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Exiting a Corporate Marriage

Successful business relationships ("corporate marriages") require comprehensive shareholder agreements that address a range of issues such as control of the company and exiting the company. Since the relationship between business partners can change over time, it is essential to ensure that the correct exit provisions are included in the shareholder agreement to address the possibility that a shareholder may eventually wish to exit the shareholding relationship.

If the shareholder agreement contemplates no or limited exit mechanisms, either intentionally or not, shareholders will be forced to either negotiate the exit, negotiate a mechanism for the exit or appeal to the courts to have the corporate marriage dissolved. Either of these options can create a disadvantage to the departing shareholder, who may struggle with establishing a fair price for the exit or who may not receive much leniency from a court.

Various exit mechanisms can be built into a shareholder agreement to prevent any complication at the time of the exit, and this article will focus on four that are commonly used.

The first mechanism is referred to as a "Shot-Gun". Under this mechanism, a shareholder makes an offer to either sell his/her/its shares to the other shareholder(s) or buy their shares. The offers are made on the same terms and at the same price per share. This mechanism works well when the relationship between shareholders is balanced and one party does not have an advantage over the other party either through shareholdings or financially.

Another mechanism is the "Right of First Refusal" where typically, if one or more shareholders receive an arm's-length offer from a third party to purchase all of their shares, the other shareholders have a period of time to match the third party offer and purchase the shares. Should they decline, the exiting shareholder can complete the sale to the third party. This exit mechanism is widely used in shareholder agreements but may prove to have limited value for minority shareholders, since a third party is not likely to make an offer to purchase minority shares or may not wish to deal with minority shareholders.

The "Tag Along" (also known as "Piggy Back") mechanism allows for a shareholder to sell to a third party as long as the offer extends to the other shareholder(s). All shareholders have the option to participate but are not compelled to sell their shares to the third party. If only a few shareholders participate in the Tag Along, then the third party has no choice but to purchase all of the shares participating in the Tag Along, yet may not actually gain control over the company.

Finally, similar to the Tag Along is the "Drag Along". However under the Drag Along, the other shareholders are compelled to sell their shares to the third party. This mechanism works well by allowing a third party to purchase the whole company from the shareholder who can impose the Drag Along.

Overall, the mechanisms that work best are those such as the Shot-Gun or Drag Along, which empower the shareholder(s) or the third party who is interested in running the business to gain control.

Shareholder agreements are very complex commercial documents. It is highly recommended that business partners seek the help of legal professionals to prepare a well-drafted shareholder agreement at the outset of the business relationship to facilitate an exit down the road whether voluntary or involuntary.