Small Business Toolkit

QUARRY PARK LAW

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Foreword:

I am delighted to present the enclosed publication on business law relevant to the local community.

I have striven to make the articles relevant and touch upon issues that concern the community at large. To that end, I have volunteered my time to research and publish these pages free of charge.

Should you have any questions or concerns about the publication, or if you have any legal questions in relation to the foregoing, I invite you to contact me at the address noted above.

This publication is offered free of charge to members of Calgary's business community. You are free to distribute this publication provided that the author is credited for his work.

The law is always subject to change, and the opinions or assertions expressed in this publication are current only as of the release date of this publication. The information in this publication are for general information purposes only and are not intended to be legal advice. Do not rely upon the contents of this publication without first obtaining legal advice. Your particular needs will likely require information that is not included in these pages. I am disclaiming all responsibility for any reliance placed upon any information contained herein.

These pages are specific to the Province of Alberta only, and may not apply to other jurisdictions.

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I.

TYPES OF BUSINESS VEHICLES

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Types of Business Vehicles

Generally speaking, a for-profit small business can take the following forms:

1. Sole proprietorship
2. Partnerships
    a. General Partnership
    b. Limited Partnership
3. Joint Venture
4. Co-operative
5. Corporation
6. Special forms – LLP's, ULC's, LLC's, trusts, etc.

Vehicles under the above item 6 are used in specialized circumstances and are beyond the scope of this article. The most frequent small-business vehicles are sole proprietorships and corporations. However, each structure delivers advantages and disadvantages from the perspectives of liability, tax, and cost.

1. Sole Proprietorship

The sole proprietorship is the simplest form of business. It is ideal for a single investor, where risks of liability are low and easily insured, and where tax treatment favours a simple structure as opposed to incorporation. Income and expenses of the business are treated as income and expenses of the individual, so there is no separate tax return for the business, and no threat of double taxation as would occur with a corporation. Finally, there are no fees to worry about for incorporation or filing of annual returns with the Alberta Corporate Registry.

However, for all its advantages, sole proprietorships operate under a significant risk because all liabilities of the business are treated as liabilities of the proprietor. If your business suffers an unexpected claim, then there is no barrier between the claimant and the person operating the

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business as there is under some other business vehicles. This means when the business is sued, it is the business owner who is sued as a result.

2. Partnerships

A General Partnership, as defined by the *Partnership Act* (Alberta) is quite simply "a relationship that subsists between persons carrying on a business in common with a view to profit". It need not be registered with the Corporate Registry, and indeed, there is much caselaw determining whether persons have been acting in partnership or otherwise (most commonly as joint venturers). Members of a company, such as shareholders, are specifically excluded from this definition. Like a sole proprietorship, it is a simple arrangement: there is no need for registration, and the profits and losses of the General Partnership flows to the General Partners for tax purposes. It also has its dangers: each partner can bind the General Partnership by unilateral action; also, each General Partner is entirely responsible for the liabilities of the General Partnership. This means that each General Partner could be liable for each other General Partners' actions which might give rise to a claim against the General Partnership.

A Limited Partnership is a special form of Partnership. In a Limited Partnership, there is always at least one General Partner which carries unlimited liability for the liabilities of the Limited Partnership, and which acts as the agent of the Limited Partnership to bind the Limited Partnership by unilateral action (much like a General Partnership). However, a Limited Partnership also involves Limited Partners. Liability of Limited Partners is generally limited to the extent of their investment (excluding consideration of any indemnities or guarantees they may grant for the liabilities of the Limited Partnership). However, Limited Partners typically do not act in any management capacity nor can they typically bind the Limited Partnership by their unilateral action. Profits and Losses of a Limited Partnership (as well as the business of the Limited Partnership and a whole host of other matters) are shared as stipulated by the governing Limited Partnership Agreement. Typically, a Limited Partner

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will hold a number of Limited Partnership Units that correspond to their investment – and share of the profits and losses – in the Limited Partnership.

3. Joint Venture

A Joint Venture is similar to, but distinct from, a Partnership. A joint venture is merely two actors which contract with each other for a specific purpose. These actors must be careful to ensure their relationship does not fall under the definition of a Partnership, i.e. "a relationship that subsists between persons carrying on a business in common with a view to profit", as doing so will have tax and liability consequences. One example of a Joint Venture could be the common ownership of a productive asset or piece of capital machinery. Each owner has a distinct business separate and apart from the other, however, they both use it in the course of their own individual business. The rights and obligations of each participant will be defined by the contract between them.

4. Co-Operative

Cooperatives are governed by the *Cooperatives Act* (Alberta), and are usually seen in industries such as agriculture and housing. Under this structure, each person who wishes to be involved or have rights under the Cooperative purchases a membership or membership shares. A Cooperative is a democratic institution – each member usually has one vote. Cooperatives may also issue investment shares, which carry the rights, liabilities, and obligations detailed in the Articles of the Cooperative. The Members of the Cooperative can share in the profits of the Cooperative via the distribution of Patronage Dividends, which is typically based on the usage each member makes of the Cooperative.

5. Corporation

A corporation is a separate person from its shareholders (i.e., its owners) at law. This means

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that a Corporation can execute its own contracts – typically through the actions of its Directors or Officers – it can own property, and it can sue and be sued.

The basic founding documents of a corporation include the following (and are further explained in the Article entitled "*Corporate Basics – Articles, Bylaws, and the Unanimous Shareholder Agreement*" in this publication):

- *Articles of Incorporation*. This establishes the Corporation's name, its business (if restricted), share structure, number of directors, restrictions on share transfers, and any other special considerations.

- *Bylaws*. These typically govern meeting or resolution procedure (such as voting procedure and quorum requirements), how notices may be given, rules for transferring shares and security, etc.

- *Unanimous Shareholder Agreement.* This agreement is a controlling document for the present and future shareholders of the Corporation. It typically governs things such as the procedure for transferring shares, the identity of Directors, how to value shares and the various rights of shareholders (often included, for example, is a right of first refusal on shares sold by other shareholders). Generally speaking, a Unanimous Shareholder Agreement can be a useful tool in the event of irreconcilable shareholder disputes, as it can provide for a clean – and hopefully undisputed – exit strategy.

The separation between the Corporation and its Shareholders is called the "corporate veil" (this terminology arises from an old British House of Lords decision from 1897 known as *Salomon v. Salomon*). Subject to various certain exceptions, such as fraud, a Shareholder is normally protected against the liabilities of the Corporation. Indeed, the "corporate veil" may be pierced in a number of circumstances, however this is beyond the scope of this article.

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Incorporation can be done federally or provincially; which route is taken will depend on the number of provinces in which the business operates, cost, provincial laws (including tax laws), the number of directors that are Canadian residents, and various other considerations. If Federal incorporation is pursued, the Corporation will also need to be registered in Alberta upon commencement of business in the Province.

It is most often helpful to create a Minute Book for the Corporation. The Minute Book holds records of legal significance to the corporation, further detailed in the Article titled “Keeping your minute-book and corporate records up-to-date”.

Also, sometimes a Corporation will commission for itself a Seal. A Corporate Seal accompanies the signature of a Director/Officer (or agent of the Corporation) on contracts to evidence that the Corporation is legally bound by the contract. The seal has historic significance – in fact, old common law determined that such a Seal must accompany a contract in order for the contract to be enforceable – but in the modern era the necessity for a seal can often be circumvented, sometimes by way of an affidavit sworn by a Director or Officer attesting to corporate authority.

A Corporation is governed by its Board of Directors. The Directors have the ability to bind a Corporation to contracts and meet to manage the business and affairs of the Corporation (although the Directors may generally sign a resolution in lieu of meeting).

Subject to the Articles, the Bylaws or any Unanimous Shareholder Agreement, the Directors may then appoint Officers with such duties and responsibilities as they determine, and delegate to them powers to manage the business and affairs of the corporation. Common positions for Officers include a President, Vice-President, Secretary and Treasurer.

Upon incorporation, a Corporation may take a traditional name (such as “XYZ Widget Co.”) or a numbered name (such as “123456789 Alberta Ltd.”). A Corporation's legal name must

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accompany its contracts, and oftentimes a corporation will register a Trade-mark or Trade-name for the name under which it does business. If incorporating under a more traditional name, the registrar must first approve the use of that name, and it cannot be similar or confusing with an existing name.

Finally, a corporation issues ownership capital in the form of shares. A corporation may have many classes of shares, for example, Class "A" Shares, Class "B" Shares, and Class "C" Shares, each with their own rights in terms of voting, redemption and retraction options, preference to the liquidated assets of the Corporation, etc. These rights will be outlined in the Articles of Incorporation. These are explained in more detail in the Article entitled "*Corporate Basics – Articles, Bylaws, and the Unanimous Shareholder Agreement*" in this publication).

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II.

SHOULD I INCORPORATE?

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Should I Incorporate?

Depending on the business, incorporation can provide a great many advantages. For other businesses, incorporation might not necessarily be the right step.

One main advantage conferred upon incorporation is that of limited liability to the owners (its shareholders). For the shareholders, this often means that they are protected from the liabilities of the corporation, unless of course they have personally guaranteed a liability or are otherwise personally responsible. In this case, and barring any special circumstances giving rise to personal liability, a shareholder's risk exposure is no greater than the value of their shares held. This is enshrined in the principle of the “corporate veil”, which has been a part of the common law since the decision of Salomon v. Salomon by the British House of Lords in 1897. Put simply, a corporation is a distinct and separate entity from its shareholders.

Since a corporation is a separate person in the eyes of the law, it allows the corporation to do things in its own name, rather than in the name of its shareholders. These things include purchases, sales, incurring debt, suing and being sued.

Consider the following hypothetical: a corporation operates in a brick-and-mortar storefront. One day, a careless shopper slips on a wet floor, breaking her ankle and subsequently suing the store for damages. Insurance was on your to-do list but isn't in place yet. The suit succeeds and the Plaintiff obtains judgment or a settlement for damages. If this judgment is greater than the corporation can pay (bringing it into bankruptcy or insolvency), the Plaintiff may be barred from going beyond the corporation to sue the shareholders for any deficiency.

Sadly, the loss of the business is still the result (as is a lesson in obtaining adequate insurance). In this hypothetical however, incorporation in this case has protected the shareholders of the business from further harm by insulating them against further loss. Liability can result from a multitude of sources, the above example reflecting one such. Others might include negligence

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in the provision of a service or manufacturing a defective product, or breach of contract (for example, by not delivering a product on the date agreed).

One must appreciate that different considerations apply to directors and officers. These individuals have responsibilities to the business and do have liability that extends beyond that of a mere shareholder, although it is questionable whether they would be held accountable for the above example. It is common for directors and officers to acquire policies of insurance to mitigate these risks. Additionally, unanimous shareholder agreements often provide for corporate indemnification of directors and officers in certain circumstances. Please see Chapter Three of this publication for further details.

At the end of the day, whether you incorporate or not depends on a multitude of factors, including dollar amount of revenues, expenses, loans entered into, how many employees the business has, and whether the business is an e-business or a traditional business. An entrepreneur with no employees working from home without a risk of product or service liability may very well not wish to incorporate at all, to keep costs down.

A corporation does not die with the proprietor – shares are distributed along with the estate of the deceased shareholder, so there is continuity of the business. This also allows for succession planning. Further, the Corporation can invite investors to buy shares to provide financing for business operations if they wish, as an alternative to debt financing (or in some cases, to provide security for debt financing).

Keep in mind that there are really two aspects to the question of incorporation – legal and financial – and I have only covered the first. I encourage entrepreneurs to seek the advice of a qualified accountant for the consequences of incorporation as it relates to taxation. Incorporating can allow a business to receive tax benefits, such as the Small Business tax deduction (which gives a favourable taxation rate for active businesses making up to $500,000 per year) and the potential to defer personal income tax.

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III.

DIRECTORS AND OFFICERS – DUTIES AND LIABILITIES

Directors and Officers – Duties and Liabilities

This is not a comprehensive list of all duties and liabilities that a director or officer may carry. For further information, please contact a lawyer directly for your particular circumstances.

The duties and liabilities of a director is separate and distinct from the liability of a shareholder, whose liability is generally protected by virtue of what is known as the *corporate veil* – a principal arising from the separateness of a corporation and its actors discussed elsewhere in this publication.

As it stands, Directors and Officers carry a fiduciary relationship with a corporation, which is a special legal relationship recognizing that the director/officer has a certain minimum standard of conduct. These duties include the following:

1. They must act honestly and in good faith with a view to the best interests of the corporation; and
2. They must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

These duties are specifically enumerated in the *Business Corporations Act* (Alberta). Other aspects of these fiduciary duties exist, however, and generally speak to acting in the best interests of the corporation. Some of these other aspects of the fiduciary duties include the following:

- The duty to avoid conflicts of interest;
- The duty to avoid using his or her position for personal gain;
- The duty to maintain the corporation's confidential information;
- The duty to serve the corporation; and
- The duty to exercise independent judgment.

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For instance, directing the corporation to undertake an action which benefits the director at the expense of the corporation would be a breach of these duties. A simple example might be directing the corporation to enter into a contract for an inflated price with another company owned by that director.

Directors and Officers must disclose any interest in a material contract entered into by the Corporation, and the corporation must keep records of such disclosures. Further, a director with a material interest may not vote on any resolution to approve the contract. There are certain exceptions to this, including contracts dealing with the directors' remuneration; indemnity or insurance granted to the director by the corporation; or if the contract relates to a corporate affiliate.

If a director or officer fails to disclose a material interest, the Courts may render the contract unenforceable.

In some cases, the duty to act honestly and in good faith with a view to the best interests of the corporation may be impossible to fulfil if the same person is a Director or Officer of two competing corporations. A Director or Officer must therefore take great care to ensure this does not happen.

Other Duties

As outlined in the *Business Corporations Act* (Alberta):

- A Director or Officer may not issue shares for deficient consideration other than money;
- A Director or Officer may not permit the payment of an unreasonable commission on the sale of shares;
- A Director or Officer may not approve certain payments (including dividends to shareholders) or indemnities if the Corporation does not meet a minimum solvency standard.

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Duties Imposed by By-laws, Unanimous Shareholder Agreements, Articles of Incorporation

In addition to the above, a Director and Officer must comply with any duties or limitations imposed by the corporation's by-laws, Unanimous Shareholder Agreement, and Articles of Incorporation.

Liability

Directors and Officers can be personally liable for breaching any of the above duties.

However, there are additional sources of liability, arising from various provincial and federal laws. These liabilities cover a wide range of laws, from the Criminal Code to environmental legislation.

It is outside the scope of this article to discuss all sources of liability. However, some notable examples include the following:

- Directors are liable for the past six months of employee wages whilst they were Directors (with some limited exceptions);
- Directors are liable to the Canada Revenue Agency for withholding amounts for employees(for example, income tax, Canada Pension Plan, and Employment Insurance) and G.S.T. remittances;
- Liability may result from misrepresentation of financial statements and disclosure documents under the *Securities Act;*
- Liability may arise from non-compliance with Canada's new anti-spam legislation, which came into force July 1, 2014.

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Tips on avoiding liability

Often, a corporation will indemnify directors or officers for reasonable costs, charges, and expenses involved in an action, provided that the director or officer acted in good faith and with a view to the best interests of the corporation, and in the case of a criminal or administrative action enforced by a monetary penalty, that the director or officer had reasonable grounds for believing that their actions were lawful. This indemnity may be given a number of ways, and is very often included in a Unanimous Shareholder Agreement or executive employment agreement.

Another common protection is through the use of insurance. Most major insurers provide policies to insure directors and officers against certain actions or amounts provided that the directors or officers have acted honestly and in good faith with a view to the best interests of the corporation.

Of course, the best way to avoid liability is to ensure a Director or Officer satisfies all duties in the first place. If directors can show due diligence and prudence in making a decision, the courts will be more likely to find that a duty of care has been met satisfactorily. One such way might be to implement of a system for the review, consultation and consideration of stakeholder interests (using outside experts as necessary) in relation to Director and Officer decisions.

It is important to note that a director has been deemed to consent to a resolution or action taken by a corporation unless a dissent or abstention is recorded in the minutes; the director sends a written dissent to the secretary before the meeting is adjourned or by registered mail to the registered office of the corporation immediately after the meeting is adjourned; or otherwise proves they did not consent. This is important because liability may attach to a Director if no such record is made.

IV.

CORPORATE BASICS:

ARTICLES, BYLAWS, AND THE UNANIMOUS SHAREHOLDER AGREEMENT

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Corporate Basics – Articles, Bylaws, and the Unanimous Shareholder Agreement

This article will briefly touch upon the Articles of Incorporation, Bylaws, and Unanimous Shareholder Agreement; their purpose, and common terms found in each.

1. Articles of Incorporation

The Articles of Incorporation determine the following:

- The name of the Corporation;
- The classes of shares, and any maximum number of shares that the corporation is authorized to issue;
- Restrictions on share transfers (if any);
- Number, or minimum and maximum number, of directors that the corporation may have;
- Specifics of any restriction from carrying on a certain business, or restrictions to carrying on a certain business; and
- Other rules or provisions (if any).

Ordinarily the section dealing with classes of shares will be lengthy and detailed. The goal, at least for a startup, is to provide flexibility in the event of future restructuring. Even though there may be only one shareholder today who holds 100% of issued shares, it is a good idea for the articles to provide for a large number of classes of both Common and Preferred Shares in the event of future financing, the addition of a new Shareholder/Director, the implementation of an estate freeze (which is a tax favourable method of transferring future growth of a Corporation to a third party) or the introduction of an employee stock ownership plan.

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Some typical rights granted to various shares include:

- Voting rights. Usually, each Common Share will possess one vote. Not all shares will have a voting right. Oftentimes, Preferred Shares will not carry a voting right.

- A right to receive dividends. These dividend rights may or may not be cumulative, whereby if the Corporation does not pay a dividend in any given year, they are obligated to pay the "missed" payment for the next year; that is, the dividends accumulate year-after-year.

- Redemption/Retraction rights. A Redemption Right is a right held by the Corporation to redeem or purchase the Redeemable Shares at a price which is set out in the Articles of Incorporation. A Retraction Right is similar, in that the Shareholder has the right to have the Corporation purchase back the Retractable Shares at a price which is set out in the Articles of Incorporation.

- Rights to the return of capital. Upon the liquidation of the Corporation's assets and/or dissolution of the Corporation, some shares will have a right to the proceeds of liquidation, up to a predetermined amount (such as the Redemption amount referred to above). Typically, the Preferred Shareholders will have priority over the Common Shareholders for these proceeds.

Schedules are also usually attached to the Articles of Incorporation to address both share transfer restrictions as well as other provisions. These will often cover items such as ensuring that no share transfers take place without approval of the Directors, having the Corporation carry a lien against the shares for any amounts owing to the Corporation by the Shareholder, borrowing provisions, setting out a maximum number of shareholders (if applicable), and prohibiting any invitation to the public to subscribe for shares (if applicable). These last two are usually implemented in order to comply with *Securities Act* (Alberta) requirements.

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2. Bylaws.

Bylaws of the Corporation ordinarily govern Shareholder and Director meeting or resolution procedure, such as voting procedure and quorum requirements. They can be quite lengthy, and ideally should cover a whole range of matters, such as (the following list is by no means exhaustive):

- The Business of the Corporation (registered office, seal, financial year-end, the execution of instruments, banking arrangements, etc.);
- Borrowing powers by the Directors on behalf of the Corporation;
- Matters pertaining to Directors (number of directors, meetings of Directors, quorum, qualifications to run as Director, term and removal, etc.)
- Powers of Directors or Officers to appoint Committees;
- Officers and their responsibilities, terms, removal, etc.;
- Director and Officer (A.K.A. "D&O") Insurance to be obtained, and any indemnity by the Corporation in favour of Directors or Officers in certain circumstances (for further information, see the Article entitled "Directors and Officers – Duties and Liabilities");
- Shares – transfer rules, share certificate forms, surrender and registration of shares, transmission of shares upon death of a shareholder, etc.
- Dividends – rules for declaring dividends, record dates, interest payable, etc.
- Matters pertaining to Shareholders – meetings, voting, quorum, notices, allowance for proxy voting, etc.

Once enacted, the bylaws are binding, so it is a very good idea to be familiar with them and ensure the rules are followed!

3. Unanimous Shareholder Agreement

Any number of shareholders can sign an agreement for certain matters governing themselves. This is separate and distinct from a Unanimous Shareholder Agreement. A Unanimous

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Shareholder Agreement is a controlling document for the shareholders, both present and future, of the Corporation. All shareholders must be a party to the Agreement (hence the term "Unanimous"). It typically governs things such as procedure for share transfers, identity of Directors, how to value shares, rights of shareholders. Generally speaking, a Unanimous Shareholder Agreement can be a useful tool in the event of irreconcilable shareholder disputes, as it can provide for a clean (and hopefully undisputed) exit strategy.

Common aspects of a Unanimous Shareholder Agreement are as follows:

1. Control over management of the Corporation. Generally speaking, the *Business Corporations Act* (Alberta) grants Directors wide powers to control the Corporation. Minority shareholders might feel somewhat powerless compared to majority shareholders who ultimately determine who these Directors are. A Unanimous Shareholders Agreement can go a long way to alleviate the concerns of a minority shareholder as to management. The Agreement can designate issues such as who Directors can be, or restrict the powers of those Directors and grant certain powers or management functions to the Minority Shareholder.

2. Issuance of further shares. The Shareholders may wish to restrict who may become a shareholder in the future, or even restrict present shareholders from purchasing or selling shares to or from other present shareholders or the Treasury. Oftentimes, this is done by way of a right of first refusal – if a shareholder wishes to sell their shares to a third party, they must first offer the shares to present shareholders at a price and on terms and conditions substantively similar to those offered to the third party. Another common mechanism is a buy-sell (A.K.A. "shotgun") clause, whereby a shareholder who wants to exit (or wants another shareholder to exit) can offer to both purchase and sell all shares to or from the other shareholder; both offers being of the same price per share. The other shareholder must then choose to accept one of the offers – either to buy all of the other shareholder's shares, or to sell to the other shareholder all of his shares.

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3. Dispute Resolution. The Agreement may provide for mechanisms to resolve disputes – such as a tie-breaking vote or even the flip of a coin. It will often allow for arbitration or mediation by a mutually acceptable party or parties as an alternative to costly litigation. In the event of irreconcilable differences, it can provide for a way to exit, such as by way of right of first refusal or shotgun as noted above.

4. Share Ownership – the Agreement may control who may own shares. For instance, the Agreement may contain so-called "Piggyback" and "Drag-Along" rights: if one shareholder sells his or her shares to a third party, the other shareholders have the option (in the case of a Piggyback clause) or are obligated (in the case of a Drag-Along clause) to sell to the third party their shares as well.

5. Share Options – the Agreement may provide for an option to purchase further shares from (A.K.A. "Call Option") or to sell shares to (A.K.A. "Put Option") the Corporation.

6. Insurance provisions – the Agreement may detail insurance policies to be obtained by the Corporation, such as D&O insurance and life insurance on the lives of major Shareholders. In the event of death of a shareholder, for example, the life insurance proceeds can be used by the Corporation to repurchase the shares held by that shareholder at the time of their death.

7. Family Law Matters – Often, an Agreement will provide that in the event a matrimonial property order is sought against a shareholder, that shareholder is obliged to sell their shares back to the Corporation, or the Corporation may have the option to repurchase its shares from the shareholder.

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V.

KEEPING YOUR MINUTE-BOOK AND

CORPORATE RECORDS UP-TO-DATE

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Keeping your minute-book and corporate records up-to-date

The Minute Book is a record-keeping tool to provide a convenient place to determine the legal status of a Corporation. It will contain records of the following:

- the Certificate of Incorporation
- Articles of Incorporation
- Bylaws
- Unanimous Shareholder Agreements
- Share Certificates
- Share transfer records
- Minutes of Shareholder and Director meetings and resolutions
- Records of Directors and Officers
- Disclosures of conflicts of interest
- Annual returns
- Financial statements
- Major contracts
- Certain other items, if relevant.

It is important that these records are kept up-to-date. Ideally, a person should be able to pick out a Corporation's minute book and immediately be able to determine the Directors, Officers, Shareholders, their rights, and any other relevant matter as outlined above. If a Corporation fails to keep the records required per s. 21 of the *Business Corporations Act* (Alberta), the Corporation may be liable to a fine of up to $5,000.

One reason it is important to keep things up to date is that various actors – shareholders, directors, creditors, and their agents or legal representatives – have a right in varying instances to access some of these records.

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Annual returns must be filed each year to provide the Corporate Registry an update on certain corporate information. If this annual return is not provided within a certain period of time, the Corporation will be struck from the register and dissolved.

The Corporate Registry must be updated at other times as well – for example, s. 113 of the *Business Corporations Act* (Alberta) requires the Corporate Registry to be updated on the particulars of any change in Directors within 15 days of any such change. Section 20 requires an update on the Registered Office or Records office, also within 15 days.

These returns are in addition to any tax returns issuable to the Canada Revenue Agency. Additional filing requirements will apply to a Distributing Corporation, as required by the *Securities Act* (Alberta).

When a corporation is formed, organizational minutes or resolutions must be passed by the Directors and Shareholders. Typically, these will deal with the election of the first Directors and Officers of the Corporation (including setting maximum and minimum numbers), shareholder subscriptions for shares, the appointment of an auditor and banker, the confirmation of the records address for the corporation, the confirmation and establishment of the Corporation's bylaws, the adoption of a corporate seal, and the determination of the financial year end.

On an annual basis, the Corporation must also take care to hold meetings or pass resolutions as required by the Business Corporations Act. The Act requires a Corporation's Shareholders to meet annually in order to confirm Director elections or appointments, appoint or dispense with the appointment of an auditor, and allow the Directors to present the financial statements for the Corporation. The Directors must also meet annually to confirm the financial statements, and to confirm Officer appointments.

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VI.

BRANDING:

TRADEMARKS AND TRADE-NAMES

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Branding – Trademarks and Trade-Names

Upon incorporation, a business will want to direct its mind to the name of the business and protecting its brand from being used or plagiarized by others. A brand name is crucial for differentiation, and laws provide a mechanism to ensure its protection. Generally speaking, a business name can be registered by way of trademark or trade-name. While superficially similar, there are significant differences between the two, not the least of which is degree of protection and registration cost.

A Trademark is defined by the *Trade-marks Act* (Canada) as:

1. a mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, sold, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others,
2. a certification mark,
3. a distinguishing guise, or
4. a proposed trade-mark;

A trademark does not need to be a name or words only. It can be a picture or logo as well. Registration of a trademark helps to protect your use of the registered mark for 15 years across Canada. Registration is *prima facie* evidence of ownership.

Trademarks can arise under common law as well in the absence of registration. Drawbacks with this approach include the uncertainty of the trademark (it must pass the common law test to be recognized – and hence involves litigation), and the fact that it may not grant Canada-wide protection.

Registering a trademark helps protect against another business using that mark in a confusing

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manner without putting themselves at risk of a legal claim for so-called *passing off*.

Generally speaking, the following marks are prohibited from registration (there are subtleties and exceptions to each):

- names and surnames;
- clearly descriptive marks;
- deceptively misdescriptive marks;
- words that denote a geographical location commonly known to be the place of origin of such goods or services;
- words in other languages;
- words or designs that are considered confusing with a previously registered trademark or pending trademark; and
- words or designs that nearly resemble a prohibited mark.

In contrast, a trade-name is defined in the *Trade-marks Act* (Canada) as:

the name under which any business is carried on, whether or not it is the name of a corporation, a partnership or an individual

A trade-name is different from a trademark. It may allow a business to operate under a certain name, and may be used as evidence towards the existence of a trademark at common law where a trademark has not been registered. A trade-name alone, however, may not be sufficient to establish a trademark at common law. As such, a trade-name alone (without registering a trademark) may not be sufficient to prevent a competitor from selling similar products with a similar name. As such, to best protect a business' brand and goodwill, it is often good practice to register the trademark.

VII.

INSURANCE FOR SMALL BUSINESSES

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Insurance for Small Businesses

Insurance can be confusing. A lot of insurance options are available to businesses, and in some cases certain insurance is unique to certain businesses or industries. For example, the construction industry has a swathe of unique insurance available, from Builder's Risk insurance to Boiler and Machinery insurance; if you rent out premises, you may have Tenant's insurance or insurance covering the building itself; and if you have a farm you may have Crop insurance. Depending on your business, you may look into obtaining more specialized insurance, such as Professional Liability Insurance, Environmental Impairment Liability Insurance, or Terrorism Insurance.

It is often good practice to contact a trustworthy insurance broker to determine what forms of insurance are available to your business. This article will explain the different types of commonly available insurance, as well as certain basic concepts, such as deductibles, limits, and co-insurance. Your industry or business may be able to obtain insurance that is not listed here.

It is highly important to ensure your policy limits will cover the anticipated amount of loss. This is particularly important when considering co-insurance clauses.

Types of Insurance

Common insurance options available to small businesses include Property and contents insurance, Commercial General Liability ("CGL"), Directors' and Officers' Liability ("D&O"), Key Man, Fidelity, and Business Interruption. Whatever insurance policy a business has, it is extremely important to review the policy and ask your insurance broker or agent about what is included and excluded from coverage.

CGL insurance typically covers bodily injury or property damage suffered by a third party

which the insured is legally liable to pay (for example, a customer who injures themselves in your establishment). Individual business circumstances are highly relevant to the coverage provided. For example, it may be necessary to obtain endorsements to the policy to cover property temporarily held by the business (for example, a storage or dry-cleaner business), alcohol service, special types of business, or special business or asset location.

D&O insurance may cover a director or officer's “wrongful acts” in the scope of carrying out their duties, and possibly cover costs relating to defence or administrative or criminal proceedings. However, coverage will not generally cover actions made in bad faith or criminal acts. Common exclusions to insurance include fraud, intentional non-compliant acts, and illegal actions. Often these policies are on a “claims made” basis; such that coverage must be in effect during the policy period when a claim is made, in order to be covered.

Key Man insurance helps to protect the key employees of a business. Typically, it will take the form of life insurance or disability insurance on the life of the employee and name the business as beneficiary. Life insurance may also be obtained on the life of major shareholders to allow the corporation to repurchase the shares on the death of that shareholder (often mandated by way of a Unanimous Shareholder Agreement, for instance).

Fidelity insurance protects against “bad apple” employees. This insurance will come into play when a business suffers financial loss arising from fraud or embezzlement by an employee.

Business Interruption insurance protects against financial loss during a period of shut-down, usually due to a disaster (such as fire). The inclusions and exclusions will be specifically detailed in the policy of insurance.

If your business operates on a receivables basis, you may consider Accounts Receivables insurance to help cover instances in which customers cannot or do not pay their bills.

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Deductibles and Co-Insurance

A deductible is relatively straightforward and is a minimum portion of any claim which the insured party is responsible to pay as part of a claim under a policy.

Co-insurance is more complicated. The insurer will pay a portion of a loss or claim based on a ratio. This ratio is determined by the policy, co-insurance amount, and value of the assets insured. Coverage amounts are further reduced through deductibles or other fees. For an exact calculation of your coverage, it is important to contact your insurer.

Clearly, it is very important to be familiar with the extent and degree of coverage. Co-insurance can significantly shift the burden of loss onto the insured if appropriate coverage is not in place. Further, exclusions can operate to completely remove a loss from scope of coverage. It is crucial to read the fine print, and get a detailed rundown of your policy from your insurance agent or broker. They may also be in a position to recommend other types of insurance and loss coverage your business should obtain.

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VIII.

FINANCING:

GUARANTEES, SECURITY, AND PERSONAL LIABILITY

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Financing – Guarantees, Security, and Personal Liability

Financing is a relatively straightforward concept – a lender provides immediate capital in exchange for a promise to pay it back at a later time, together with interest. Interest may be fixed for the duration of the loan at a set interest rate, or, it may be "variable" or "floating" (typically expressed as a certain percentage amount above or below the prime rate of the bank of choice). The concept of "security" allows the lender to reduce their risk by giving the lender the ability to control or liquidate the assets of the debtor in the event that the debt is not repaid as agreed. Security can take the form of real property (e.g. in the case of a mortgage or HELOC), personal property (for example, the assets of the business – this security is often registered at the Alberta Personal Property Registry), or even assets acquired in the future (known as "after acquired property"). A lender which has priority over such security and who has a right to it – say, by way of default by the borrower under the underlying loan agreement – will be in a position to take possession of, or sell and keep the proceeds of such security to satisfy the debt owing.

A loan will typically be either a fixed or revolving type. Fixed loans are simple – you promise to pay the principal amount back at a certain schedule with interest (with or without penalty for pre-payment – known as "closed" and "open" loans, respectively). Revolving loans allow you to borrow up to a certain maximum principal amount. If you have borrowed less than this amount, or have paid some of it back, you can re-borrow up to the maximum amount when you need it. Operating lines of credit often carry this structure.

A "vendor take-back loan" is simply an arrangement under which the vendor of an asset finances the purchase by the purchaser. In the case of land, instead of paying cash immediately for the land (as would normally be obtained from a third-party mortgage lender), the buyer will owe the money to the seller. Effectively, the seller becomes both the seller and mortgage lender.

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Documents often required to be executed as part of a loan will include the Loan Agreement itself, which contains the terms and conditions of the loan and repayment; a Security Agreement, which will provide security rights to the lender; Guarantees and/or Indemnities; and a Promissory Note. A Promissory Note is a short document evidencing a promise to pay a certain amount at a certain time, and is similar to an "IOU".

If you are obtaining debt financing for your corporate business, there is a strong probability your creditor will require some or all of the principals involved (major shareholders, directors, officers) to guarantee the loan. A Guarantee operates to provide recourse to the lender against the person signing the Guarantee if principal the debtor fails to comply with the terms and conditions of the loan.

Not all Guarantees are the same, however, and it is important for guarantors to obtain independent legal advice to fully understand the extent of their liability. Some guarantees will have an upper limit to the extent of liability to the guarantors, others will have no such limit. Some Guarantees will serve to cover all past, present and future obligations of the debtor to the creditor, unless some notice is provided to the creditor some time in the future. If there are multiple guarantors, each one should know whether they are each liable only for a share or fraction of the debt, or the entire amount. Sometimes the creditor will look to the guarantors once all security of the primary debtor has been exhausted, but other times this is not necessary as a prerequisite. If representations have been made by the creditor as to the Guarantee or its operation, it is important that these be in writing and not in conflict with the wording of the Guarantee. Some guarantors will be required by the lender to sign security agreements in addition to the Guarantee.

It is important for a Guarantor to read and understand the text of the Guarantee. Each guarantor should keep a copy of the Guarantee for their reference, and not deliver the Guarantee to the lender unless they have received proper legal advice. Finally, once the debt has been repaid, it is important to ensure the Guarantee is returned by the lender.

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IX.

EFFECTIVE BUSINESS CONTRACTS:

THE IMPORTANCE OF A CLEAR, CONCISE AND TAILORED CONTRACT

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Effective Business Contracts: The importance of a clear, concise and tailored contract.

A well-written contract is immensely valuable. A given contract will typically spell out the specific obligations of each party, when payment is to be made and by whom, remedies that are available upon default of payment, representations and warranties, and the division of liability should something go awry. The importance of a good contract is even greater where the amount of money involved is substantial, or when risk of liability is high.

I have seen many businesses use a very basic purchase order as their standard-form contract. Unfortunately, when there is a problem, such a contract is often too short and vague to provide much guidance – is the seller bound to deliver if the buyer doesn't pay? Who is liable for the delay in such an event? What about causes of delay beyond the control of either party? Is staggered payment acceptable? Is there a warranty for parts or service? Who carries the risk of loss? When is risk of loss transferred (on shipment from the warehouse? On delivery?) Whose law governs when you cross jurisdictional boundaries?

Take, for example, the case of *Aero Aviation Inc. v. Dac Aviation International Ltée*, an Alberta Court of Queen's Bench decision from 2010. In this case, the Plaintiff performed repairs to an aircraft owned by the Defendant. The parties had a contract, and the final invoice amount was for just over half a million dollars. The case was an application for summary judgment – so there must be no genuine issues for trial in order to succeed. The Defendant refused to pay; the Plaintiff sued.

During the course of repair, the Plaintiff ceased work on the basis of an interim invoice which went unpaid. The Defendant complained that the original contract didn’t contemplate interim invoices being issued. After some delay resulting from this non-payment, and ultimately after the completion of repairs, the Defendant signed an invoice detailing payments to be made to the Plaintiff along with a statement that the Defendant would not contest the invoice. The Plaintiff was unwilling to deliver the aircraft back to the Defendant unless this was signed and

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agreed to by the Defendant. The Defendant, requiring the aircraft for its business, signed the papers but ultimately did not pay.

The Plaintiff sued, and the Defendant claimed in response that the amount was excessive and that the repairs were not completed on a timely basis, and counterclaimed for damages as a result of the delay.

The Court recognized that the estimated timeframe for completion of repairs would be difficult to ascertain at the outset, given the scope of work to be done. But the Court also recognized that there was no term in the contract outlining which party will take responsibility for any delay, or whether any interim invoices could be issued.

In the result, the Court held that there were genuine issues for trial and the Plaintiff's claim for summary judgment was dismissed. Consequently, because of a contract which did not optimally consider the circumstances and business reality of the party relying on such contract, the Plaintiff must prepare for an expensive and lengthy trial application to recover its money (or settle out of court on a negotiated amount). The contract **did not** (crucially, in this case) contemplate for delay, timeframe for completion, or the payment of interim invoices. The Court, if possible, must determine the intentions of the parties outside of the strict wording of the contract.

Battle of the Forms

One peculiar instance where contractual uncertainty raises its ugly head is that of a vendor issuing a quotation form to a purchaser, either in response to or preceding the purchaser issuing a purchase order form of their own. In this instance we have two separate, and possibly contradictory, contractual forms – each with their own terms and conditions. When both are signed and something goes wrong, which one governs? This is determined on a case-by-case basis, and the outcome can be costly and uncertain. The easiest way to resolve this is in

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advance – perhaps going so far as to create a custom agreement between the two parties – before performance of the contract is underway. Either way, businesses must recognize when such contradictions arise, and would be wise to negotiate which terms will ultimately govern.

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X.

FRANCHISE BASICS

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Franchise Basics

What is a franchise?

A franchise is a relationship between one party (legally referred to as the "franchisor") and an entrepreneur (known as the "franchisee"). The franchisor allows the entrepreneur to use its business model, processes and intellectual property. Normally, it will encompass marketing, supply, and intellectual property, amongst other things. In return, the entrepreneur will pay money to the franchisor, typically in the form of continual royalty payments based on the periodic revenues of the franchisee.

The franchise contract is the cornerstone of this relationship. It is the document which gives rise to a large portion of the legal rights, obligations and remedies between the parties. It is extremely important that all who are involved understand the contract and its implications. It is therefore highly recommended that everyone involved obtains legal counsel to ensure they understand it. As a typical investment in a franchise amounts to many thousands of dollars, it is important that your rights and liabilities – and consequences for breach – are well-known and understood at the outset.

The franchise contract does not exist in a vacuum. Rather, it is construed against a backdrop of common law and legislation. In Alberta, as in certain other provinces, the legislature has codified certain obligations and rules to govern franchises; the Act is called the *Franchises Act*. These rules provide, among other things, minimum disclosure requirements to prospective franchisees, obligations of fair dealing, special rights in favour of franchisees (such as the right to associate with other franchisees), and special consequences in the event that such rules are breached.

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Minimum Disclosure

The Act provides that at least 14 days prior to either money being paid by the franchisee to the franchisor (except as a deposit), or the signing of an agreement between them (including the franchise agreement). Generally, the franchisor must provide a host of information, with specifics as required under the regulations, including such matters as franchise fees, territory, general and financial information, initial investments required, the basis behind earnings claims, the details of civil litigation and liabilities, and recent bankruptcy or insolvency proceedings. Full disclosure requirements can be found in the Act and its Regulations.

These disclosure requirements have been introduced in order to ensure that prospective franchisees are properly prior to entering a franchise agreement or paying money for one.

Deposit Payments

As mentioned above, the Franchises Act provides that disclosure must be made 14 days before either an agreement is signed or consideration is paid to the franchisor. An exception is made for deposits. If a deposit is refundable without any deductions and given under an agreement that in no way binds the prospective franchisee to enter into any franchise agreement, and if the deposit does not exceed the amount prescribed by the regulations (presently 20% of the initial franchise fee), then a franchisor can then demand an up-front refundable deposit prior to giving any disclosure.

The Contract

While the Act provides certain minimum requirements, the contract serves as the main document outlining each parties' specific responsibilities.

Certain terms are common amongst franchise contracts. These are outlined below. A

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prospective franchisee should be absolutely certain that he or she understands the whole agreement. It is wise to obtain counsel to assist for any questions you may have with respect to your rights and obligations under the agreement.

Term and Renewal

The term of the contract determines how long the agreement will remain in place.

The term of the agreement may or may not include a right to renew, and if so, fees and conditions associated with renewal. The renewal term may or may not be the same amount of time as the initial term. Typical conditions for renewal on the part of the franchisee include the giving of minimum notice prior to the termination of the initial term, being in good standing under the agreement (there being no default under the contract and all fees due being paid), and executing the franchisor's then-current franchise agreement (which may include higher fees or other new obligations).

There may also be provisions to provide for early termination, if one of the parties wants to terminate the agreement prior to the ordinary expiry, or there may be automatic termination or termination at the option of the franchisor in the event that certain serious events or breaches of the agreement occur.

Termination prior to the ordinary term may also result in additional payments being due which may need to be paid by the franchisee.

Fees

Typically, the franchise fees will be categorized between initial franchise fees and continuing royalty fees. The initial fee is paid upfront upon the grant of franchise, whereas royalties are paid throughout the life of the franchise. Note that these initial and royalty fees, while possibly

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the bulk of the fee payments made, are not necessarily (indeed they are unlikely to be) the only fees paid. Other fees are imposed routinely for renewal of the franchise agreement, contributions towards a local and/or regional advertising fund, fees for any breaches, termination, or assignment of the agreement (transferring the contract to a third person), among others. Other costs include those borne by the franchisee in its operations, but not paid directly to the franchisor, such as insurance payments mandated by the franchise contract, or employment withholdings for the Canada Pension Plan and Employment Insurance. One must look throughout the entire contract to determine what the franchisee will be exactly expected to pay, and ensure that projected earnings and finances will permit such payments.

Territory and Location

The franchise agreement should spell out the exclusive territory, if any, which is to be made available to a franchisee. If exclusive territory is granted, this typically means the franchisor will agree not to grant or open another franchise in the defined area. Some franchisors grant a large area to the franchisee, whereas others do not grant exclusive territory at all. Territory can have a strong impact on potential revenues and helps to ensure that same-brand franchises do not cannibalize one another's sales.

Support

Initial and ongoing support from the franchisor may be a very important determinant of a prospective business' success or failure. Generally, a franchise agreement should govern the training of employees, new franchisee orientation programs, and management and operations training.

Other support may be provided in the form of advice or assistance in construction or renovation, operation of the business, opening, and employee training.

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This support should be clearly stated in the franchise contract (or a binding ancillary document), and the obligations of the franchisor should be clear and unambiguous. Support given by a franchisor is often a key to the success of a new franchisee, and such commitments are strongly urged to be made explicit.

Insurance

Generally, the franchisee will be expected to obtain certain minimum insurance coverage in order to cover potential losses to the franchisee and franchisor. These losses may relate to property loss, business interruption, general liability, employer's liability, automobile liability (if applicable), among others.

Exactly the kind of insurance the franchisee will need to obtain will be spelled out in the franchise contract. It is important that the franchisee keep its insurance in good standing. Besides being an uncovered risk to the business, failure to carry insurance could very well be a breach of the franchise contract (not to mention being poor business practice).

Confidentiality, Non-Competition and Non-Solicitation

When a franchisee opens its business, it is often given access to trade secrets, operating methods, customer lists, financial details, recipes, and other information that is valuable to the franchisor. In a franchise agreement, this information is normally protected by prohibiting the franchisee from disclosing such confidential information.

Upon the termination of business of the franchisee, the franchise agreement normally contains a promise on the part of the franchisee not to compete in a similar business for a certain amount of time and in a certain area, or to offer employment to existing employees, or to own or operate a business of the same kind as the franchise.

Other Obligations

Normally, many additional obligations are imposed within the franchise agreement covering matters such as the proper keeping of accounting records, permission for inspections to be made by the franchisor, mechanisms for financial auditing, direction to follow the franchisor's operating standards manual, obligations to maintain uniform standards of service and repair, maintaining the premises, and using designated supplies or suppliers.

Obligations of a franchisee will not be limited to the main franchise agreement. Other contracts may include non-competition agreements (if separate from the franchise agreement), guarantees, employment agreements, financing agreements, supply agreements, assignments of franchise, leasing arrangements for premises, and others. These will arise at different stages of the life of the franchise, and often multiple times, though many of them will be necessary at the commencement of business.

Guarantees

Normally, the franchisor will require key principals, shareholders and/or directors of a corporate franchisee to guarantee the debts of the franchisee in favour of the franchisor.

It is extremely important that those signing guarantees are aware of the nature of the obligations which they are guaranteeing, the amount of liability involved, to whom they are guaranteeing funds, which person's debts are being guaranteed, and the duration of the guarantee. Other terms will be spelled out in the guarantee and it is important that these additional terms are well known as well.

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Conclusion

The legal framework around franchises is complex. Besides existing legislation, common law (judge-made law) and contract law serve to magnify this complexity. It is very important for a franchisor to know that its contract is enforceable and provides reasonable obligations on all parties, and it is important for a franchisee to understand its terms and to have foreknowledge of expectations. Occasionally, a franchisee may desire to negotiate alternative terms which will be more suitable to their needs. The starting point is to ensure that these needs are understood and accounted for in the contract.

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XI.

PLANNING FOR SUCCESSION:

SHAREHOLDERS' AGREEMENTS, SHARE TRANSMISSION,

MARRIAGE, AND YOUR WILL

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Planning for death – Shareholders' Agreements, Share Transmission, Marriage, and your Will.

It is important to properly and clearly plan for the succession of one's business in the case of death, divorce, incapacity or disability well in advance of the occurrence of these events. Mostly these matters pertain to Corporations; in the event of death of a sole proprietor, for example, the business is normally terminated with that person. A sole proprietor may wish to incorporate to simplify succession. Planning in advance for contingencies is key – otherwise, a surprise event in the life or death of a key shareholder can result in chaos or a surprise and unintended change in control and management of the business.

With corporations, life is relatively simple – whomever owns the shares owns the business. Succession planning at its core is the direction of the transfer of those shares upon the happening of certain events. To protect against an unanticipated divorce of a major shareholder for example, a Corporation may find it to be in its best interest to arrange in advance to repurchase the shares from that divorcing shareholder in exchange for fair market value of the shares in the event of a divorce. This is normally taken care of well in advance by way of the Unanimous Shareholder Agreement (please refer to the chapter entitled, "Corporate Basics – Articles, Bylaws, and the Unanimous Shareholder Agreement") or even by way of a matrimonial contract. Alternatively, a shareholder may wish to bequeath their shares by way of a Will to their children (again, subject to restrictions in the Unanimous Shareholder Agreement, other corporate documents, or estate law).

Transmission upon Death

Estates law can be complicated in that a testator may have an obligation to provide for certain parties upon their death (for example, a dependent child). However, in the simple case where no corporate, family or estate restrictions apply, a shareholder may be free to distribute his shares to a beneficiary of his or her choice. In this case, the shareholder may provide in their

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Will for the shares to be given to a certain party (say, for example, a person's husband or children). On this shareholder's death, the personal representative of the deceased's estate will apply to the Corporation for *Transmission* of the shares into the name of the personal representative. This will place the shares in their name to be dealt with in trust for the benefit of the beneficiaries under the Will. This can mean sale and distribution of proceeds, or alternatively a further transfer of the shares in the names of those beneficiaries.

Planning in Advance

At the end of the day, it is wise to plan for succession when the business is created. Place your mind to what happens in the event of death, divorce, incapacity, or disability of the major shareholders and/or directors. These questions must be answered and plans made accordingly:

- Where do the shareholders want the shares to go?
- Where does the Corporation want the shares to go?
- Where does the family want the shares to go?
- What restrictions or laws are in place governing transfer of the shares?
- Is life or disability (key man) insurance practical and worth obtaining?
- How will management of the corporation be affected by succession?
- Who will manage the business in the interim?

These answers will of course depend on the number of shareholders and the size and value of the corporation.

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BASIC NEW PRIVATE SMALL BUSINESS LEGAL CHECKLIST

For New Businesses Generally:

___ Retain a lawyer

___ Retain an accountant and auditor, if necessary

___ Choose a business vehicle

___ Register Trademark or Trade-name

___ Obtain insurance

___ Obtain any licenses (including municipal business licenses) as required

___ Draft and prepare solid standard business contracts

For New Corporations:

___ Consider the following:

 ___ Maximum number and classes of shares to issue

 ___ Rights to attach to share classes

 ___ Number and identity of Directors and Officers

___ Choose jurisdiction (Federal or Alberta) and register corporation

___ Shareholders to pass incorporating resolutions re: election of Directors

___ Shareholders to subscribe for shares

___ Directors to pass incorporating resolutions re: registered office, auditor, confirming share subscriptions by shareholders

___ Directors and Shareholders to pass Bylaws and Unanimous Shareholder Agreement

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