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Partnership Agreements - They Can Save You Heartache

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by John Polyzogopoulos
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Disputes among shareholders in small, closely-held businesses that are often family-run are much like family law disputes. The main difference is that the battle over custody of the children is substituted for the battle for custody or control of the business. Emotions in both types of cases can run high.

When economic times are tough, the incidence of breakdown of partnerships, including marriages, can be expected to increase. Given the current economic climate, it would not be surprising if the amount of litigation arising out of such disputes were to rise.

For clients who may happen to find themselves in business partnerships that are no longer working for them, here are some thoughts that would be helpful to keep in mind.

Although shareholder disputes have many things in common with family law disputes in terms of the emotions involved and the lengths to which the parties will go to protect their interests (or inflict harm on the other side's interests), the law relating to each kind of dispute is very different.

Certainly, the likelihood of ending up in court over the breakdown of a relationship increases where, in the case of a marriage, there is no pre-nuptial agreement (called marriage contract in Ontario), or, in the corporate context, no pre-existing shareholders' agreement.

The absence of a shareholders' agreement, however, is much more difficult to overcome than the absence of a marriage contract. This is because, in family law, one spouse or the other is entitled by law to end the relationship unilaterally. In conjunction with that right, the principle of no-fault is very much embedded in family law, where the spouses have economic rights and obligations based on net worth and income, irrespective of their conduct. Except where the conduct of one parent can be detrimental to the best interests of the child, conduct also plays little role in determining custody, which is awarded generally to the primary care-giving parent.

When it comes to shareholder disputes, however, absent a shareholders' agreement, there is no legal right for one shareholder to remove another from the corporation or to allow a shareholder who wishes to exit the corporation to force the remaining shareholder to buy out his or her interest. There is no mechanism for an orderly division or wind-up of a corporation when one shareholder unilaterally decides that he or she wants out. Rather, as will be seen, the relevant statutory provisions focus on the parties' conduct, which, of necessity, becomes the centre of attention in such cases.

Court orders that require one party to buy out the other, or that force the liquidation or wind up of a corporation, can only be obtained in exceptional circumstances, and only following an intensive examination of the party's conduct, their interests and the best interests of the corporation. Such claims are usually made under what is known as the "oppression remedy" contained in section 248 of the Ontario *Business Corporations Act*.

In order for a complainant, usually a shareholder but often a director or creditor, to be entitled to a remedy under that section, the complainant must show that the actions (*ie.* conduct) of the corporation or any of its directors are being, or are being threatened to be exercised in a manner that is "oppressive" or "unfairly prejudicial to" the complainant, or that "unfairly disregards the interests" of the complainant. If that is the case, the court, essentially, may make "any interim or final order it thinks fit." This includes requiring the corporation to purchase a shareholder's shares, obliging one party to buy another party out, or liquidating or winding up the corporation. The focus of the section is on conduct, and only conduct.

The oppression remedy is among the broadest and most powerful remedies known in law. It is almost without precedent in any other area of the law. What can be classified as "oppressive", "unfairly prejudicial" or "unfairly disregarding interests" is limited only by the imagination. The powers of the court are specifically limitless.

Members of Blaney McMurtry's business law group have extensive experience in advising clients on organizing their business affairs in such ways as to minimize the likelihood or impact of future shareholder disputes. This involves preparing a carefully drafted shareholders' agreement that provides for the parties' rights and obligations, including unilateral rights of dissolution. Such rights of dissolution can include rights of first refusal, shotgun rights and put or call rights, all of which have their relative advantages and disadvantages and can be tailor-made to the particular circumstances of each client.

If matters have already turned for the worse and it is too late to implement or amend a shareholders' agreement, members of our commercial litigation group can assist in navigating the treacherous waters of shareholder litigation with a view to obtaining the best possible results. ■