

LEGAL UPDATE

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INVESTOR AGREEMENTS – PRE-EMPTIVE RIGHTS AND EXIT STRATEGIES

Many types of business ventures contain methods whereby an investor can either protect his holdings, or sell his holdings.

Below is a summary of the basic types of protections that relate to shareholders, but these principles apply to other business ventures as well.

Pre-emptive Rights Pre-emptive rights allow existing shareholders the right to buy newly issued shares from the company, before such shares are sold to outside third parties. This protects existing shareholders by allowing them to retain their percentage of ownership in the company.

Right of First Refusal A right of first refusal requires a selling shareholder to first sell his holdings to the other existing shareholders. If the other existing shareholders are not able (or willing) to purchase the shares, the selling shareholder may then sell to a third party.

Tag-Along Right (Piggy Back Rights) A tag-along right requires a selling

shareholder (usually a majority shareholder) to provide the other shareholders the opportunity to sell their shares on the same terms and conditions as would apply to the majority shareholder. This protects the other shareholders and allows them to participate in any sale.

Drag-Along Right A drag-along right allows a selling shareholder (usually a majority shareholder) to force the other shareholders to sell their shares on the same terms and conditions as would apply to the majority shareholder. This protects the majority shareholder and allows for all of the shares of a company to be sold at the same time.

Shotgun Clause A shotgun clause allows a shareholder to offer to purchase the other shareholders' shares at a specified price. The other shareholders are able to either sell their shares at such price, or to purchase the offering shareholder's shares. Such clauses are common in companies where there are two owners with equal shares in the company.

In addition, it is common to have a "valuation clause", which provides a method to determine the value of a company's shares. Since most small companies are private, the shares are hard to value without a

predetermined method. Having this clause will reduce the disagreement and uncertainty that occurs when a shareholder wants to buy or sell shares.

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