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News

Notice from Corporations Canada

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Corporate Law Conference, 4th Edition (French only)

The 4th edition of the corporate law conference organized by Éditions Yvon Blais and moderated by Marc Guénette, Thomson Reuters – Marque d'or, will be held on November 23, 2017, in Montreal. With new themes and new speakers, this event is a must for all corporate law practitioners.

More details ›

Article

The importance of a shareholder agreement: the buy-sale agreement upon death

"In this world nothing is certain, except death and taxes."
- Benjamin Franklin (inventor and American politician)

Corporate laws regulate the creation, the existence and the dissolution of corporations in addition to imposing certain public order rules. Many aspects of the existence of a corporation are not governed by law or if they are, they may be contrary to the wishes of the corporation's members, namely its shareholders. If these aspects are not of public order, shareholders may adopt agreements that reflect not only their actual wish, but also govern their behaviour among themselves.

The majority of corporations operating in Québec are SMEs with few shareholders and these usually play a key role in the affairs of the corporation. The agreeance among shareholders is so important to the success of the corporation that a disagreement between them often leads to the cessation of its activities. It is therefore in the best interest of shareholders to ensure that no unwanted person will join

the corporation's shareholding. Hence, one of the primary roles of a shareholder agreement is to restrict access to the shareholding of the corporation to those who have been chosen or accepted by existing shareholders in order to favour and maintain the best possible understanding between them.

Many issues can be covered through an agreement: preserving the proportionate ownership of shares, maintaining a market for the shares, withdrawing all or some powers from the board of directors, establishing a method of valuing shares, adopting a Dispute Resolution Procedure (DRP) for settling disagreements between shareholders, preventing competition against the corporation and disclosure of sensitive information to third parties, detrimental to the corporation, etc. The issues are almost unlimited.

There are basically two types of agreements:

1. The Shareholders' Agreement; and
2. The unanimous shareholder agreement whose purpose is to restrict, in whole or in part, the powers of the board of directors, powers that will be assumed by the shareholders.

The shareholder agreement is intended to govern the behaviour of shareholders among themselves. As mentioned above, the issues covered are very numerous. Conventions can be very elaborate, complex and costly documents. Even very expensive.

However, the various points covered by a shareholder agreement can be separated to address specific issues. In doing so, two goals are achieved:

1. A specific and relevant issue that concerns the shareholders is addressed
2. While substantially reducing the costs of the agreement.

One of the most important issues for shareholders is the ownership of shares following the death of one of them. Since this death is inevitable, but unpredictable, it is an issue that can easily be settled through a buy-sell agreement.

This agreement, which is very simple, is, in our opinion, a must, and should be part of any discussion between legal counsel and its clients when setting up a corporation. Upon the death of a shareholder, the provisions of the Civil Code on Successions apply, in particular sections 625, 744 and 858. If nothing is foreseen and planned, the deceased's shares will be transmitted to his estate and therefore to his heirs. This means that shareholders-founders and shareholders-managers will be associated with people they do not want and they will not be able to prevent this, unless they pay a prohibitive price for the shares, everyone having his price, as we all know.

In order to prevent shares from being passed on to undesired heirs, to ensure that shareholders will always be associated with people they have chosen and trusted, the buy-sell agreement upon death is the instrument designated for that purpose.

This agreement is simple and inexpensive, since it contains clauses providing for the strictly necessary to accomplish its purpose. It must provide at least:

- An agreed value;
- A repayment plan for the shares sold;

- An irrevocable offer of sale;
- An irrevocable obligation to buy;
- The taking and maintaining of an insurance policy to be able to pay the sale price of the shares or to pay a substantial down payment on that price;
- An adjustment of the selling price in the event of disagreement with the tax authorities as to the valuation of the shares of the selling shareholder.

We are convinced that any business, like any marriage of heart or reason, requires the signing of agreements governing important issues, which will have to be resolved sooner or later. In this matter as in many others, it is better sooner rather than later. One thing is almost certain: if nothing is foreseen and planned, it is usually too late when the issue arises.

Because of its simplicity and affordable cost, it is not only bold to go into business without this instrument, but there is no economic reason to justify why there is no buy-sell agreement upon death. Any problem raised later will necessarily be much more expensive, not to mention the stress associated with it, than the cost to adopt such agreement.

A shareholder agreement is fundamentally an insurance policy, at little cost in this case to the shareholders to mitigate the consequences of certain future events. The assurance that their original intent will be respected and that the event will also be settled according to their original intent. Without prohibitive costs. The redemption of the shares in the hands of the estate is planned in advance, as well as its terms and conditions, while ensuring that the buyers have the necessary funds for such a redemption. The shares are bought back from the estate at fair market value and the shareholders ensure that they are surrounded only by the persons with whom they want to be truly associated. Simply, easily and inexpensively. It's a win-win.

On its transactional site, netco.net, Marque d'or offers this solution online. You proceed to the constitution and the organization proceedings of your corporation, you check "Buy-sell agreement upon death" and you're ready to go. Nothing's easier. As part of this transaction, the cost for this buy-sell agreement is $150.

Jurisprudence

CRT-Hamel c. Société de transport de Montréal

27 April 2017, Superior Court, EYB 2017-279140

Relying on the fact that the Société de transport de Montréal (the STM) awarded a contract to a corporation (EDT) whose name does not appear in the register of businesses authorized to conclude public contracts, contrary to an *Act Respecting Contracting by Public Bodies* (ACPB), the plaintiff seeks an interim injunction order to suspend the execution of the contract.

Article 21.17 ACPB lays down the obligation of a business wishing to conclude a contract with a public body, to hold an authorization issued by the Autorité des marchés financiers (AMF). It states that an undeclared partnership, in particular, is a business. Section 21.18 ACPB provides that each business making up a consortium must hold such authorization. EDT is both an undeclared partnership and a consortium. The term "consortium" is not defined either in the *Civil Code of Québec* or in the ACPB.

According to the website of the AMF, if the consortium takes the form of an undeclared partnership, no authorization is required for this business. The plaintiff's appearance of right is therefore unclear. Nor is the criterion of serious or irreparable harm satisfied. As for the balance of convenience test, it clearly favors the STM. The application for an interim injunction is dismissed.

3209725 Canada inc. c. Aluminium Amtek inc.

18 May 2017, Superior Court, EYB 2017-279974

The parties have joined forces to form a corporation to provide a bundled supply of aluminum for the benefit of its shareholders. The plaintiffs are seeking, among other things, damages for breach of the duty of loyalty and the implied non-compete obligation under the partnership agreement. There is no basis for concluding that such a non-competition or loyalty clause (even implicit) forms part of the agreement. Moreover, the protocol even stipulates that the parties agree not to include such a clause in view of the nature of the undertaking and the fact that the partners retain the possiblity to obtain supplies elsewhere. Finally, when the agreement was negotiated, the parties even refused to limit their commercial activities to certain specified territories. The only objective of the agreement is to provide supply to members of the partnership only. The latters are subsequently free to carry out their activities in any territory.

In light of the foregoing, there is no need to retain the personal liability of shareholders and directors or to grant the oppression remedy. The application for a permanent injunction, accountability and for damages is therefore rejected.

8104573 Canada inc. c. Martin

23 May 2017, Superior Court, EYB 2017-280202

The present litigation concerns a sale of the assets of a corporation that filed for bankruptcy protection to two corporations. The agreement was for all inventories, not part of them. However, some of the goods sold were no longer in the premises at the time of deliverance having been sold by the seller to a third party. It is clear that the sole director and director of the vendor corporation committed an extracontractual fault. He made false representations to buyers to save time to allow the third party to recover the goods sold without right. This director is therefore jointly and severally liable with his corporation for any damage caused to the purchasers. However, the court refused to apply section 317 CCQ, as the corporation was not used by its directors to camouflage fraud.

Pham c. Ngo

29May 2017, Superior Court, EYB 2017-280248

In the case of the dissolution of a private issuer, a shareholder claims to the other one, half of the contributions made in the corporation. The shareholder invokes a verbal agreement to share profits and losses equally. Even if this agreement is denied by the defendant, the overwhelming evidence

establishes the existence of a verbal agreement between the shareholders, invoked by the plaintiff. However, the corporation's declaration of dissolution, completed and signed by the plaintiff, indicates that the corporation no longer has any debt. In that case, can the defendant put forward a plea of peremptory exception? No, because there is no obvious intention on the part of the plaintiff to discharge the defendant from her debt to her, that debt arising from the shareholders' agreement.