Can a Shareholder Agreement Prevent Conflict Among Business Owners

By JoAnn Lombardi, President VR Business Brokers/Mergers & Acquisitions

Shareholder agreements enable owners to plan their company's future - whatever unexpected events might befall it. These agreements assign ownership, set a value for company shares, dictate buyout terms, and outline how the company is to be managed. This detailed plan helps to eliminate surprises and minimize disagreements down the line.

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Keeping It Inside

Often, businesses draft shareholder agreements to prevent owners from selling their stakes to outside parties or to restrict share ownership transfer upon an early abandonment of an owner's obligations. An agreement typically requires that an owner who wants to sell to someone outside the company give remaining shareholders the right of first refusal, or an option to buy the shares at a certain price.

This first-refusal provision may stipulate that a seller offers shares to the remaining owners at the same price and terms - including financing - offered by the outside party. The other owners typically are given 30 to 60 days to make their decision and arrange to finance. If they can't match the outside party's offer, they may have to accept the new partner.

Shareholder agreements also set up a succession plan to go into effect when an owner retires, dies, withdraws, or has his or her ownership terminated for cause. When owners die, their shares pass through their estates to their beneficiaries. If there are no buy-sell provisions, beneficiaries aren't required to sell their shares to the company. If they elect to sell them back, they can dispute the shares' value. Or the beneficiaries may choose to sell to an outsider - or to keep the shares and take an active role in the business.

Buy-sell provisions in the shareholder agreement protect remaining shareholders by requiring them or the company to buy back shares from the deceased owner's beneficiaries at a predetermined price per share. Carefully worded buy-sell language also eliminates tax consequences when a company elects to redeem the shares of a deceased owner.

Other Valuable Functions

Shareholder agreements might also discuss:

- Owner compensation, work benefits, and retirement benefits;
- The percentage of shareholder votes required to approve major decisions such as electing directors, transferring or issuing new shares, borrowing funds, or making large capital expenditures;
- Methods for resolving owner disagreements and disputes - including provisions for the departure of shareholders and procedures for enforced share sales;
- Shareholders' responsibility is to lend the company money if it can't find conventional financing to buy back shares.

Attorneys, CPAs, and business insurance agents can assist you in drafting your shareholder agreement. This expert advice will help ensure that every owner's interests are represented fairly and that the agreement will hold up in court if a dispute ever escalates to litigation.

Plan for Peace

Whether your company is still in the planning stages, has been in business for years, or is combining with another company, it's a good time to consider writing a shareholder agreement. This document can help you deal with whatever comes your company's way - and preserve the peace while doing it.