



## **Shotgun Clauses and Auction Agreements; Alternative Processes to Problem Resolution**

**By David C Bentall**

Even if family members decide to one day go their own way, and no longer remain in business together, this doesn't need to destroy their relationships. Unfortunately, in my opinion, "shotgun clauses" are often inadvertently killing many family businesses in Canada.

### **Conflict is Normal**

We have all seen the news stories exploiting conflicts in family companies. It is true, family members who work together often have disagreements. This is normal. However, just because family members have a difference of opinion, it doesn't need to tear the family apart, nor does it need to land them on the front page of the local paper. In an ideal world, we would be able to avoid family conflict altogether. However, as long as we have imperfect people working together, we will have challenges.

Therefore, we need to plan ahead so we can learn to manage conflict in such a way that it doesn't destroy our families and our businesses. Unfortunately, most families simply keep their fingers crossed and hope they won't have any disagreements. As a result, they don't take the time to develop appropriate provisions that can help preserve their business from generation to generation.

In a family business, the shareholders of the company are often related to one another, either by blood or marriage. However, they are also connected by virtue of the shares they own. If they are wise, they will have created a shareholders' agreement which will clarify how they plan to make decisions, how they can buy and sell shares, and how they will appoint board members, etc. Unfortunately, most families have never taken time to think about the importance of these issues.

I understand this, because as a former owner of a family company, I was also more interested in building the business than I was in some legal document sitting in a file somewhere. However, wise owners (especially sibling partners) invest in learning about these issues so that they don't risk losing all that they have built in their business by not knowing how their shareholders' agreement works.

My dad made precisely this mistake. He worked for our family enterprise for 50 years, and was instrumental in creating a remarkable track record of business success. Sadly, even though he was the largest shareholder of our family business and was the Chairman of the Board, the company was forcefully taken away from him. This situation could have been avoided had he taken the time to become more familiar with the company's shareholders' agreement and how it operated. He was just too busy building the business to bother thinking about it! This situation is all too common across our country.



He and his brothers had no "conflict resolution mechanism" in their shareholders' agreement. As a result, there was no way for the three boys (my dad and his brothers) to determine who should ultimately own and control the business. To prevent this kind of situation, the most common solution is to insert a "shotgun clause" into the family company's co-owners agreement.

## **Shotgun clauses**

Simply put, a shotgun clause provides a mechanism for any party to the agreement to abruptly end the co-ownership. This can be done by one party formally providing written notice of their desire to do so. When doing this, they are then obliged to state the price at which they would be willing to either buy their partners shares, or to be bought out. Such a clause can be a very effective mechanism for arriving at a fair price. I think this is perhaps the main reason why this mechanism is virtually ubiquitous in our country.

However, I think a "shotgun clause" is a very poor way to determine who in the family will own the company in the future. Furthermore, it is definitely not a good way to build and maintain family harmony. Just like a shotgun can kill, I believe shotgun clauses can kill family relations. It does this by putting a razor's edge on negotiations, and then by loading a gun and pointing it at one partner's head. Obviously, this is hardly the best environment for building rapport between siblings or other relatives.

## **Auction agreements**

As a creative option, I recommend to my clients that they consider what our lawyer recommended we incorporate into our family's shareholders' agreement. When my sisters and I were co-owners of Dominion Construction, we had a private auction as our conflict resolution mechanism instead of a shotgun clause. Simply explained, we had an understanding which would allow for a carefully structured auction between the shareholders. In the event of a dispute, or a desire to discontinue our partnership, any one of us could initiate the auction. Whoever wanted to do so would then be required to offer to buy the others out by starting the bidding process for the company. The other shareholders would then be given the choice to either sell, or bid a higher price.

As President of the company, this clause gave me confidence that I would be able to continue to own, and run, the business indefinitely, unless I was offered a price at which I would be happy to sell. For my sisters, this arrangement gave them the assurance that they could either buy or sell the company whenever they wanted to, with confidence that they would get a price they would be satisfied with.

In our specific case, Helen, Mary and I had a harmonious working relationship for 10 years, between 1988 and 1998. During that time we saw the company sales grow from \$150 million per year to just under \$300 million. We had no major disagreements during that time and successfully paid off all the debt we had incurred



when acquiring the business. At the end of this period, Helen and I were able to sell the business to my other sister, Mary. All of us were satisfied with the price agreed to, but we were spared the stress and uncertainty which I think a shotgun clause would have likely caused.

If you don't know what your shareholders' agreement says, chances are pretty good that it contains a "shotgun clause". This is likely not what you want to have in your documents, especially if you want to preserve family harmony in the future. Consider a more creative solution, and investigate the idea of utilizing an 'auction clause' instead. As a result you may be able to sleep better at night, and you may be able to preserve relationships in the family.