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5 Tips for Implementing an Effective Shareholder Agreement

A Shareholder Agreement is an incredibly flexible document, and for this reason, no two agreements are going to look quite alike. Shareholder Agreements are voluntary, but it is wise to remember that they need to adhere to the same principles that apply to any contract and that they need to be reasonable.

1. What are your governing documents missing?

Shareholder Agreements complement a corporation's constitutional documents—the Articles of Incorporation and the Bylaws. It addresses circumstances not addressed by the Bylaws.

2. Is there a Buy-Sell in place?

Are there Buy-Sell terms in the Bylaws, or is there a separate Buy-Sell Agreement? If not, the Shareholder Agreement should address the events upon which a Shareholder must sell his or her shares and the other Shareholders (or business) must buy those shares. It is important that the Buy-Sell provisions be as robust as possible, and at a minimum address the death, disability, or divorce of a Shareholder. It is beneficial for the Agreement to address how shares are valued in the case of these triggering events. It is also incredibly important that the Buy-Sell has a contingency in the event that the Shareholders become deadlocked.

3. Are there restrictions on transferring the shares?

In the closely-held business setting, there should be a restriction on the types of transfers a Shareholder may make with his or her shares. The Shareholder should be prevented from making transfers outside those permitted in the Shareholder Agreement or upon the consent of the other Shareholders. These restrictions, however, need to be flexibly drafted to permit certain types of transfers undertaken for tax planning and estate planning purposes.

4. Is the agreement a unanimous agreement amongst all Shareholders?

Shareholders are not beholden to an Agreement they did not execute or to which they did not consent, so unanimous consent of all of the affected Shareholders is important. However, if a Shareholder Agreement is in place before a person becomes a Shareholder, then it will likely bind the newer Shareholder.

5. Does the Shareholder Agreement capture what is important to the Shareholders?

Shareholder Agreements are customizable, and can be designed around the unique concerns of the Shareholders. The agreement can help ensure that certain Shareholders are able to appoint a certain number of the Directors. Or, it could establish the criteria by which someone is permitted to become an employee of the business. It could also allow a Shareholder not on the Board to observe Board Meetings. The terms of the Agreement can be drafted to protect what is important to the owners.

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