

Topic 21: Agreements

Farms enter into formal (written) and informal agreements all the time. Trust is used the basis from which business is conducted in virtually all situations and especially where the agreements are informal (not written). Trust works well until there is a disagreement or one party of the agreement becomes upset. A formal agreement helps to work through disagreements but in the absence of a formal agreement, resolution can be extremely difficult.

Implementing a transition plan will require that specific agreements be in place. These agreements must be formalized.

This topic is not intended to replace the advice from a professional.

UNANIMOUS SHAREHOLDER AGREEMENT

A shareholders agreement is an agreement between the shareholders of a corporation covering the following items:

- ownership and voting rights
- control and management
- provision for the resolution of future disputes
- how any future capital contributions or financing arrangements are to be made
- other provisions as dictated by the shareholders

Not all companies have a shareholder agreement, but it is **strongly** recommended. Partnerships can have a similar document called a partnership agreement. To be legally binding, shareholder and partnership agreements must be written by a lawyer.

This topic is **not** designed to create a legally binding document. It is designed to help families to identify the points they would like structured into agreements and become part of their transition plan.

The following list of considerations is designed to cover the parts of a shareholder agreement. Some of these parts are not required for partnership agreements but can be included. If you are completing this exercise for a partnership agreement, consider all parts. Your lawyer can advise which ones can or should be included in the final partnership agreement.

Why is this relevant?

The following list of agreement considerations can be referred to for any of the following situations:

- existing corporations that already have a shareholder agreement in place but will need it to be modified or updated as part of the transition plan
- existing corporations that do not have a shareholder agreement already in place
- new corporations that will be formed as part of the transition plan
- partnerships that already have a partnership agreement in place but will need it to be modified or updated as part of the transition plan
- new partnerships that will be formed as part of the transition plan

How will this help transition planning?

- The exercise promotes communication.
- It helps family members understand how future issues will be resolved.
- Once completed, the agreements provide a common base from which the transition can move forward.
- The agreements can be shared with non-farming family members and used to keep them informed about the structure of the business.
- It can help to minimize the potential for conflict.
- It requires that you talk to an advisor. Getting external input can be really valuable.

Instructions

1. If you are modifying an existing shareholder or partnership agreement:
 - a. Refer to your existing agreement.
 - b. Go through the following list of considerations and change, modify, or comment as applicable.
 - c. Take your modified document to your lawyer and he or she will make the necessary changes and suggest other things you should consider.
2. If you are creating a new shareholder or partnership agreement:
 - a. Go through the existing list of considerations and document or comment as applicable.
 - b. Take the document to your lawyer and he or she will make the necessary changes and make suggestions for other things you should consider.

How does this apply?

This exercise is designed to have families begin considering the items and areas they would like structured into their agreements as part of the transition. Take your agreement comments and questions to your lawyer for final review.



PLANNING POINTERS:

- Do not defer this activity.



WHAT TO WATCH FOR:

- Having an agreement in place **before** you have to deal with issues about the structure of the business is a huge advantage. It is virtually impossible to come to an agreement on how you would have resolved an issue after the issue is already a reality — **especially** if there is conflict.
- Do not skip this activity.



EXERCISE: Go to the forms appendix at the back of this guide for the Unanimous Shareholder Agreements information on pages 295-298.

Next steps

Congratulations on completing this topic. You are now a step closer to having a transition plan for your farm. Please proceed to the next topic area on your Transition Plan, but don't forget to add any assigned tasks that were generated by working through this topic.

Unanimous Shareholder Agreements

List of Agreement Considerations

Terms of Agreement: It is important that an agreement contain a clause on the length of time the agreement remains in place. Things to consider include: Should it be 10 years, should it be terminated upon the death of a shareholder or should it be perpetual? Because circumstances change, consideration should be given to the term of the agreement.

A. Provisions for Control

- How many members will there be on the board of directors?
- Will each shareholder be entitled to a nominee on the board?
- What will be the quorum for a properly constituted meeting of the board?
- Who will be the officers of the corporation?
- Will the directors and officers be paid by the corporation? If so, how is their remuneration determined?
- Which officers will be authorized to sign cheques and other banking documents on behalf of the corporation?
- Will two signatures be required for cheques over a certain limit?
- Who can bind the corporation in regard to other matters?
- How will auditors, accountants and lawyers be decided?
- How will meetings be called (mail, other, how many days in advance)?
- Who will be notified of formal and informal meetings?
- Who will vote at the meetings?
- Will votes be decided by simple majority or special majority?
- What circumstances will require a special majority?

B. Operation and Finance of the Corporation

- If funds are required by the corporation, how are those funds to be obtained?
- Will these funds be obtained by the corporation borrowing from a financial institution?
- If the corporation is otherwise unable to obtain these funds, will the shareholders be required to provide guarantees?
- If guarantees are provided, will they be limited guarantees and will guarantor liability be joint and several?
- If the corporation is unable to obtain the required funds with the assistance of shareholder guarantees, will shareholders be required to provide loans to the corporation? Will shareholder loans be secured?

If shareholder loans are secured, under what conditions can a shareholder enforce his right to payment?

How will profits be distributed (salaries, bonuses, dividends, repayment of shareholder advances)?

Will shareholders be allowed to work for the corporation?

What are the powers of the shareholders regarding terminating another shareholder who is an employee of the corporation (ex: for causes such as failure to perform duties)?

C. Restriction on the Transfer of Shares

Will there be a restriction on the transfer of shares?

If so, will this restrict the ability of a shareholder to pledge shares to a bank or transfer shares to a family member or related corporation?

If the shareholders are corporations, should the shareholders be restricted from transferring shares of the shareholder?

D. Death of a Shareholder

In the event that a shareholder dies, should the estate be bound to sell the deceased's shares to the other shareholders, to the corporation for cancellation, or should the estate be allowed to keep the shares?

If an estate is required to sell and the corporation or remaining shareholders are required to purchase the shares, should there be insurance policies on the lives of the shareholders to ensure that the other shareholders of the corporation can afford to purchase the shares in the event of death?

If insurance policies are required, should the corporation pay the insurance premiums?

Upon death, how should the purchase price for the shares be paid (ex: a percentage at the time of the sale and the balance paid in equal consecutive monthly instalments over a period of years with or without interest)?

E. Events Requiring a Mandatory Sale by the Shareholder

Which events should result in a shareholder being required to sell all of the shareholder's shares of the corporation:

The death of the shareholder?

The disability of a shareholder, which results in the shareholder not being able to devote the time and attention required by the corporation?

The shareholder reaching a certain age (ex: 65 years)?

A default by the shareholder under the shareholder agreement or any related agreement?

The insolvency of a shareholder?

F. Disability of a Shareholder

If a shareholder is employed by the corporation, should the shareholder be entitled to continue receiving compensation in the event of a disability?

If so, for how long?

How should disability be defined?

Should a shareholder be required or have the option to sell shares if a disability continues for an extended period of time?

G. Right of First Refusal

If a shareholder is entitled to sell shares of the corporation to a third party, should that shareholder be required to offer the shares to the other shareholders on the same terms and conditions as the bona fide third party offer?

If the other shareholders do not wish to purchase the first shareholder's shares, should they be entitled to require the third party purchase their shares as well (piggy back rights)?

If the other shareholders do not wish to purchase the first shareholder's shares, should they be forced to sell their shares to the third party if the third party wishes to purchase all of the corporation's outstanding shares (drag along)?

H. Buy/Sell

This provision allows a shareholder to provide notice to all other shareholders advising them of a set price for purchase of all the other shareholder's shares or for sale of all owned shares to them. Once a shareholder triggers the buy/sell it is then up to the other shareholders to determine if they wish to be buyers or sellers.

I. Call

Should a shareholder be entitled to require one or more other shareholders to sell their shares in the corporation upon notice?

If so, should this right be exercisable immediately or only after some period of delay?

How will the price be determined?

How will the price be paid?

J. Put

Should a shareholder be required to purchase another shareholder's shares at the option of that other shareholder?

Should this right be exercisable immediately or only after some period of delay?

How will the price be determined?

How will the price be paid?

K. Pre-emptive Rights

If the corporation wishes to raise additional funds by issuing and selling new shares from treasury, should the existing shareholders have the first opportunity to purchase the new shares?

If any shareholders do not wish to purchase these new shares, should the remaining shareholders be entitled to purchase the additional shares, which may result in their holding a disproportionate number of shares?

L. Dispute Resolution

Shareholder agreements often contain a clause, which provides for arbitration in the event that a controversy or claim arises which cannot be settled. The agreement can also be drafted so that the parties must attend mediation prior to starting an action if a claim cannot be settled otherwise.

M. Non-Competition/Confidentiality/Non-Solicitation

Will the shareholders be required to promise that while they are shareholders they will:

- not compete with the corporation in any manner
- not solicit any of the corporation's clients
- promise to keep all confidential information they receive confidential

Should the terms of this clause be extended so that it applies even when the individual is no longer a shareholder? If so, how long should the non-competition/non-solicitation clause continue and what is to be the geographic scope of the covenant?

N. Valuation of Shares

How will the shares of the corporation be valued for sale purposes?

- by a predetermined formula
- by the shareholders themselves
- by endorsing a schedule to the agreement
- by a third-party valuator/auditor

Will the shares be valued annually?

O. Employment

- if one or more of the shareholders is employed by the corporation, should typical employment provisions be included in the shareholder agreement to protect the shareholder, the corporation, or both of them?
- should salary levels be agreed upon for some pre-determined period of time?
- should notice of termination of employment periods be agreed upon?
- should employment automatically terminate if a shareholder sells his shares?