Key Issue Voting in Shareholder Agreements

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Introduction

One important purpose of a shareholder agreement is to modify the decision-making matrix provided by the company's enabling legislation (the "**Act**") or the voting matrix provided for in the corporation's incorporation documents (the "**Articles**").

The purpose of this article is to provide some background on that issue, and provide a list of decisions shareholders could consider when deciding what will or will not require shareholder approval and what level of shareholder approval will be necessary.

Some Concerns from the Legislation

Using Ontario for example, the Ontario Act provides that (emphasis added):

- The corporation is effectively *run by its directors* who have *broad* decision-making power.
- Decisions made by the directors are by simple *majority* vote with each director having *one vote*.
- Directors are appointed by a *simple majority* vote of the *voting* shareholders so whoever has voting majority (more than 50%) controls the board and almost everything the company does.
- When shareholder approval is required, it is typically a *simple majority* vote of the *voting* shareholders *present* at a shareholders' meeting called for that purpose.
- However in special cases non-voting shareholders have a vote or say.
- And in some special cases the approval of at least 2/3rd of all *voting* shareholders *present* at a shareholders' meeting called for that purpose.

Shareholders in private companies often want to modify this matrix, through a Voting Trust, Pooling Agreement or Shareholder Agreement (collectively "**SA**")[1].

[1] A shareholder agreement can involve all the shareholders in the corporation, or just some of them.

A Voting Trust or Pooling Agreement does not have to be unanimous and allows the participating shareholders to agree how they will vote on bloc, but does not restrict or alter the power of the directors.

A typical Shareholder Agreement is usual unanimous, involving all the shareholders, and forces the directors to defer certain issues to the shareholders for approval or alters director decision making authority so that some special thresholds have to be met.

Some Key Director Questions

If you are working on a shareholder agreement for your private company, some key director related questions for you to consider are:

– How many directors will there be?

– Who can appoint or remove them?

– Will directors vote one vote per director or something else?

– Do certain director decisions require special levels of approval at the board level?

– Do you want to restrict the power of the board of directors so that some key issues have to be referred to the shareholders?

– If yes, what issues have to go to the shareholders and which ones will you leave with the directors?

Some Key Shareholder Questions

Some key shareholder related questions for you to consider include:

– Do you want to restrict the power of the board of directors so that some key issues have to be referred to the shareholders?

– If yes, what issues will be referred to the shareholders and which ones will be left with the directors?

– What will be the threshold percentage for approval of those issues?

– Will there be issues that require unanimous approval or will give minority shareholders a veto?

– Are there any other special shareholder approvals that you want to have in place?

Some Key Decisions to Consider

A partial list of decisions that shareholders often consider in determining (i) what they will vote on versus what they will leave to the directors and (ii) what percentage of shareholders or directors are required to approve each decision includes the following:

DECISION	WHO MAKES IT?	WHAT LEVEL OF APPROVAL?
A fundamental change in the business of the corporation.		
The approval of a yearly budget or business plan.		
Any operating expenditure or obligation which is in excess of those permitted by the budget or some other standard.		
Any capital expenditure or obligation which is in excess of those permitted by the budget or some other standard.		
Whether or not the corporation will have audited statements.		
The appointment of corporation auditors or accountants.		
The appointment of corporation bankers, lawyers, and other key advisors.		
The setting up of corporation bank accounts and signing authority over same.		
Who has ability to contract on behalf of the corporation, and any special requirements for type or size of contract?		
The hiring or firing of officers or other key persons.		
The compensation arrangements for directors, officers and key persons.		
The implementation of any stock option plan or the issuance of any stock options.		

DECISION	WHO MAKES IT?	WHAT LEVEL OF APPROVAL?
Any change in the number of directors.		
The appointment or removal of directors.		
Any change to the corporation's Articles.		
Any change to the corporation's by-laws.		
The taking of any steps to wind up or terminate the corporate existence of the corporation.		
The amalgamation, continuance, merger, consolidation or reorganization of the corporation or the approval or effecting of any plan of arrangement by the corporation.		
The creation, acquisition or disposition of any subsidiary of the corporation.		
The taking, holding, subscription for or agreeing to purchase or acquire shares in the capital of any other corporation.		
Redemption, purchase for cancellation or other acquisition of corporation shares by the corporation or other retirement of capital by the corporation.		
The authorization, issuance or sale of any shares of capital stock or other securities of the corporation, or the granting of any options, warrants or other rights to acquire shares or security of the corporation.		
Any subdivision, consolidation, conversion, reclassification or modification of any kind of outstanding shares in the capital stock of the corporation.		
The sale, transfer, charging or pledging of corporation shares or shareholder loans by any shareholder.		

DECISION	**WHO MAKES IT?**	**WHAT LEVEL OF APPROVAL?**
The borrowing of funds from any shareholder and the terms of same.		
The sale, transfer, assignment, charging or pledging of any shareholder loans by any shareholder.		
The sale, lease, exchange or disposition of all or a substantial part of the property or assets of the corporation, including any licensing or disposition of the corporation's intellectual property outside the ordinary course of business.		
The purchase, sale or lease by the corporation of any real property, other than leasing corporation premises for the day-to-day operation of the business of the corporation.		
The general assignment of property of the corporation for the benefit of its creditors or the filing of an assignment or proposal or consenting or not apposing a petition under the *Bankruptcy and Insolvency Act* or any insolvency or arrangement legislation including but not limited to the *Companies Creditors Arrangement Act*.		
Any borrowing or securing any indebtedness on the credit of the corporation other than as described in an approved business plan.		
The lending of money by the corporation to any person other than as described in the approved business plan.		
Providing guarantees or financial support to any person other than a wholly owned subsidiary of the corporation or as described in the approved business plan.		

DECISION	WHO MAKES IT?	WHAT LEVEL OF APPROVAL?
Any transaction not in the ordinary course of business for the corporation or with any person who does not deal at arm's length with the corporation or any shareholder therein, except in accordance with the approved budget or business plan.		
The entering into a partnership, exclusive license, any arrangement for the sharing of profits, joint ventures or arrangement involving the sale, assignment or dilution of any material intellectual property rights of the corporation which would have a material effect on the use and enjoyment by the corporation of its intellectual property rights.		
The declaration of any dividends, distribution of assets or return of capital of the corporation.		

Conclusion

Getting decision-making properly structured is one of the key reasons for doing a shareholder agreement in a private company. The matrix provided by corporate legislation can work well, especially when there are a large number of shareholders. However in private companies with a small number of shareholders it can lead to a power imbalance one way or another that can cause friction or dysfunction.

As in everything to do with shareholder agreements the process of working through this matrix is as important as the finished product, as discussing and agreeing on what to do can really strengthen your partnership.

It is also important to get good professional advisors and to not attempt to finalize this on your own. You might do something like this a few times in your career. An experienced corporate lawyer will do this many times a year, and with a more complete understanding of the legal framework in which you are operating and how to take advantage of it or modify it to meet your needs.