

A Reminder About The Need For Shareholders' Agreements*

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Because there is no automatic mechanism for shareholder divorce, people who enter into corporate business ventures with others should also enter into shareholders' agreements. These agreements can provide remedies and liquidity options in the event of death, change of circumstances, or disagreements among shareholders.

Falus v. Martap Developments 87 Ltd., 2012 ONSC 2301, exemplifies how shareholders' perspectives can change as they age and how statutory remedies can be too limited to respond to new and challenging circumstances. The parties in *Falus v. Martap* were Tom and Vince, two elderly gentlemen who had conducted business together for many years; in fact, they were the original equal shareholders of Martap. Although Martap was initially dedicated to real estate development, it had evolved primarily into an investment vehicle. Martap owned a multistorey building situated on land that was leased for a term of 99 years and had prepaid all rent due under its lease. The units in the building were leased to a non-profit housing provider for a term of 40 years, and the base rent due under the lease had been prepaid. There were retail stores at ground level, and a property management firm was retained to assist in managing the retail tenants.

Martap underwent a reorganization when Vince implemented an estate freeze. The freeze resulted in Vince's children becoming the owners of common shares and Vince becoming the owner of preferred shares. Tom did not implement an estate freeze. The mechanics of the reorganization resulted in Tom owning both common shares and preferred shares. Tom's preferred shares were identical to Vince's preferred shares. Tom's common shares were identical to the common shares owned by Vince's children. There was no evidence that Tom objected to the reorganization at the time of its implementation, and evidence was adduced to show that Tom had consented to certain required shareholder resolutions.

Tom claimed that Vince was "attempting to force me to accept Antoinette [Vince's daughter], and to a lesser extent his other children, as my new partners." He proposed to Vince that one of them buy out the other, but after some discussion, Vince told Tom that he did not want to sell his interest in Martap.

Vince's refusal to sell resulted in Tom's application to the court for an order for a shotgun buy-sell of the Martap shares or alternatively for the winding-up of Martap. He relied on provisions in the Ontario *Business Corporations Act* that give courts the discretion to order the wind-up of a corporation if, among other grounds, there is oppressive conduct or if a wind-up would be just and equitable in the circumstances.

Tom's view was that the corporation was deadlocked. The court, however, found no evidence of his exclusion from management or his inability to exercise his rights in governing Martap. An application to wind up a corporation on just and equitable grounds requires a breakdown of the relationship of trust and confidence between the shareholders. The disagreement between Vince and Tom did not impair or threaten to impair the operations of Martap. Rather, it was based on Tom's expectation that he would not have to deal with anyone but Vince during his association with Martap and that he was entitled to terminate the relationship when Vince decided to withdraw from it and involve his children. In the court's opinion, there was no evidence to justify Tom's expectation. There was no shareholders' agreement, no evidence of discussions regarding succession, and no evidence that Tom disagreed with the estate freeze that resulted in Vince's children becoming common shareholders. Accordingly, Tom's application failed.

Falus v. Martap illustrates that one shareholder may become locked into an ongoing business arrangement with another shareholder's family. It is therefore prudent for shareholders to formalize their expectations about this and other matters by writing a shareholders' agreement.

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