The Importance of Shareholder Agreements

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As CALU members know very well, it is extremely important for partners in a private business, whether incorporated or not, to have an up-to-date shareholders agreement which governs the operations of the business and disposal of shares under various scenarios. The recent decision in *Falus v. Martap Developments 87 Limited* (2012) ONSC 2301 ("Martap") once again illustrates this point and should serve as a caution for all business owners that don´t have a shareholders agreement.

In this case, Tom Falus (age 76) and Vince Benedetto (age 80), had been friends and business partners since the 1980's, and had incorporated Martap in 1987 as equal shareholders. They did not have a shareholder agreement and, for many years, did not require one to operate the business smoothly and successfully. However, this happy situation did not continue and became the basis of legal proceedings.

The origin of the shareholder dispute was an estate freeze that Vince implemented in 2003, under which each of his four children became common shareholders of Martap. Some changes were also made to Tom's shares under the reorganization, but he essentially remained a 50% shareholder. According to the judgment, Tom understood that Vince required these changes for estate planning purposes.

At that time, Martap´s assets were mainly comprised of rental properties with external property managers. However, Tom asserted that there was an element of decision-making and management required within Martap, and he was unhappy with the increasing involvement of Vince's children, especially his daughter Antoinette. Tom felt that Vince was forcing him to accept his children as business partners, and that the children did not have the necessary experience for their roles.

After failed attempts at purchasing the shares owned by Vince and his children, Tom commenced legal proceedings. He argued that Martap was deadlocked and asked the court either to force a sale of the shares or to require a wind-up of the corporation. In his submissions, Tom relied on the oppression remedy contained in the Ontario Business Corporations Act. In other words, he argued that the behaviour of Vince and his children essentially prevented him from exercising his rights as a shareholder.

The Court found no evidence supporting Tom's contention that the operations of Martap were "deadlocked" and that he was unable to act as a shareholder. In particular, there was no basis in support of Tom's contention that he should only have to deal with Vince in the running of Martap. There was no shareholder agreement, nor was there any evidence that Tom objected to Vince's children becoming shareholders. In fact, Tom had signed resolutions and other documents that were required to implement the changes to the corporation.

As a result, the Court determined it had no legal basis to order a termination of the business relationship and refused to require a sale of any shares or a wind-up of Martap. Pending an appeal, the shareholders must now find other means of resolving their differences.

The following "lessons" may be taken from this decision:

- Even the most successful business relationships will change. Shareholders retire, get divorced, have financial problems, become disabled or die. In other cases, such as Martap, the younger generation takes on increasing business responsibilities and share ownership. A properly drafted shareholder agreement can provide the necessary framework for managing this change. If a shareholder agreement had been prepared, even as late as 2003 when the estate freeze was implemented, these unfortunate proceedings would likely have been avoided.

- Legal details do matter, a lot. The Court took special note of the fact that Tom consented to the estate freeze and signed other documents, including ones under which two of Vince's children were elected directors of Martap. If Tom had asked more questions at the time the freeze was being implemented, or if he had sought independent advice, he might have been better prepared to deal with the new circumstances.

As noted, this decision is clearly a wake-up call for business owners who are in “partnership” and operating without a shareholders agreement.

About the Author

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