

## Shareholders' Agreement: Resolving Shareholder Conflict Before it Starts

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It is an unavoidable cost of conducting business that your corporation will inevitably be embroiled in a litigation dispute. What most owners do not realize, however, is that the disputes that cause the greatest level of damages to their business are the internal fights between the shareholders. The commercial litigators at Duncan Craig LLP are often called upon to resolve disputes between shareholders. How efficiently we can help resolve the conflict is often dependent on the dispute resolution mechanisms contained within a shareholders' agreement, if such a document even exists.

The types of disputes that can arise between shareholders are varied and their impact on the business can range from minor irritation to potential demise. Common disputes between shareholders include:

- Conflict over the direction of the company
- Underperformance or low involvement by one of the shareholders / directors
- Disagreement over compensation for directors / shareholders
- Conflicts of interest between competing investments
- The taking on of debt or ability to pay off debt
- The value of shares if one owner is looking to sell

A well-drafted shareholders' agreement can help prevent or minimize disputes by setting out the policies for managing many of these issues. It can also be used to specify the process for resolving disputes should they still occur. Having dispute resolution policies in place will help protect the ongoing operations of the company by setting out the timeframe and process for resolving the conflict. For serious disputes, the shareholders' agreement can also be used to keep matters out of the Courts until the mutually agreed resolution mechanisms have been exhausted.

For more minor conflicts, most matters can be resolved at directors' meetings by majority vote or at a shareholders' meeting based on ownership of shares. In many cases, however, shares in the business are split 50/50 by two owners, which can create a corporate deadlock unless parties are willing to compromise.

If a dispute is more serious the shareholders' agreement can require that it progress to mediation. A well trained, independent mediator can help manage the process and facilitate the negotiation discussions which can lead to a resolution agreement. The shareholders' agreement can also specify that disputes over financial matters can be referred to an independent financial expert. In both cases, the shareholders' agreement should also specify how the mediator or financial expert should be selected. Binding arbitration can also be used as a prescribed mechanism for dispute resolution in the shareholders' agreement.

If a conflict progresses to the point where the corporate shareholders no longer feel they can work together, the shareholders' agreement can specify how the sale of the business or individual shares should take place. A buy-sell provision, commonly referred to as a 'shot gun' clause, allows one shareholder to offer to purchase the shares of the other shareholder (or alternatively, sell their shares to the other shareholder) at the price of their choosing. The shareholder receiving the offer can either accept the offer and sell their shares or buy out their colleague on the exact same terms. Alternatively, the shareholders' agreement could require the sale of the business in its entirety.

Agreeing on the dispute mechanism clauses of a shareholders' agreement is a bit like signing a marriage pre-nuptial agreement. When relationships are strong and there is no conflict is the ideal time to ensure the shareholders' agreement contains the provisions needed to prevent and resolve disputes. Without the provisions in place, each owner will spend more time and money on a dispute that could have been prevented or minimized in the first place.

The bottom line is that an ounce of prevention in preparing a shareholders' agreement is worth a pound of cure in the courtroom. If you have any questions, please [contact us](#).

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