Why a Shareholders' Agreement is crucial for your Company.

A Company with two or more shareholders should have a Shareholders' Agreement. The Shareholders' Agreement provides a framework to navigate within regarding the shareholder's rights and obligations, and the protection of the interests of all the shareholders in the event of changing circumstances.

The agreement should provide guidelines about how the ownership of the company will operate, including an outline of the funding of share transfers, management rights, dividend policies and details of how equity will be provided to employees. As well as setting parameters for company operations, the overview helps guide shareholders through issues not dealt with elsewhere in the agreement.

Some other key considerations to include in a shareholders' agreement for your company:

How are the Company's shares valued? This price is critical to a wide range of actions, including issuing new shares and shareholder sales. There are several valuation methods such as capitalisation of earnings, discounted cashflows and net tangible assets. All are subjective – different external valuers can come up with different valuations of the same company, so the agreement should specify an agreed methodology.

Did you know there are several exit strategies available for shareholders to buy and sell their shares? Setting out formal processes that govern how shareholders can exit the business and at what price, can remove a major source of contention in private company ownership. The sale process should give existing shareholders pre-emptive rights to purchase the stake before it can be sold to an outsider using the valuation method set out in the agreement. Should the partners refuse this "first right" to buy, then the selling partner can then find a third-party buyer at the same (or higher) asking price.

What happens in the event of death or disability? How are the Shares handled? How do existing partners protect the company? The shareholder agreement can ensure shareholders are able to afford to purchase the stakes of co-owners in the event of death or disability, by funding such a sale through linked life and trauma insurance. The death of an owner can cause problems for private companies – relatives may wish to realise inherited company shareholdings, thus requiring other shareholders to raise finance or face the prospect of the stake being sold to an outsider. The shareholder agreement can stipulate that each owner should take out life and trauma insurance to the benefit of other shareholders, which then provides finance to buy the stake in event of death.

How are Dividends Paid? Set out how often dividends will be paid and how their value will be determined (e.g., as a percentage of net profits). The agreement should say when they are not to be paid – such as when working capital is required and liquidity ratios have fallen below a threshold.

What happens when you cannot agree? The Agreement doesn't handle your particular problem? Although the agreement should stem most possible sources of conflict between shareholders, it should also anticipate that owners may disagree occasionally and provide a mechanism to resolve differences. The most common approach is to nominate a third-party mediator.

We've only discussed a few considerations when putting together your company's shareholders' agreement. Let's discuss in detail: call our offices 905-456-9969 or email ruby@rutmanlaw.com.