Unanimous Shareholder Agreement Disputes: Drafting Tips and Best Practices

Prepared for: Legal Education Society of Alberta

Unanimous Shareholder Agreement Disputes

Presented by:

Kristos J. Iatridis

Bennett Jones LLP

Calgary, Alberta

For presentation in:

Edmonton, Alberta – April 6, 2016

Calgary, Alberta – April 20, 2016

UNANIMOUS SHAREHOLDER AGREEMENT DISPUTES: DRAFTING TIPS AND BEST PRACTICES

1. INTRODUCTION

This paper is intended to serve as a supplement to the presentation on Drafting Tips and Best Practices given by Kristos J. Iatridis in for the Legal Education Society of Alberta program on Unanimous Shareholder Disputes held in Edmonton on April 6, 2016 and in Calgary on April 20, 2016.

This paper is divided into three main components:

(a) Identification of key areas where disputes may arise and provision of sample clauses to help your clients avoid these disputes.

(b) A discussion of Enduring Powers of Attorney versus Irrevocable Powers of Attorney.

(c) A brief case study that will serve as a guide when enforcing a drag-along clause in a USA.

2. KEY AREAS OF POTENTIAL DISPUTE AND SAMPLE CLAUSES

As solicitors, it is our role to assist our clients in negotiating agreements that will provide as much clarity as possible to the business deal that has been struck while, at the same time, anticipating contentious issues that may arise in the future. While good drafting cannot, in itself, prevent a conflict from arising between parties, it can provide your client with the tools it may need to prevent a conflict from advancing too far or, in extreme situations, provide your client with the ammunition required to be successful in the context of a litigated settlement.

This section will identify key areas where disputes may arise among shareholders in the operation or disposition of a company, and provide sample clauses that will assist your clients in either preventing a dispute or being successful if a dispute cannot be avoided.

Avoid Conflicts among Constating Documents

A USA, together with the articles and by-laws of a corporation, comprise the fundamental governing documents, or constating documents, of the corporation. The constating documents set out for the shareholders how the corporation will be governed in any number of key areas. As such, in order to avoid confusion and potential conflict, the constating documents of any corporation should be drafted in such a way that they do not become cross-threaded with each other.

However, because it is common for articles, by-laws and USAs to cover similar topics, and because the USA is the document on which shareholders will most likely focus their time and attention, a USA should, at a minimum, include a "paramountcy" clause which states that the USA is intended to govern in the event of any conflict among the USA and the other constating documents. In order to give further effect to the clause, you may also consider including a concept providing that the shareholders shall agree to vote in favour, or otherwise cause to be amended, other constating documents in the event of a conflict with the USA. Such a clause would read as follows:

> **Conflict**
>
> In the event of any conflict between the provisions of this Agreement on the one hand and the Articles, By-Laws, or both, on the other, the provisions of this Agreement shall govern. Each Shareholder agrees to vote or cause to be voted the Shares owned by it as necessary so as to cause the Articles or By-Laws, or both, as the case may be, to be amended to resolve any such conflict in favour of the provisions of this Agreement.

Board Nomination Rights Should Reflect Potential Changes in Shareholder Base

When dealing with one or more large shareholders, it is common for these large groups to require the right to nominate directors to the board of the corporation. The determination of how many board seats will typically be allocated to a particular shareholder will typically be made at the time that the shareholders make their initial investments in the company. However, because a USA is a permanent fixture of the company, and can be very difficult to amend, the board nomination provisions should be flexible enough to contemplate future changes in the composition of the shareholders in the event that any large shareholder has its shareholding reduced, for any reason, over time. In the event that a shareholder's nomination rights step down with its shareholdings, the remaining board members should be granted the authority to fill the vacancy left when a step-down occurs. An example of such a clause would read as follows:

> **Board Nomination Rights - Step-Down**
>
> If [Majority Shareholder] no longer owns or controls at least 30% of the issued and outstanding Common Shares (calculated on a non-diluted basis), one [Majority Shareholder] Nominee shall immediately resign as a director and if the applicable [Majority Shareholder] Nominee does not tender his or her resignation, the Shareholders shall immediately cause all of the Shares directly or indirectly owned thereby to be voted to remove such director. On the resignation or removal of such director, any vacancy on the Board shall be filled by a majority of the remaining directors or such position may remain vacant. For greater certainty, [Majority Shareholder] shall be permitted to retain one [Majority Shareholder] Nominee for so long as it owns or controls at least 15% of the issued and outstanding Shares (calculated on a non-diluted basis).