



SHAREHOLDER | PARTNER COUNSEL

THE SHOTGUN AGREEMENT:

IF I PULL THE TRIGGER, WILL I SHOOT *MYSELF*?

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“Sometimes the smartest move is to not invoke the terms of the buy-sell”.

In the last issue of *Shareholder/Partner Counsel* we talked generally about the buy-sell agreement and the reasons for having one. One type of buy-sell is the shotgun agreement, which, if triggered, will result in the mandatory buy-out of one or more shareholders. Triggering a shotgun agreement is, theoretically, a quick and easy way to end a business relationship. Or is it?

Are you sure you want to pull the trigger?

It sounds easy. Just read the document, follow the recipe and “voila”, you’re free of those who would hold you back. But, do you really want to risk it? Is pulling the trigger the smartest thing to do? There are other options to consider, with business and legal consequences. Circumstances change. Businesses grow. These factors can have an impact on the enforceability of the agreement, or the advisability of invoking it.

Reading the fine print

Be sure that your agreement says what you think it says. Whether you are the shooter or the target, you need to understand the terms of the agreement. You need to understand your legal rights and obligations in the context of all the circumstances of the business, and the shareholders’ relationship, as they have evolved.

Shooter or Target

Sometimes the smart move is to not invoke the terms of the buy-sell. Rather, sit back and let someone else do it. Knowing the potential consequences of activity versus passivity will help you properly develop your strategy. For example, which will you choose

to control – the price or the decision to be the purchaser? If price is the most strategic factor for you, then set the price, call the shot and pull the trigger.

Did you know....

Parties preparing to enter into a partnership or unanimous shareholder agreement should get independent legal advice. Many agreements are prepared by corporate/partnership counsel, whose mandate is not to protect the rights of the individual parties. The protection of those rights is up to the individuals and their counsel.

The point is, strategy and preparedness are important to anyone contemplating pulling the trigger. One businessperson learned this to his detriment recently in a case involving one of our clients, a local business shareholder. Our client was caught off guard when his estranged co-shareholder presented him with an offer pursuant to the shotgun clause in their shareholder agreement. He thought that his dream was lost and that he had no options. However, when we read the fine print of the agreement we quickly determined that the offer made did not correspond with the requirements of the agreement. The offering shareholder, in his case, made a fatal error.

“Those party to shotgun agreements must be prepared to be governed by them to the letter...”

Somewhat high-handedly, he presumed that our client would not have the means to reverse the offer and purchase his shares. So, his offer “deemed” our client to be the seller.

To ensure he had his way, the offeror invented some further rules. His offer stipulated that, until the date of our client’s acceptance of the offer, the price of the shares would increase \$1,000.00 per day (if our client elected to buy), and would decrease \$1,000.00 per day (if he elected to sell his shares). Obviously, the offeror anticipated that our client would be unable to arrange financing, especially if the price was increasing at \$1,000.00 per day.

Our position was that the offer was deficient in several respects. It was, therefore, unenforceable. The offering shareholder had drafted his offer without regard to the rules set out in the shareholder agreement. The Court agreed.

In the meantime, during the time it took to litigate, our client was able to arrange financing and to turn the tables by making a proper offer. Our strategy, in this case, was to control the decision to buy. Our client ended up with the company and at a very favourable price.

The points to be taken from this story are:

- Those party to shotgun agreements must be prepared to be governed by them to the letter;
- Attempts to circumvent the terms of an agreement, or to unfairly use them to force a party’s hand prematurely may well

- result in a turning of the tables;
- Shotgun agreements can have brutal and, usually, irreversible consequences which should be considered prior to entering into or triggering one;
- Never invoke or respond to an offer pursuant to a buy-sell agreement without proper legal advice.

In the next issue of
Shareholder/Partner Counsel...

Watch for our series on the enforceability of unanimous shareholder and partnership agreements, beginning with ***“When binding contracts aren’t: The judicial override of USAs and partnership agreements”***.

The legal professionals at Prowse & Chowne bring you ***Shareholder/Partner Counsel***, dedicated to the discussion of issues particularly important to the small businessperson. Look for it bi-monthly for information and insight into the various legal remedies available to shareholders or partners with grievances; means available to resolve inter-shareholder disputes, including mediation; the oppression and derivative action remedies available through the Alberta *Business Corporations Act*; conflicts of interest; issues related to shareholder loans and shareholder agreements; and much more.



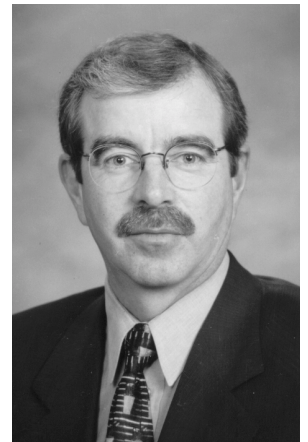
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J. Cameron Prowse, BA LLB, a managing partner in Prowse & Chowne, offers over 22 years of legal expertise to the Alberta and N.W.T. business communities. A recognized and practiced litigator, Cameron has a special interest in business law.



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