

Shareholder Agreements - Do You Need One? and 5 Mistakes to Avoid

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Why Shareholder Agreements Matter

- Legally binding documents that outline rights and obligations of all shareholders
- Go beyond Articles of Incorporation to provide detailed operational clarity
- Private and flexible, unlike public Articles of Incorporation
- Essential for both startups (providing structure) and established companies (offering protection during changes)
- Serve as proactive tools to prevent business disputes between shareholders
- Cover operational roles, decision-making powers, ownership rights, and exit procedures



Mistake 1: Using Generic Templates

- One-size-fits-all templates rarely account for your unique business circumstances
- May not cover specific funding arrangements or unique voting rights
- Could contradict your Articles of Incorporation, earlier start-up agreements, or create ambiguity
- Every business has unique relationships and dynamics
- Generic agreements miss tailored provisions around key decision-making
- Small investment now, prevents costly disputes later
- EXPERT HINT: It's easier to negotiate when the company has nothing, much harder when the product or revenue has arrived



Mistake 2: Unclear Roles and Responsibilities

- Failing to define specific responsibilities and commitment to necessary time investment
- Especially problematic when mixing active shareholders with passive investors
- Agreement should outline operational involvement, voting powers, and reporting duties
- Clear role definitions prevent misunderstandings from becoming problematic
- If continued service to the company is a condition of stock ownership, it needs to be in writing



Mistake 3: Missing Exit Strategy

- Failing to plan for share transfers can cause severe business disruptions
- Must address: Can remaining shareholders prevent third-party acquisitions?
- Include company and stockholder rights of first refusal and buyback provisions
- Clearly define buyback cost calculation methods
- Plan for succession when shareholders die or become incapacitated
- Outline transparent processes for sale or transfer of shares
- Exit strategies protect the company's future during ownership changes



Mistake 4: No Dispute Resolution Process

- Disagreements arise even in the healthiest businesses and between friends
- Include mechanisms for resolving disputes without litigation
- Establish options or requirements for mediation or arbitration
- Create procedures for deadlocks (casting votes or third-party intervention)
- Provide exit options when differences become irreconcilable
- Proactive dispute resolution saves time, money, and relationships



Mistake 5: Ignoring Minority Shareholder Rights

- Minority shareholders (under 50% ownership) need protection from majority override
- Failure to protect can lead to unfair treatment claims and legal action
- Can result in forced exits and damaged business reputation
- Include reserved matters requiring unanimous or supermajority approval
- Establish pre-emption rights on share issues and transfers
- Draft 'tag-along' clauses to protect minority interests during sales
- Balanced agreements prevent frustrations and disputes

Got Questions?

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