

SHAREHOLDERS' AGREEMENT CHECKLIST

CONTENTS		PAGE
A.	Date.	1
B.	Identification of Parties.	1
C.	Recitals.	1
D.	Interpretation and General Contract Provisions. . .	2
E.	Scope and Nature of Shareholders' Relationship. .	3
F.	Conduct of Affairs of Company.	3
G.	Financing.	8
H.	Restriction on Transfer/Right of First Refusal. . .	9
I.	Compulsory Buy-Out (Shotgun Clause).	11
J.	Obligation to Join in Sale.	12
K.	Obligation to Purchase.	13
L.	Indemnification and Discharge of Guarantees. . .	13
M.	Insurance Policies.	13
N.	Sale on Death.	14
O.	Valuation of Shares.	16
P.	Wills.	17
Q.	Default.	17

CHECKLIST

A. DATE

1. Date of agreement. _____

B. IDENTIFICATION OF PARTIES

1. Individual shareholders (all shareholders must be parties, including non-voting shareholders). _____

2. Company. _____

3. Where shareholder is company, consider adding its shareholders as parties to covenant regarding control of shareholder company. _____

C. RECITALS

1. General statement of legal relationship among parties. _____

2. Company particulars, which provide background

information needed to understand terms of shareholders' agreement, such as:

- a) Business that will be carried on. _____
- b) Authorized capital, including list of shares issued to each shareholder. _____

- c) Reasons for entering into agreement. _____

D. INTERPRETATION AND GENERAL CONTRACT PROVISIONS

- 1. Definitions - define all terms as needed. _____
- 2. Term of agreement. _____
- 3. Arbitration clause. _____
- 4. Notice procedure. _____
- 5. Additional documents. _____
- 6. Counterparts. _____
- 7. Time is of essence. _____
- 8. Entire agreement. _____
- 9. Enurement. _____
- 10. Currency. _____
- 11. Headings for convenience only. _____
- 12. Governing law. _____
- 13. Gender. _____
- 14. Calculation of time. _____
- 15. Legislation references. _____

- 16. Extended meaning of shares. _____
- 17. Severability. _____
- 18. Termination of prior agreements. _____
- 19. Assignability. _____
- 20. Facsimile clause. _____
- 21. Schedules, such as:
 - a) Certificate of Incorporation. _____
 - b) Articles of Incorporation. _____
 - c) Bylaws. _____
 - d) Life insurance policies. _____
 - e) Pro forma budget. _____

E. SCOPE AND NATURE OF SHAREHOLDERS' RELATIONSHIP

- 1. Agreement governs dealings. _____
- 2. No shareholder has power to bind any others except as expressly permitted. _____

F. CONDUCT OF AFFAIRS OF COMPANY

- 1. Statement that, except as provided in agreement, conduct of company's business shall be governed by articles and *The Business Corporations Act*. _____
- 2. Directors:
 - a) Number. _____
 - b) Appointment (e.g. each shareholder to appoint one or more nominees, all shareholders to agree on appointment of _____

- nominee to break any deadlocks). _____
- c) Resignation. _____
- d) Filling vacancies. _____
- e) Removal (e.g. cause for removal, procedure, replacement). _____
- f) Right of director to appoint alternate. _____
- 3. Quorum for transaction of business:
 - a) Number constituting a quorum, and whether nominee for each shareholder is required to be present. _____
 - b) What happens when there is not a quorum (e.g. adjournment, with whoever attends adjourned meeting constituting a quorum). _____
 - c) Procedure for breaking a deadlock. _____
- 4. Directors' meetings:
 - a) Place and time. _____
 - b) Calling a meeting, including notice requirements. _____
- 5. Shareholders' meetings:
 - a) Place and time. _____
 - b) Calling a meeting, including notice requirements. _____
 - c) Quorum and voting. _____
- 6. Officers and employees:
 - a) Positions. _____

- b) Duties. _____
 - c) Appointment (e.g. shareholder nominees to be appointed). _____
7. Major decisions requiring unanimous approval or special approval of directors or shareholders, such as:
- a) Sale, lease, transfer, mortgage, pledge or other disposition of undertaking of company or subsidiary: see *The Business Corporations Act*, s. 183. _____
 - b) Increase or reduction in capital of company; issue of additional shares in capital of company. _____
 - c) Consolidation, merger or amalgamation of company with any other legal entity. _____
 - d) Capital expenditures or commitments exceeding specified amount. _____
 - e) Leases of company property having capital value exceeding specified amount. _____
 - f) Borrowing by company or subsidiary which would result in aggregate indebtedness exceeding specified amount: see *The Business Corporations Act*, s. 183(1). _____
 - g) Loans by company or subsidiary to shareholder or affiliate. _____
 - h) Contracts between company and shareholder or affiliate. _____
 - i) Any transaction out of ordinary course of business of company, including establishment of new business ventures. _____
 - j) Any change in authorized signing officers in _____

- respect of legal documents or any financial institution.

- k) Amendments to articles, bylaws and other fundamental changes such as amalgamations: see *The Business Corporations Act*, ss. 98 and 167.

- l) Payment of dividends and profits of company.

- m) Adoption or amendment of budget.

- n) Any agreement by company restricting, or permitting any other party to accelerate or demand payment of company indebtedness upon sale, transfer, or other disposition by shareholder of his or her shares or loan.

- o) Any amendment to any employment contract made between company and one of other parties to agreement, or representatives of one of those other (corporate) parties.

- p) Employment by company of any relatives of shareholder or, if a corporate shareholder, its representative.

- q) Wavier or appointment of auditor.

- r) Other decisions of particular importance having regard to nature of company business.

- s) Compensation of directors, officers and key employees: see *The Business Corporations Act*, s. 120.

- t) Issue, redemption, hypothecation or purchase of shares.

- u) Declaration of dividends and dividend

policy.

8. Where shareholders will be running business, consider:

a) Including shareholders' employment provisions in shareholders' agreement.

b) Having separate employment or management contracts tied to shareholders' agreement so that default by shareholder under his or her employment contract would trigger default under shareholders' agreement.

c) Restricting ability of directors to manage business of company.

9. Shareholders' duties to company:

a) Duty not to compete, during time he or she is shareholder and reasonable time thereafter, within reasonable geographic area.

b) Methods for authorizing exceptions to duty not to compete.

c) Duty of confidentiality.

10. Statement that each shareholder acknowledges that, by reason of his or her unique knowledge of association with business of company, the covenants set out in para. F.9 are reasonable and commensurate with protection of legitimate interests of company, and that it is agreed that covenants shall be several and subsist even if rest of agreement is terminated.

11. Bank and accounts.

12. Signing officers.

- 13. Auditor/accountant. _____
- 14. Books of account, financial statements and accounting principles. _____

- 15. Indemnification of shareholders and directors:
 - a) Who will become liable for obligations of company? _____

 - b) Who will incur personal liability in connection with company? _____

- 16. Pro forma budget (consider attachment as schedule and inclusion of statement of intent). _____

G. FINANCING

- 1. Initial financial contribution required from each shareholder, distinguishing between subscribed capital (equity) and shareholder loans. _____

- 2. Mechanisms by which company may raise additional funds for working capital:
 - a) Borrowing from institutional lender: _____
 - i) Whether company is required to try to obtain funds in this manner before turning to shareholders. _____

 - ii) Whether shareholders are required to enter into guarantees of indebtedness of company (consider provision that liabilities for guarantees shall be shared pro rata and each shareholder will indemnify others for his or her share of amount guaranteed). _____

 - b) Borrowing from shareholders:
 - i) Circumstances in which company _____

may do this, how division is made and whether there is maximum amount that may be demanded.

ii) Contribution and repayment to be pro rata.

iii) Notice requirements.

iv) Shareholders' obligation (or option) to advance funds.

v) Where shareholder is obliged to advance funds, sanctions for failure to do so (may take form of dilution in shareholding if shareholder refuses to provide requested financing).

c) Whether shareholder loans bear interest.

d) Provisions regarding repayment of shareholder loans, including whether there is right to demand repayment.

e) Distribution of net profit:

i) Statement that distribution will occur except as prohibited by terms of debt financing, and to extent permitted by law, after board has provided (by resolution) for such reserves as are necessary.

ii) Frequency of distribution.

iii) Priorities (e.g. repayment of loans, dividends).

H. RESTRICTIONS ON TRANSFER/RIGHT OF FIRST REFUSAL

1. Right of first refusal to be offered to company or

other shareholders, setting forth investment offered for sale.

a) Purchase price, which must be within guidelines set out in agreement.

b) Terms and conditions of sale, including method of payment, whether price may be paid over time and, if so, provisions regarding interest on unpaid balance, security on unpaid balance (e.g. in form of escrow agreement annexed as schedule), and whether prepayment can be made without penalty.

c) Prospective purchase (where there is offer from third party). Consider whether it should be pre-condition that third party offer has been obtained.

d) Whether offer may be accepted in part, or must be accepted in its entirety or not at all.

e) Length of time offer is open for acceptance (as set out in agreement).

f) If offer has not been wholly accepted within specified time period, offeror has right, for specified period of time, to dispose of investment to third party (specify whether this may be to any third party, upon no better terms and conditions than were set out in offer, or to particular third party, where terms and conditions offered have first been offered to other shareholders and have not been taken up), provided that third party has entered into agreement with company and shareholders by which third party is bound by agreement.

g) Provisions regarding completion of sale (including where, when and how).

- h) Consider including set-off where vendor is indebted to company. _____

- 2. Whether disposition to affiliate is authorized and, if so, under what conditions (e.g. that affiliate will remain affiliate so long as it holds investment and, prior to ceasing to be affiliate, will transfer investment back to shareholder; that affiliate is bound by agreement). _____

- 3. Defaulting shareholder is not entitled to dispose of his or her investment pursuant to above provisions unless prior to or concurrently with transfer he or she ceases to be defaulting shareholder. _____

- 4. Except as provided in agreement, no shareholder shall dispose of his or her investment without meeting requirements set out in agreement (e.g. prior written consent of other shareholders, or of any other party where such consent is required by agreement between company and that party). _____

- 5. No shareholder shall encumber his or her investment except as provided in agreement. _____

- 6. Upon execution of agreement, shareholders shall surrender to company each share certificate, which shall be endorsed to indicate that transfer is subject to agreement. Consider whether shares should be placed in escrow to be dealt with in accordance with agreement. _____

- I. COMPULSORY BUY-OUT (SHOTGUN CLAUSE)**

- 1. Shareholder may make compulsory offer to other shareholders to either sell all of his or her investment or buy all of other shareholders' investment at price and on terms and conditions set out in offer. _____

- 2. Notice requirements and limitation periods are as set out in agreement. _____

3. Shareholders to whom offer is made have option of buying (pro rata) or selling, but failure to give notice of election within specified time period shall be deemed to be acceptance of offer to sell. _____

4. Provisions for handling situation in which some shareholders elect to sell and some to buy. _____

5. Provisions regarding completion of sale (including where, when and how). _____

6. Consider including set-off where vendor is indebted to company. _____

J. OBLIGATION TO JOIN IN SALE

1. Shareholder may require other shareholders to join in sale of whole of business to outsider, by notifying them of offer or alternatively, compelling other shareholders to sell their shares to it. This is commonly known as a "call" provision and is usually used to give majority shareholder the right to remove minority shareholder in specific circumstances. _____

2. Notice requirements and limitation periods are as set out in agreement. _____

3. Alternatively, shareholders to whom offer is made have option of buying investment of shareholder who gave notice (pro rata) at offered price, or of joining in sale of all investment to third party. This is commonly known as a "piggy back" provision and ensures protection of minority shareholders. _____

4. Provisions for handling situation in which some shareholders elect to sell and some to buy. _____

5. Provisions regarding completion of sale (including where, when and how). _____

6. Consider including set-off where vendor is indebted to company. _____

K. OBLIGATION TO PURCHASE

- 1. Shareholder may require company or other shareholders to purchase his or her investment in circumstances set out in agreement (e.g. retirement from work force or from active involvement in company's business). This provision creates liquidity for minority shareholder and is commonly known as "put" provision. _____

- 2. Price, terms and conditions and procedure areas set out in agreement. _____

L. INDEMNIFICATION AND DISCHARGE OF GUARANTEES

- 1. Obligation of shareholders and company, where shareholder has disposed of all of his or her investment in compliance with agreement, to use their best efforts to have any guarantee or pledge issued or granted by shareholder discharged or cancelled, and to indemnify departing shareholder for liabilities arising with respect to such a guarantee or pledge subsequent to his or her departure. _____

M. INSURANCE POLICIES

- 1. Obligation of company to own and maintain life insurance policies of specified value on all shareholders and representatives of corporate shareholders (such as policies to be listed in schedule to agreement). (Or, alternatively, obligation of shareholders and representatives to own and maintain cross-cross life insurance policies). _____

- 2. Obligation of shareholders to cooperate (e.g. by attending physical examinations). _____

- 3. Rights of company with respect to policies, such as:
 - a) To apply any policy dividends to payment _____

of premiums.

- b) To collect death benefits.
- c) No right to modify or impair any rights or values of policies, or exercise any rights of ownership, except as provided in agreement or with prior written consent of shareholders.

4. Rights of shareholders with respect to policies, such as:

- a) To obtain information from insurer regarding status of policy on his or her life.
- b) To pay premiums where company fails to do so, and to be reimbursed.
- c) To purchase policy on his or her life, at price set out in agreement (e.g. cash surrender value), on happening of specified events (e.g. termination of agreement during lifetime of shareholder).
- d) Apply any dividends received on policy to premiums.

5. Uninsurability provisions.

N. SALE ON DEATH

Caveat: This section of the checklist is very involved with tax legislation which changes regularly. It may be appropriate to consult a tax expert before drafting these clauses.

- 1. Where shareholder who is an individual dies, his or her personal representatives shall sell, and company or remaining shareholders shall purchase, from estate the investments held by deceased at death.
- 2. Where representative of corporate shareholder dies, shareholder shall sell, and company or remaining shareholders shall purchase from corporate

- shareholder, the investment held by it at date of representative's death. _____

3. Purchase price and terms and conditions of payment are as set out in agreement. _____

4. Where purchase is required to be made by company, and surplus and capital dividend account is insufficient to authorize purchase, parties to agreement agree to take such steps as are necessary to increase account to amount sufficient to authorize purchase. _____

5. Where purchase is required to be made by remaining shareholders, it shall be on a pro rata basis. _____

6. Company shall, upon death of shareholder or representative, claim and collect proceeds of life insurance policy. The proceeds shall be applied as set out in agreement (e.g. to pay any indebtedness of company to deceased, to pay purchase price, to pay remaining shareholders who make purchase). Consider appropriate disposition of excess insurance proceeds. _____

7. Provisions regarding completion of sale (including where and when). _____

8. At closing the following shall occur, in order set out in agreement:
- a) Purchasers shall pay purchase price, or specified percentage of it, to vendor, and deliver any documents that may be required (e.g. promissory notes, escrow agreements). _____

- b) Unpaid balance, if any, shall be paid and secured as set out in agreement. _____

- c) Vendor, on receipt of purchase price or portion payable pursuant to para. N.3., shall give to purchasers all share certificates, _____

instruments, conveyances, assignments and releases as may be reasonably required to complete sale and to transfer all of investment.

d) Where purchasers are remaining shareholders, company shall pay to them a capital dividend equal to lesser of purchase price or proceeds of life insurance policy (and, in latter case, company shall elect to have dividends payable out of its life insurance capital dividend account pursuant to provisions of *Income Tax Act*).

9. Provision for purchase price adjustment to take into account value of investment as determined by Revenue Canada.

10. Provision that agreement shall have no application upon death of final shareholder or representative of corporate shareholder, notwithstanding any other term of agreement.

O. VALUATION OF SHARES

1. Valuation formula must be practical, reasonable and certain. The following are examples of different methods of valuation:

a) Directors determine value with third party valuation should directors fail to do so or should departing shareholder object to valuation.

b) Purchase price fixed to certain date after which purchase price is set by agent or failing an agent, by third party valuator.

c) Share price set by agreement and failing agreement by third party valuator. If that valuation is objected to, second third party valuation is obtained and if that is objected to, average of the two is taken.

- d) Valuation based on earning power of company. _____

- e) Fixed value to certain date followed by value set by agreement of parties and failing that agreement set by Board of Arbitration consisting of three parties. _____

- f) Third party valuation by accountant and should parties object, valuation to be determined by panel selected by parties. _____

P. WILLS

- 1. As alternative to sections M and N, where shareholders are all natural persons, consider provision that each shareholder shall make and maintain will providing that others will inherit his or her shares. (Note: if will is later changed, it is not likely that it will be set aside on basis of agreement). _____

Q. DEFAULT

- 1. Circumstances that constitute default, such as:
 - a) Failure to carry out obligations under agreement after other shareholders have made written demand that failure be cured. _____

 - b) Failure to defend a proceeding affecting possession or management of shareholder's investment after other shareholders have made written demand that failure be cured. _____

 - c) Bankruptcy, commission of act of bankruptcy, appointment of receiver or receiver-manager with respect to shareholder's assets, or assignment for benefit of creditors or otherwise. _____

 - d) Change in control of corporate shareholder. _____

- e) Termination of employment of shareholder, or representative of corporate shareholder, who was employed by company. _____

 - f) Incapacity (as defined in agreement). _____
 - g) Retirement. _____
2. Consequences of default (indicate if consequences differ for different types of default; indicate alternatives), such as:
- a) Winding-up of company under articles. _____
 - b) Other parties may waive specific default. _____
 - c) Other parties may pursue any remedy available in law or in equity. _____

 - d) Other parties may take such actions as may reasonably be required to cure default, in which case expenses shall be recoverable as provided in agreement. _____

 - e) Implementation of buy/sell procedure, whereby:
 - i) Defaulting shareholder is deemed to offer to sell all or part of his or her investment to company or other shareholders. _____

 - ii) Purchase price is determined as set out in agreement (e.g. discounted value for specified types of default). _____

 - iii) Terms, conditions and procedure are as set out in agreement. _____

 - f) Where default consists of failure to make loan to company as required under agreement, additional remedies may be provided to non-defaulting shareholders, _____

such as:

- i) Recovery of loans made to company. _____

- ii) Right to elect not to make loan without being held to be in default. _____

- iii) Right to make loan on behalf of defaulting shareholder and be entitled to reimbursement from defaulting shareholder and from company out of any funds owing to defaulting shareholder; this may bring defaulting shareholder out of default, if requirements set out in agreement are met. _____

- iv) Right to force defaulting shareholder to sell some or all of its shares. _____

