<u>Exit mechanisms in a Shareholders' Agreement</u>

While much time and energy is often spent on the logistics of entering into a business relationship, far less attention is paid to getting out of one. Unfortunately, many people come to realize that not having a proper mechanism to effect a shareholder's exit – whether forced or otherwise – is to their detriment. Although each corporation and the dynamic between its shareholders differ on a case-by-case basis, the need for a proper exit strategy is universal. A proper shareholders agreement should contain at least some of the following clauses which contemplate a shareholder's exit from the corporation.

<u>Compulsory Buy-Sell Clause aka "Shotgun" Clause</u>

A shotgun clause begins with an offering shareholder giving notice (called a "Shotgun Notice") to a receiving shareholder of their intention to enforce the shotgun clause. The receiving shareholder will thereafter have the option to either sell its shares at the price specified in the shotgun notice or buy out the offering shareholder at the same price. In this way, a shotgun clause is an effective – albeit aggressive – way to ensure that one of the shareholders is removed from the corporation. The danger created from enforcing a Shotgun clause is that the end result is uncertain. A shareholder who has enforced the clause in the hopes of buying out another shareholder may instead find that they are the ones being bought out instead. This is the inherent risk in enforcing the clause.

<u>Non-Participating or Inactive Shareholder Clauses</u>

A non-participating shareholder clause refers to various provisions that deal with what happens to the shares of shareholders who are non-participating in the corporation. Unlike shotgun clauses, which are fairly uniform, the provisions contained in a non-participating shareholder clause may vary greatly depending on the risks each corporation is specifically trying to guard against. Typical provisions include protecting against the possibility of a shareholder not participating in the company for a specified period of time (often due to physical or mental illness or due to prioritizing other business ventures) as well as protecting against the possibility a shareholder goes to jail.

Regardless of the provisions contained in each specific shareholders agreement, the end result for a non-participating shareholder is the forced sale of that shareholder's shares to the corporation or to the other shareholder(s). In this way, non-participating shareholder clauses are useful tools for preventing situations where some shareholders are generating a disproportionate amount of the corporation's value due to other shareholder(s) being unwilling or unable to make contributions themselves.

Exiting Shareholder or Put Rights

Rather than just forcing the exit of another shareholder, shareholder agreements may include provisions that allow a shareholder to force their own exit. This can be done through a put right or an existing shareholder clause. Put rights give a shareholder the right to require the corporation to purchase the shareholder's shares. The price per share is either specified in the agreement or set at a fair market value to be determined. Exiting shareholder provisions are somewhat similar to put rights except that the clause often requires that the other shareholders themselves purchase the exiting shareholder's shares rather than the corporation itself.

Conclusion

A shareholder's exit strategy is just as important as the entry. Individuals become shareholders in a corporation because, presumably, it makes business sense for them to do so.