BUSINESS LAW

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1. ORGANIZATIONAL CONSIDERATIONS

Starting a business is an extremely exciting proposition, but does requires careful analysis of the desired organizational structure. The 3 main choices are sole proprietorship, partnership and corporate.

Sole Proprietorships

As an individual carrying on business in your own capacity, you have initial cost savings and a simple structure. For less than $100.00 in filing fees, you can reserve and register your business name with the B.C. government at www.bcbusinessregistry.ca, (while at the same time complying with all the other government requirements enumerated on the site).

There is a significant downside, though, in that you are personally liable for all losses, and also for damages to others for losses suffered through your actions or omissions in your business.

Partnerships

Another fairly straightforward way of setting up your business is to collaborate with one or more others. While a partnership declaration should be filed under B.C.'s *Partnership Act*, there is otherwise no requirement for any type of written agreement (though it is certainly highly recommended, as discussed below).

The main disadvantage is the same as that for sole proprietorships, in that there is no limited liability. Further, each partner is bound by the liabilities which the other partners might have incurred in their business dealings.

Corporations

Also known as "companies" or "limited companies", corporations are separate legal entities from their principals, or shareholders. They have the powers of a natural person, in almost all situations, and can own property, earn income and retain profits without necessarily distributing them. They can be registered under B.C.'s laws or elsewhere, but if the latter then must register in B.C. if carrying on business in this province.

The main disadvantages of operating as a sole proprietorship or a partnership are significantly minimized by incorporating. The concept of limited liability means that debts of the corporation are usually not debts of the individual shareholders or directors/officers, who

are also not generally personally liable for the consequences of the corporation's actions which cause loss or damage to others.

Rather than be taxed on business income on a calendar year basis (such as exists for the above business structures), corporations are able to choose their fiscal year end, thereby allowing deferral of taxes. There are other very valuable tax advantages such as income splitting opportunities to withdraw money from the corporation at beneficial tax rates, while income earned by most smaller corporations are taxed at a preferred rate. Additionally, a huge advantage over unincorporated entities is the possibility of no capital gains tax payable on the sale of qualifying shares (though restrictions apply).

Having a corporate entity provides increased credibility, with suppliers and financial institutions offering more flexibility. In particular, the sale of shares can be used to raise financing. Different types ("classes") of shares can be created in a corporation which will entitle holders to varied voting rights, dividends, and distribution on winding-up.

Note, however, that the benefits of limited liability are well recognized by landlords, suppliers and lenders, such that personal guarantees are usually required from the principals of corporations.

The affairs of the corporation will be governed by B.C.'s *Business Corporations Act* and by a corporation's bylaws ("Articles") which together provide a valuable set of rules and guidelines not available to sole proprietorships or partnerships. It is still highly recommended that shareholders formalize their relationship by entering into a shareholders agreement (discussed below).

There are additional legal and accounting costs associated with setting up and maintaining a corporation, but in general these are far outweighed by the above significant advantages. The lawyers at Mountain Law Corporation have considerable experience in providing you with more information relating to all of the above (and much more), so we look forward to assisting you with your business start-up.

2. MERGERS & ACQUISITIONS

The fancy heading really means the integration of your business operations with another and the purchasing of a business. As you can read under the "Our History" heading on this website, Mountain Law Corporation's success in the Sea-to-Sky Corridor has resulted from the acquisition of two other businesses. Through those purchases, we obtained quality staff, acquired a great many clients, and even increased our market share by reducing the number of competitors in the area!

Other reasons for a merger and/or acquisition would be the reduction of costs through efficiencies, diversification of services or products, and increased access to funds or assets for expansion. There are also possible tax benefits to be derived from such a move, which are better discussed with your qualified accountant.

There are also a myriad of risks, though, in the process of merging with or acquiring a business. Critical to your success will be the early and successful engagement of a

competent business lawyer, who will conduct the necessary background checks ("due diligence") and document the transaction appropriately. We at Mountain Law Corporation have that experience and would be delighted to be of assistance to you in such an endeavour.

3. SHAREHOLDER & PARTNERSHIP AGREEMENTS

Where there is more that one person involved in a business enterprise, there should be a written agreement governing the relationship between the multiple parties, whether the business structure is a partnership or a corporation (see above).

Partnership Agreements

When businesspeople collaborate, they rarely focus on the possibility that some day their association will fall apart. Without a well-drafted agreement, there are a multitude of issues to settle which can result in tremendous expense and stress. For example, when can a partner actually leave the arrangement and with what type of notice? What happens on disability, retirement or even death? How are the partnership assets valued and disposed of? It is far better to develop a carefully thought out partnership agreement while the relationship of the partners is positive.

Shareholder Agreements

Similar principles apply here relating to the early need for a comprehensive agreement. The additional danger, though, is that the shareholders mistakenly believe that the bylaws ("Articles") of the corporation together with B.C. *Business Corporations Act* (quite apart from judicial interpretations of the law), provide sufficient direction regarding their relationship. In fact, there are many critical matters which either need additional clarification or are missing completely from those documents or case law.

Shareholder agreements require the parties to identify and refine their business objectives and to specify how to deal with issues and problems which might occur in their future dealings.

a) **Management**
Identify the directors, officers and even key employees and what responsibilities (including signing authority) each might have. Should there be related consulting, management or employment agreements? What should be the quorum for decisions and should that be different for varying scenarios?

b) **Financing**
The type and extent of raising or borrowing capital needs to be addressed. Will it be through shareholder loans, institutional financing, or a combination of both, and on what terms and conditions?

c) **Share Transfers**
Often restrictions are desired on the transfer of shares in the corporations but detailing the circumstances can be onerous. Rights of first refusal require

shareholders first to offer their shares to the other shareholders or the corporation before selling to an outside party. Should they be offered at "fair market value" and how is that to be calculated?

d) Buy/Sell Provisions
A mandatory forced sale by a shareholder usually applies upon retirement, incapacity, bankruptcy, death, termination of employment or default under the shareholders agreement. How much should the sale price of the shares be discounted?

e) Insurance
There are significant advantages associated with having a corporation own and maintain life insurance on shareholders. Upon the death of a shareholder the deceased's family can receive a tax-free settlement and the remaining shareholders don't need to pay out the family or have them continue to be involved with the company.

f) Mediation/Arbitration
Perhaps most valuable is a clause requiring the parties to go to mediation and then binding arbitration in the event of deadlock or disputes. Such proceedings are generally less expensive and disruptive than court action, and best of all are private.

The foregoing brief overview of partnership and shareholder agreements is designed to alert you to the pitfalls of not having one. Contact the experienced lawyers at Mountain Law Corporation for more details and to receive a much more comprehensive no obligation checklist to assist you in your decision-making.

4. COMMERCIAL LEASING

It is vitally important to obtain comprehensive legal advice in commercial leasing situations due to the nature, value, complexity and duration of such leases, whether as a landlord (lessor) or tenant (lessee). Just 20 years ago most leases were on preprinted forms totalling five pages, while now it is common to see ones of 60 pages in length. It is commercial landlords who come up with the form of lease to be used in specific situations, and so this discussion is designed for the commercial tenant confronted with the thick stack of paperwork. Note that for residential leases in B.C., pretty much all that needs to be known is set out extremely well on the government website under "Legal Links" near the end of this website.

Parties

Consideration must be given as to who is to be on the lease; that is, should you incorporate and use the company as the tenant? In that case, the landlord will most likely require at least one principal of the company to be guarantor (sometimes called "covenantor" or "indemnitor") in case the corporation does not or cannot fulfill its obligations. However, depending on your negotiation powers, you may be able to avoid providing a personal guarantee to the landlord.

Term

One of the most important decisions for a commercial tenant is the length of the lease commitment. It can be broken up into shorter, renewable terms or can constitute one long term. In general the landlord will prefer the latter, while the former gives the tenant more flexibility in case, for example, it needs to move because its business operations are expanding or shrinking.

Condition of Promises

Though leases often contain an “as is, where is” type of clause, commercial tenants should review the state of repair of the building as a whole, besides the proposed space to be leased. The best time to negotiate the remediation of any deficiencies without paying is at the negotiation stage with the landlord.

Zoning

It is surprising how frequently a prospective business operation falls afoul of restrictive zoning for the contemplated premises. Court cases have held that it is the duty of the tenant to exercise due diligence in ascertaining the applicable zoning, absent a warranty by the landlord in that regard. The Function Junction commercial area where our Whistler offices are located is infamous for its complicated and often incomprehensible patch-work of zoning regulations.

Rent

There are usually two and sometimes three types of “rent”. Base rent is expressed as a certain dollar figure per square foot of rentable area (which is usually more than the actual useable area, so be clear on the calculations).

“Additional” or “triple net” rent comprises the tenant’s reimbursement to the landlord of property taxes, insurance and operating costs. The characterisation of what is and is not included here can be of high importance to a tenant who does not wish to be responsible for the landlord’s administrative fees, the building’s structural repairs, audit expenses and capital items of the landlord, the landlord’s borrowing costs, etc. Consider requesting that the landlord use all reasonable efforts to minimize its costs.

“Percentage” rent is fairly common in retail situations, where a percentage of the tenant’s gross sales are paid to the landlord as part of the monthly rent. Again, depending on the tenant’s bargaining ability, different percentages relating to gross sales generated can be agreed to, and even a higher base level than what is proposed in the lease agreement. The determination of “gross sales” should be examined too, so that credit/debit card charges and bad debts are excluded.

Exclusivity & Use

Depending on the tenant mix of the building, the landlord might be prepared to grant exclusive rights to the tenant to sell certain types of goods or deliver specific services, or indeed to operate a particular type of business. Conversely, if there are existing restrictive covenants in

favour of other businesses in the building or mall, explore their implications carefully. Finally, is the permitted “use” set out in the lease by the landlord sufficient for both present and future purposes?

Parking

The zoning of commercial premises, particularly restaurants, may require that a certain amount of parking be available, so careful consideration is needed here. If the landlord is unable to provide sufficient parking then consider asking for assistance in entering into arrangements with a neighbouring property owner.

Relocation

Usual for shopping centres is the right of the landlord to relocate the tenant to another area of the mall. While the tenant’s negotiation power may not be strong enough to negate the landlord’s unrestricted right, minimization of the inconvenience might be achieved through the landlord picking up all costs of the move (including interruption of revenue stream) or by the tenant requiring that the exposure and walk-by traffic be similar at the proposed new location.

Assignment/Subletting

Arguably the most important lease provision to negotiate besides the rent and term, the assignment and/or subletting clauses must be examined carefully for re-negotiation. Most landlords are willing to relax the often strict language in their “standard” leases prepared by their lawyers. Absent restrictive wording, a tenant is able to assign or sublet the premises it occupies; however, leases set out detailed prerequisites of the landlord’s consent. The landlord will want to receive complete disclosure as to the proposed assignee or sub-tenant’s background in determining whether to grant approval. It may refuse to release the tenant from its obligations and may even have the ability to terminate the lease upon a request by the tenant to assign or sub-lease.

Renewals/Extensions

Most leases stipulate that the tenant has the option to renew or extend only if there have not been any defaults in the performance of its obligations under the lease. The tenant can often have this restrictive clause ameliorated so that a renewal option or extension must be granted so long as it is not in default at the time of exercising its option or extension request. That way, the landlord cannot rid itself of a problematic tenant at the end of a lease term. The rental rate at renewal or extension is determined by arbitration if the parties cannot agree, but the tenant should consider imposing a cap on any increase, or forcing an arbitrator to determine the new rent values without taking into account the tenant’s improvements.

Rights of First Refusal/Options

To provide more flexibility to the tenant, it may be able to negotiate its right to match an offer to lease for adjoining premises in case of the need to expand. Further, although resisted by landlords, it may be able to formalize an agreement to be able to match any offers to purchase the leased premises. The same can be true for both existing and possible expanded premises regarding securing options to lease or purchase.

As can be quickly assumed from a perusal of the above summary, competent legal advice is necessary when negotiating and entering into a commercial lease agreement, so contact the experienced lawyers at Mountain Law Corporation at an early stage.

5. SUCCESSION PLANNING

Compared to employees, employers have a myriad of factors to take into account when considering retirement, and should begin their planning several years ahead of time. There are a number of options available to the business owner which can only be briefly considered here.

Selling to Family

For many family-owned enterprises, this is the preferred route. However, it is usually the one most fraught with making difficult decisions about the different involvement and interest level of the family members. In addition, there is rarely money available for an outright or even partial purchase, so special attention needs to be given to the possible reorganization of the corporate structure to accommodate this eventuality. A careful balancing of the degree of control to be kept by the business founder vis-a-vis that to be exercised by the incoming family member is also needed.

An “estate freeze” would permit the value of specific “preferred” shares in the corporation held by the founders to be “frozen” (limited to the value at the time the freeze is instituted), while new low value “growth” shares would be issued to the incoming family members. The objective is to cap the value of the founders’ shares so that capital gains taxes on death are limited to the existing value of the corporation. An additional advantage is that the founders can gradually liquidate their preferred shares to provide for a steady retirement income.

Selling to Employees

We have been involved in several situations recently where employees have taken over the businesses of their employers, though again where relatively little money has initially changed hands. The key here, besides choosing the correct employees, is to structure the transaction in such a way that the employer continues to retain control while giving the designated employees the sense that they will participate in the business’ future growth. A carefully worded buy/sell agreement characterized as a shareholders agreement will go a long way to defining the roles and responsibilities of the various parties, and what might happen in the event of disability, death or changes in the business.

Selling to Others

In this scenario, much more so than the two options discussed above, the payment of a significant purchase price will likely occur. However, fastidious planning would be needed, often well ahead of time, to find the right buyer (often using an agent or broker), to maximize the value of the business, to negotiate the best possible purchase terms, and to reduce taxes payable on a sale.

A decision must be made about selling assets versus shares, and a careful understanding of the different tax consequences is an absolute requirement. Deferred purchase payments should be secured by some type of collateral, whether that be the business itself or other property of the purchaser.

As can be ascertained from the above quick discussion, considerable tax and legal advice is needed. The experienced lawyers at Mountain Law Corporation can provide reliable guidance at all stages of any proposed transaction, in conjunction with that of tax accountants and financial planners.

6. COMMERCIAL CONTRACTS

Much of the every-day dealings for businesses are defined by the written agreements they enter into with other parties. Lawyers are critical partners in drafting, interpreting and enforcing those agreements. From commercial leases discussed in detail above, to contracts with customers and suppliers, and to agreements with employees, consultants and contractors, many of the so-called "standard-form" documents contain provisions which are either onerous, prohibited or simply illegal. For example, courts will often not award interest on outstanding invoices unless there is a formal credit agreement agreed to in writing. In addition, if the interest rate is only stipulated as being on a monthly basis (rather than on an annual basis), then the Canada *Interest Act* will only permit the statutory rate of 5% per annum to be charged. A good business lawyer at your side can provide both proactive and reactive legal advice.

7. CONSTRUCTION AGREEMENTS

Standard form contracts specifically designed for home or commercial construction are a rare breed compared to other legal products widely available to the public today. Therefore, lawyers are often involved to assist contractors or owners with the unwieldy and complicated Canadian Construction Documents Committee ("CCDC") documents.

Home construction agreements should contain various terms such as an arbitration clause, nomination of a "payment certifier" and numerous provisions addressing the matters of substantial completion and holdbacks. Note that subsection 42(2) of the *Builders Lien Act* of B.C. states: "An agreement that this Act is not to apply, or that the remedies provided by it are not to be available for a person's benefit, is void".

The most misunderstood elements of construction contracts revolve around the definition of substantial completion and the protocol to follow for hold-backs, which is the focus of the following discussions.

Hold-Backs

Subsection 4(1) of the *Builders Lien Act* stipulates that: "The person primarily liable on each contract, and the person primarily liable on each subcontract, under which a lien may arise under this Act must retain a holdback equal to 10% of the greater of:

(a) the value of the work or material as they are actually provided under the contract or subcontract; and
(b) the amount of any payment made on account of the contract or subcontract price".

Under section 8 of the Act, the holdback is to be retained for 55 days after the substantial completion, abandonment or termination of the general or trade contract, or the certification of substantial completion. Therefore, the retention of 10% of general contract or trade contract progress draws is compulsory for the owners of construction projects (despite the prevailing practice of ignoring that legal requirement, and the possible disastrous financial consequences to an owner).

Another statutory requirement routinely ignored is the setting up of a jointly administered hold-back account by an owner and the general contractor, for non-provincial construction projects of over $100,000.00 in value (section 5 of the Act).

Substantial Completion

Substantial performance/completion of a general or trade contract is the governing trigger for the start of the 45 day lien filing period and the 55 day hold-back release period.

Under section 1 of the *Builders Lien Act*, substantial completion is achieved:

(a) For a general contract, trade contract or subcontract, when the "3-2-1" formula is satisfied; i.e., when the remaining work is capable of completion or correction for not more than 3% of the first $500,000 of the price, 2% of the next $500,000 of the price and 1% of the balance of the price.

(b) For an improvement (for example, when the 3-2-1 formula cannot be applied, such as when work is carried out on a cost-plus basis), when the improvement or a substantial part of it is ready for use or is being used for the purpose intended.

Where substantial completion cannot be determined though the issuance of a payment certifier's certificate of completion, it is a matter of establishing that fact using the above criteria. Often the issuance of a municipal occupancy permit is used.

Hold-Back Release

It is surprising how few owners will conduct a Land Title Office search to be sure no liens have been filed against their property before releasing hold-backs. A recent B.C. Court of Appeal decision also suggests that a court registry search might be necessary in case of legal action.

Strata Property

The *Strata Property Act* of B.C. in subsection 88(2) requires that a strata lot purchaser retain from the purchase price a hold-back (currently 7% of the purchase price as set out by Regulation) until the earlier of the date on which the applicable lien filing time period under the *Builders Lien Act* expires and 55 days after the strata lot conveyance date.

While there are a host of other construction issues which need to be examined, particularly those arising out of faulty design or work, they cannot all be canvassed here. Contact the experienced lawyers at Mountain Law Corporation for assistance in specific instances.

8. BEING A COMPANY DIRECTOR

If you are the director of a company, you have personal exposure to some liabilities of your company. Under B.C.'s *Employment Standards Act*, directors (and officers) are personally liable to the company's employees for up to two months of unpaid wages or overtime, severance pay or vacation pay outstanding. There are several other provincial statutes, and also the federal *Income Tax Act*, where principals of companies (not necessarily directors but also directing minds) can be held personally responsible for unpaid taxes, penalties and interest.

Further, B.C.'s *Business Corporations Act* makes it clear that failure to adhere to certain standards can results in personal liability for directors (and officers) relating to their company losses. There are also provisions in that Act which state that failure to disclose your direct financial interest in a contract with the company can result in the forfeiture of any profit gained. Obviously, disclosure in that case, or taking reasonable actions to avoid loss by the company in other scenarios, can help avoid liability.

Directors' and Officers' Errors & Omissions Insurance arranged by the company is one way to protect oneself, but there are exclusions in those policies and the cost is considerable. Exercise care, diligence and skill, and if in doubt, step aside from your obligations.

Mountain Law Corporation provides the above for informational purposes only. No legal advice on any issue is to be construed from the contents contained herein. In addition, it is understood that no content should be interpreted as the basis for a solicitor-client relationship. Please contact one of our lawyers if you wish to obtain legal advice.

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