

Best Practices in Drafting Corporate Shareholder Agreements

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Corporate shareholder agreements are vital for many companies with more than one shareholder, especially non-public companies with a limited number of persons owning shares. The shareholder agreement typically details the rights and obligations of the shareholders with respect to the buy back of stock in certain circumstances, such as the death of a shareholder, or upon the occurrence of other events, such as retirement of a shareholder, or withdrawal of a shareholder from actively managing the company. For this reason, shareholder agreements are often referred to as buy-sell agreements or buyout agreements.

The single most important step shareholders need to take with respect to a shareholder agreement is engaging competent legal counsel to assist them and the company in asking the hard questions necessary to draft an effective document that accomplishes their purposes. Because shareholders may have different interests and desires to be reflected in the shareholder agreement, it is often necessary for each shareholder to have separate legal counsel to guide them through the process and represent their interests.

Shareholder agreements are vital because Articles of Incorporation and corporate Bylaws tend to be formulaic in nature and cannot deal with the myriad of issues a shareholder agreement needs to address.

Revisions to existing shareholder agreement may also be necessary if new shareholders are added to the company, especially in the case of venture financing. Venture capital firms will insist on a new or revised shareholder agreement as one vehicle to protect their interests and the investment they make as part of a financing transaction. At the very least, all stock certificates should have a restrictive legend that states they are subject to the terms of the shareholder agreement. This puts all new shareholders on notice that they take such shares subject to the shareholder agreement.

Among the many key issues to be addressed in a shareholder agreement are the following:

1. Mandatory buyout scenarios (e.g. death).
2. Optional buyout scenarios (e.g. disability, bankruptcy, withdraw from management).
3. Restrictions on stock transfer (e.g. right of first refusal for other shareholders).
4. Terms of stock transfer (e.g. valuation method for shares)

It is also vital that spouses of shareholders be required to agree to the terms of a shareholder agreement in community property states.

Shareholder agreements are complex documents and the information contained above merely scratches the surface of issues, circumstances and details they typically address. For that reason, the best and most important practice to follow when it comes to shareholder agreements is to engage competent legal counsel to assist you and your company in asking the hard questions necessary to draft an effective document.

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