

MEMORANDUM

Shareholders Agreements

The Business Corporations Act (Ontario) (the "Act") provides that shareholders may enter into a unanimous shareholders agreement which, among other things, permits the shareholders to restrict or regulate the management of a corporation. Generally, shareholders agreements are utilized to protect the interests of the minority shareholders; document shareholders' mutual obligations and liabilities; provide for transfers of control between generations; provide for planning in the event of unexpected occurrences such as death or disability; and provide a means to resolve disputes between shareholders.

There is no "standard form" of agreement that will meet the needs of every corporation. Each agreement must be tailored specifically to the circumstances of the shareholders and the business of the Corporation. There are however several provisions usually found in a shareholders agreement.

Business Decisions

Initially, you should consider the decision making authority that is to be given to the shareholders. Without any agreement the shareholder with the majority of voting shares will be able to elect the directors and therefore control either directly or indirectly the decisions involving the business and operations of a corporation. (Some major decisions such as changes to the Articles and sale of the business will require 2/3 voting support of the Shareholders). In circumstances where the shareholders have an equal number of shares, there is potential for deadlock.

Shareholders agreements will attempt to categorize decisions which may be made by one shareholder alone, a majority of shareholders, all shareholders or such other proportion as the parties desire.

Issue of Shares

The agreement will usually restrict any further issue of shares by the Corporation without the consent of all shareholders or of certain shareholders.

Transfer of Shares

Shares are personal property and therefore transferable unless otherwise provided in the Articles of the Corporation or the shareholders agreement.

Generally in privately held corporations, shareholders do not want to discover they have a new "partner" in the corporation because a shareholder has transferred his/her shares. Therefore agreements often restrict the transfer of shares without the consent of all shareholders.

The definition of transfer may be very broad to include gifts, inheritances and pledges of shares as

security.

Right of First Refusal

If shareholders wish to restrict transfers but provide some flexibility to sell shares, rights of first refusal can be used to overcome the absolute restriction against transfers noted above.

Such a provision typically provides that in the event a shareholder wishes to sell his/her shares, then the shareholder shall provide the other shareholders the terms upon which he/she wishes to sell. The other shareholders have first right to purchase the shares in accordance with those terms. If the other shareholders do not purchase the shares, the originating shareholder is entitled to sell, on the same terms to a third party.

Third Party Offers

A similar type of provision provides that, if a third party offer is received to purchase the business of the Corporation or all of the issued and outstanding shares, a shareholder who wishes to accept such offer may require the other shareholders to sell to the third party, or purchase the shares of the shareholder wishing to sell at the same price as offered by the third party.

Triggering Events

Given that the agreement may limit the transfer of shares and given the nature of small business corporations generally, it is often difficult to market or sell shares to third parties. This becomes a burden in certain circumstances beyond control of the shareholders such as death, long term disability and bankruptcy.

Many agreements provide that in such cases, which we define as "Triggering Events", either the Corporation or the other shareholders are required to purchase the shares held by the affected shareholder. If a mandatory sell is not desired consideration can be given to including options to purchase.

It is necessary to provide how the purchase is to be conducted and payment made; what the purchase price will be or how it is to be determined; and the method in which the price will be funded. Funding is always a concern and can put unnecessary strains on the operations of a corporation. Insurance on the lives of the shareholders can be a very valuable tool.

Other events may be including in the list of Triggering Events, one of the more common being marital breakdown combined with a claim of ownership in the shares.

Buy-Sell Provisions

In small business corporations a major concern is the occurrence of a dispute between the shareholders which can render the business unmanageable. Without agreement, the only resolution

may be a winding up of the corporation and sale of its assets. On liquidation the true value of the business is never realized.

There are many types of buy-sell provisions which attempt to provide a resolution for shareholders in the event of deadlock. One of the more common provisions in a 50-50 situation is referred to as a "shotgun" provision.

The provision basically permits a shareholder to advise the other shareholder(s) that he/she wants to either sell his/her shares or purchase the other's shares at a price, which is the same in either circumstance. It is then the decision of the other shareholder(s) whether to purchase or sell.

Financing

Shareholders may wish to make provision for the method a corporation will raise funds if needed for working capital or equipment. Without an agreement there is no obligation on shareholders to invest further funds nor assist the corporation to raise funds by providing guarantees.

Agreements can provide that shareholders may be required to contribute additional monies to the Corporation by way of loan if additional working capital is required for the operation of the Corporation assuming financing is not available from other sources.

Penalties may be enforced if a shareholder fails to contribute his/her portion.

Management

Certain organizational matters such as the number of directors, quorum of directors meetings, officers, accountants and signing authority will also be specified in an agreement.

Restrictions are often imposed on the management of the Corporation without the approval of shareholders.

The shareholders may wish to set out policies with respect to when dividends shall be paid and the desirable amount of reserves.

The duties and salaries of each of the shareholders who also provide services to the corporation can be fixed. Changes to such benefits and termination may require consent of all or a portion of the shareholders or as specified in the agreement.

Liabilities

It should be noted that the Act provides to the extent the Shareholders take over the responsibilities of the directors, they also assume many of the liabilities that directors are subject to by reason of holding such position.

Generational Planning

When combined with an estate freeze, the agreement may be a very useful tool to document the "post-freeze" operation of the Corporation.

An estate freeze permits the existing shareholders to fix their current ownership value in a tax free manner while passing all or a portion of the future growth in value of the Corporation on to the next generation. A shareholders agreement can set out how the "retiring shareholders" can expect to receive any future share of income, if any, or the value or equity which they have accumulated in the Corporation. The agreement can document the method or conditions of a change of control.

Flexibility

We trust the forgoing will be informative and give you the basis for discussing the need and contents of an agreement to be tailored to your needs. Please note that the terms and structure of an agreement can be tailored to the specific needs of your business.

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Per:

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