

Practical Law Canada

Drafting a Shareholder Agreement

Welcome to the Practical Law Canada tutorial on drafting a Shareholder Agreement. The purpose of this tutorial is to show you how you can use Practical Law Canada resources to help you complete this task.

When you access our site you can see a list of all Practical Law Canada's practice areas. Practical Law Canada covers a wide variety of subjects all of which can be accessed from this page.

As drafting a shareholder agreement for a private company is a corporate matter, let's start by selecting the Corporate and M&A practice area, and then selecting the Corporations subtopic. By selecting the subtopic you can see a list of all the corporation's resources. We have organized our resources this way to make them easy to browse. The resources fall into various categories.

These categories include Practice Notes, which are straightforward how to guides. Practice Notes help you get up to speed quickly and include broad overviews as well as detailed notes on particular issues.

We also have Standard Documents and Standard Clauses, including template agreements, clauses, memorandums, and resolutions. All Standard Documents and Standard Clauses contain drafting notes to explain legal, drafting and negotiating points. The drafting notes are great time savers and can be particularly helpful at crunch time.

Next we have checklists, which include concise list of points, timetables and flowcharts you can consult to ensure you have thought of everything.

Toolkits aggregate most of the available resources on a topic. They are often the most valuable to a lawyer who is new to an area of law and wants to study it.

We also have Legal Updates. Our editors are constantly researching new sources and will promptly alert you to important developments.

Our core resources are maintained by our editors so you don't have to worry about whether or not the resource you are reading is up to date and reflects changes in the law.

Now let's look at a hypothetical scenario and see how Practical Law Canada's resources can help you draft a shareholder agreement.

Suppose a first year associate has been asked by a partner to take first crack at drafting a two-party unanimous shareholder agreement for a private corporation.

There are two shareholders; one shareholder holds 51%, the other 49% of the shares.

The partner hands you a copy of the corporation's articles, by-laws and a draft term sheet for the unanimous shareholder agreement. The partner is leaving for the day, but wants a draft unanimous shareholder agreement on her desk by end of day tomorrow.

The term sheet, among other things, stipulates that the board will be comprised of six individuals, and each shareholder will have two director nominees on the board. As the board is an even number, the term sheet states that the unanimous shareholder agreement must include a deadlock provision with a shotgun buy and sell provision.

Also, matters of importance, including any budgets and strategic plans, must be approved by a super-majority of the shareholders.

The associate needs help.

To begin with, she has never drafted a unanimous shareholder agreement before and can't remember how it differs from a shareholder agreement.

Also, she has never heard of a deadlock provision, and only knows about Russian roulette, shotguns and Texas shoot outs from the movies, but doesn't think that knowledge will help her here. She needs to quickly obtain familiarity with these concepts and draft the unanimous shareholder agreement by her deadline.

So let's see what Practical Law Canada resources are available to help the associate complete her task. As mentioned previously, the associate can browse through the corporate resources to locate those relating to shareholder agreements.

The associate can also access Practical Law Canada's shareholder agreement resources by conducting a keyword search. The keyword search works the same as a WestlawNext Canada search.

To limit your search results you can put your phrase in quotes. Your search results are listed by relevancy. Searching the phrase "shareholder agreement" in quotes will help you easily access the most relevant resources for the project.

The first resource in the results list is the Shareholder Agreement Toolkit. If you see a toolkit that means there are numerous resources on Practical Law Canada dealing with the task at hand. A toolkit is an easy way to find all relevant resources quickly.

If we select the Shareholder Agreement Toolkit, you can see a brief introduction to the topic, then a list of Practical Law Canada resources. The resources are categorized by type.

If you look at the first paragraph of the toolkit (the introduction), you can see the term "unanimous shareholder agreement" in bold and underlined. This means that the term "unanimous shareholder agreement" is found in Practical Law Canada's glossary. The associate can select the link and access the definition easily.

The definition describes the main characteristics and features of a unanimous shareholder agreement, which shows her how a unanimous shareholder agreement differs from a shareholder agreement – one problem down.

If you return back to the Shareholder Agreement Toolkit you can see all the resources Practical Law Canada has on the topic. The first Practice Note in the list is Shareholder Agreement Commentary.

If we select this Practice Note, we can see, from its table of contents and by scrolling down the document, that the Practice Note describes many of the typical conditions found in a unanimous shareholder agreement.

The Practice Note describes provisions relating to composition of the board of directors, shareholder approvals, non-competition covenants, including a general shotgun provision and deadlock. In fact, the Practice Note contains links to Checklists, Standard Documents or Standard Clauses that can help the associate draft the agreement.

The associate has now read the Practice Note and understands some basic terminology and concepts in the term sheet. But understanding concepts is one thing - being able to draft an agreement that fully addresses all the issues is another.

We know that many times junior lawyers pull up agreements that other lawyers have drafted and just modify the business terms assuming that the rest of the language will be fine because a more senior lawyer drafted it.

But, because unanimous shareholder agreements are heavily negotiated, the associate will not know which provisions are standard and which provisions have been negotiated, and there may be legal issues the associate is unaware of until they surface after the agreement is executed.

Let's go back to our toolkit, and see what other resources can help the associate draft her agreement.

One very helpful resource is the Shareholder Agreement Checklist. This checklist sets out concise points a lawyer should consider when completing a draft unanimous shareholder agreement, including considerations relating to the parties, the nature of their holdings, any protections afforded to them, and any restrictions on share transfer. The associate can compare the Shareholder Agreement Checklist to her term sheet to determine if any pertinent information may be missing from the term sheet. If she believes so, she can make inquiries with the partner well before her deadline to confirm or clarify the term sheet and produce a solid draft of the unanimous shareholder agreement.

Another very helpful resource is the form of agreement itself. There are two shareholder agreement Standard Documents in the Shareholder Agreement Toolkit.

As mentioned earlier, Standard Documents are forms or templates of agreements with drafting notes that contain drafting or negotiating points. The most relevant Standard Document in our scenario is the Unanimous Shareholder Agreement (Two-Party).

You can use a Standard Document in two ways. You can print it out with all the drafting notes to use as a guide while you draft the agreement from your firm's template; or, download and modify the Practical Law Canada Standard Document to suit your project.

Every Standard Document is downloadable into Word. The Word version is formatted normally and does not contain any drafting notes. You can save the Word version directly to your system. This form of agreement goes through all the provisions that you typically find in a two-party unanimous shareholder agreement, and will provide our associate with explanations, drafting tips and model language. For example, section 2.01 of the agreement addresses board designates.

The drafting note for this section mentions that despite having the ability to designate a director, case law indicates that the director does not work for the shareholder. The director must meet his fiduciary duties and consider the best interests of the corporation. This is a good point for the associate to remember.

Section 2.03 of the unanimous shareholder agreement addresses super-majority approval. The drafting note describes what matters should be subject to super-majority approval and mentions that the provision should not contain any unnecessary restrictions that may impede the corporation's ability to carry on business.

If the term sheet is a bit vague or unclear on what matters should be subject to super-majority approval, the associate now knows that an overly broad draft provision could encumber the corporation, and to confirm with the partner what specific matters should be included in the provision.

The associate compares the remaining provisions contained in the client's term sheet to the Standard Document, Unanimous Shareholder Agreement: Two-Party and realizes that it doesn't contain a deadlock provision with a Russian roulette shotgun, a concept which she is still somewhat unclear about.

As noted before, when you want to find resources on a specific topic, it is helpful to conduct a keyword search. If you search the phrase "Russian roulette" the first search result is the Standard Document, Shotgun Buy-sell Agreement – a document that is also found in the Shareholder Agreement Toolkit, and linked to the Practice Note, Shareholder Agreement Commentary.

The Standard Document, Shotgun Buy-sell Agreement provides a good description of the concept, including a graphic, as well as the full clause that the associate can insert into her client's unanimous shareholder agreement.

With Practical Law Canada's help, the associate has drafted her first unanimous shareholder agreement. We hope that you have found this tutorial helpful.

Of course we have resources to assist with many other projects. We encourage you to take a few minutes to search our site and see how practical Practical Law Canada can be to you. Thanks for joining us today.