the removal of individual directors from the board. As an example, a minority shareholder may want to be assured of a board seat if she invests. She can ask all shareholders to agree to this in a USA. Shareholders may negotiate for additional protections in the USA such as requiring super-majority or unanimous voting on certain significant matters or expanding the list of actions that require shareholder consent.

- *Financing:* These provisions may set out how the corporation's annual budget is to be determined and how it will be funded in the early years. If all shareholders are expected to participate in funding early stage development, the ability to make cash calls may be needed. This is a sensitive issue and would need to be considered carefully.

- *Pre-Emptive Rights*: This right requires the corporation to first offer shares to existing shareholders when it issues new shares. This mechanism can help shareholders avoid dilution.

- *Right of First Offer:* This right requires a shareholder to offer its shares to the other existing shareholders before offering to sell to third parties.

- *Right of First Refusal:* This right requires the selling shareholder to offer to sell the shares to the other existing shareholders after receiving a bona fide offer from a third party, and on the same terms as that third party offer.

- *Piggyback/Tag-Along Rights:* These rights are designed to protect minority shareholders. They typically provide that, if a majority shareholder sells all or some portion of her shares, the other shareholders must be allowed to participate in the sale on a *pro rata* basis and on the same terms as the majority shareholder.

- *Drag-Along Rights:* As opposed to piggyback/tag-along rights, these rights are designed to protect the majority interest. They typically allow a majority shareholder selling all of her shares to a third party to force the minority shareholders to sell all of their shares as well. Such a mechanism may enable the majority shareholder to command a greater premium for all the shares.

- *Buy-Sell Provisions:* These provisions describe certain triggering events for circumstances where the shareholders either may, or must, purchase or sell shares from each other. Common examples of triggering events would be: death or disability, termination of employment, fraud, insolvency, breach of the USA or an irresolvable shareholder disagreement over the operation of the business.

- *Shotgun Provisions:* These provisions are exit provisions and relatively blunt instruments, and allow a shareholder to offer to buy all of the shares held by another shareholder at a specified price per share. The other shareholder may then either choose to sell their shares at the offered price, or instead to buy all of the offeror's shares at that same price per share (ensuring that only one party is left with a position in the corporation). These can work well between shareholders with relatively equal bargaining positions, but can disadvantage a financially weaker shareholder. If the price is high the weaker shareholder may not be able to raise the purchase price and might be forced to sell.

- *Valuation Provisions:* Valuation provisions are critical in respect of any buy-sell provisions contained in the USA. Common methods for valuing transferred shares include setting an agreed price at the outset, mutual agreement of the parties, establishing a formula and obtaining a valuation from an independent third party.

- *Confidentiality of Information:* This provision protects against unauthorized disclosures of confidential information by the shareholders. It is particularly useful when the shareholders are also key employees of the corporation and have access to sensitive information.

- *Non-Competition and Non-Solicitation:* These provisions restrict the shareholders' ability to compete with the corporation or solicit employees away from the corporation for a fixed period. These provisions are likely to apply to shareholders differently depending on their level of involvement with the corporation. As above, key employees will likely be subject to stricter provisions.

- *Dispute Resolution:* These provisions provide mechanisms for resolving various disputes. Depending on the dispute contemplated, the various mechanisms may include a unilateral decision made by one of the parties, negotiation, mediation, arbitration, and buy-sell/shot-gun clauses. Buy-sell/shot-gun clauses consist of an offer by one shareholder to another to purchase all of the other shareholder's shares for a given price.

Tailoring Your USA

The terms of a USA are driven by the unique needs of the parties and must be tailored to address the particular risks and objectives of those parties. The USA should anticipate reasonably likely events in the future as well as provide flexibility for dealing with unforeseen events. Several aspects will need to be discussed and negotiated at the outset, such as the nature and composition of the board, division of management between the board and shareholders and amongst shareholders, exit rights and other restrictions on share sales and the terms of any governing documents that are already in place.

While negotiating a USA may be challenging, it is often easier to negotiate fair provisions for foreseeable issues at the outset than to do so once the event has occurred.