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Sometimes a Shareholders' Agreement must be interpreted by the Court

Even when parties enter into a shareholders' agreement, there are times when the court must assist in the interpretation of that agreement. Such was the case with Denille Industries Ltd. v. Island Enterprises Inc., 2012 ABCA 140 (CanLII).

Wayne Sopp, Menno Admiraal and Guy Bouvier were the principal shareholders in Western Camp through their respective holding companies. (Sopp owned 40/100 through Island Enterprises, Admiraal owned 20/100 through Admiraal Ventures and Bouvier owned 40/100 through Denille). They signed a unanimous shareholders' agreement.

When Wayne Sopp died in February 2010, a dispute arose regarding the interpretation of that agreement. The case primarily boiled down to the interpretation of two clauses. Those two clauses involved a "put and call arrangement."

The put arrangement in the agreement gave the estate the option to put some or all of its shares to the surviving shareholders. The call arrangement allowed the survivors to act in the event the put arrangement had not been exercised.

The estate of Sopp exercised the "put option" with respect to one of 40 shares. It offered by way of notice one share to Admiraal and zero shares to Denille. Denille objected to the notice. It sought to exercise the call option regarding 27 of the estate's shares.

Denille's primary argument was that the agreement required the principal shareholder's interest – here Wayne Sopp – to be sold to the remaining shareholders on a pro-rata basis. Denille also argued that any available insurance proceeds on the life of the deceased must be used in aid of that purchase. Denille indicated it was never the intention of the parties to have a third party such as a family member succeed the deceased by gaining an ownership interest in the company.

Denille argued that the manner in which the option was exercised violated the agreement in that the sale of one share to Admiraal altered the proportionate shareholding of the shareholders. Denille argued that through a mechanism defined in the agreement as a "withdrawing event," this transaction entitled Denille to exercise the buy/sell provision.

The estate took the position that the "call option" was not available because the "put option" had already been exercised. It argued that the insurance on Sopp's life was not used to pay for the transaction. The insurance was a convenience in the event a sale/purchase occurred; if this did not happen, the insurance proceeds remained with the company.

At trial Denille did not succeed. The judge indicated it could interpret the contract but could not rewrite it. The court did not view that a "withdrawing event" had occurred as argued by Denille. Denille appealed.

On appeal, Denille suggested that the court imply other terms such as the duty to sell all shares to keep the shareholdings in proportion and that there was a duty to use the insurance to buy all of the shares. The Court of Appeal, however, saw no reason to imply those terms. The Court indicated that such a provision was neither obvious nor necessary and would largely negate the expressed terms of the put and call arrangement.

The case provides a few good lessons. The most obvious is that optional purchase and sale provisions in an agreement may create uncertainty and disputes. As well, it is probably wise to use mandatory buy-sell funded provisions with life insurance.

These columns are current as of the time of writing, but are not updated for subsequent changes in legislation unless specifically noted.

June 2012

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