Too Many Cooks Spoil The Broth:
Shareholders' Agreements for British Columbia Corporations

By Scott T. Johnston

A past guilty pleasure of mine has been the television reality show where twelve fledgling chefs compete for the chance to win their very own restaurant. In this competition, they must prepare and cook the best risotto, while challenged by both the other contestants and by a caustic British über-chef. It occurred to me that the pandemonium experienced in this reality show kitchen might occasionally be analogous to that of the relationship among the shareholders of a British Columbia corporation. A corporation is a separate and distinct legal entity that is ultimately owned by individuals (or corporations or other entities) known as shareholders who own the shares of the corporation. So, how will the shareholders define in advance their respective responsibilities, both to each other and to the business that they are carrying on? After all, not many of us are fortunate enough to have an ill-tempered, yet proficient taskmaster to call us a "donkey" when we spoil the broth.

In previous articles, I have discussed the "Articles" of a British Columbia corporation. The Articles are a public document, which are essentially like an instruction manual for the management of the affairs of the corporation. While the Articles do specify how certain matters are to be handled among shareholders of a corporation (as well as under the provisions of the *Business Corporations Act* of British Columbia (the "Act")), there may still be disputes and situations not covered by either the Articles or the law. The legal documents that attempt to fill in these gaps are known as "shareholders' agreements".

Given the complexity and considerable variation in the types of matters that are addressed in shareholders' agreements, they are invariably drafted and prepared by lawyers. The time and cost involved in obtaining an agreement among the shareholders of a British Columbia depends on a myriad of different factors, including without limitation, the sheer number of shareholders, their fundamental understanding of the business arrangement, their reasonable (and sometimes "great") expectations for the venture, the competence of the professional legal and tax advisors to the shareholders, and, as with many human interactions, the comparative ego and affluence of each shareholder.

An exhaustive review of all of the matters and concepts that may be dealt with in shareholders' agreements is beyond the scope of this article. Accordingly, I will attempt to discuss only a couple of the more salient features of shareholders' agreements.

Management of the Corporation. Shareholders own shares of the corporation and have the power to elect and appoint individuals to act on their behalf as the directors of the corporation. The directors are charged with the exclusive power to supervise and manage the corporation and its affairs. Generally, only the majority shareholders (i.e. owning 51% or more of the shares) of the corporation have the ability to elect directors. In addition, most businesses incorporated under Act require a vote of only 66.6% of the shareholders to approve major decisions of the corporation. For example, the majority shareholders holding 66.6% of the shares could approve the sale of all or substantially all of the assets owned by the corporation. Shareholders' agreements often address the protection of minority shareholders by providing for the involvement and participation of minority shareholders in such major decisions.

Shareholders' Contributions and Financing. Shareholders' agreements often set out in detail exactly how the corporation is to be funded and how any profit that is earned will be distributed. Provisions commonly provide for the amount of money each shareholder is paying for their shares, the amount and interest payable on any shareholder loans made by a shareholder to the corporation, and the manner in which each shareholder will receive the return on their investment.

Restrictions on Transfer of Shares. Most businesses incorporated under the Act have no restrictions on how and when a shareholder may purchase more shares or sell his or her shares of the corporation to another person other than the requirement that the directors approve of such allotment or transfer. After a sale of shares by one of the original shareholders, the remaining shareholders that expected to be partners for the long haul in the venture may end up with a new shareholder that they did not anticipate being involved in the business. Shareholders' agreements routinely deal with these matters by providing for rights of first refusal by the existing shareholders to the sale of shares to a new person.

Compulsory Buy-Outs. Friends and money sometimes do not mix. It's "show business", not "show friends". Corporations in British Columbia are predominately private ones, in that a shareholder cannot freely trade his or her shares in an active market, like the shares of publicly traded corporations that are listed on the various stock exchanges. Given the difficulty in finding a market for these shares, shareholders' agreements often provide for the compulsory buy-out of shares by the corporation itself or other shareholders upon the occurrence of certain events. For example, buy-outs may be triggered upon the departure, death, disability, or divorce of an individual shareholder or in the event of a dispute among the shareholders. A shareholder may also default in respect of his or her responsibilities to the business. One of the most severe compulsory buy-out mechanisms is known as a "shotgun" clause whereby a shareholder may be effectively forced out of the corporation, which I will discuss in more detail in a future article.

Scott T. Johnston is a business lawyer with Campbell, Burton & McMullan LLP, http://www.cbmlawyers.com/our-lawyers/scott-t-johnston, practising corporate/commercial and commercial real estate law. *The general information contained in this article should not be treated by readers as legal advice or opinion and ought not to be relied upon without detailed legal counsel being sought.*