

PRACTICAL LEGAL BASICS FOR BUSINESS

When business people contemplate a new venture, or when an existing business contemplates a new transaction, they are often understandably focused on the business aspects and the profitable potential of the situation. They hope and believe the situation will turn out well. They may not focus on legal formalities or on things which might go wrong. But paying attention to those matters at the beginning can prevent substantial costs, and adverse results, down the road.

This article sets out some issues which should be considered at the inception of a new venture or transaction, drawn from the author's experience in commercial and corporate litigation.

1. Incorporation

When business people are contemplating a new venture they should retain a lawyer to create the new company or other appropriate business vehicle. They should ensure the most suitable vehicle is used, and the appropriate jurisdiction for that vehicle is chosen. Corporations are the most common vehicle. But different jurisdictions have different regulatory requirements for them. For example, they require different numbers of corporate directors to reside in the jurisdiction.

The business people should understand that a lawyer retained to incorporate the new company will represent the company, not them. The lawyer will owe the company a fiduciary duty to act in its best interests. The business people may have different interests. They should retain their own lawyers to protect those interests.

The business people should ensure that the incorporation of the new company, or other vehicle, is properly documented and that the legal requirements of the incorporating jurisdiction are complied with.

They should ensure that the legal documents implementing the incorporation reflect their business deal. For example, they should ensure that the corporate constitution, in the form of articles or bylaws, is not just a standard document taken off the lawyer's shelf, but accurately reflects their agreement. Sometimes, for whatever reason, a company is incorporated with only one shareholder. If it is later agreed that shares are to be issued to others, care should be taken that this is done as agreed.

The business people should take time to set aside their hope and optimism about their new venture, consider what might go wrong and agree on how to deal with those scenarios. The business may not be profitable, at least not for some time. The business people may have a falling out. The

personal circumstances of one of them may change, and they may need to withdraw from the business. One of them may die. All those scenarios, and others, should be considered, and responses to them agreed upon and implemented before the company is incorporated.

Most importantly, the shareholders of a new company should enter into a shareholders' agreement and ensure that it accurately reflects their agreement about their relationship.

The shareholders' agreement should include a mechanism for resolving disputes arising under the agreement and out of the conduct of the business. If there is no such agreement, the default dispute resolution mechanism will be a civil lawsuit. The shareholders should consider agreeing to arbitrate such disputes. Lawsuits are public, expensive and usually take several years to resolve. While arbitration may not be much cheaper, it is private and usually significantly faster.

The shareholders' agreement should also include a mechanism for a shareholder who no longer wishes to be involved in the business to exit. This is perhaps the most important point in this article. There are few positions as powerless as that of an unhappy minority shareholder in a closely held private corporation. Such a shareholder has no effective means of withdrawing from the company or recouping their investment without the agreement of the other shareholders. Absent that agreement, the shareholder's only alternative is litigation, which is time consuming, expensive and disruptive for all concerned.

Shareholders' agreements often create rights and obligations for the shareholders. The agreement should provide that, where appropriate, those rights and duties cease when the shareholders cease to be shareholders. For example, shareholders' rights to elect a nominee directors should cease when they cease to be shareholders.

2. **Ongoing Corporate Management**

Once incorporated the business should ensure it continues to be legally advised and to comply with the requirements of its incorporating jurisdiction. Ongoing requirements such as filing annual reports, holding annual general meetings and distributing financial statements should be complied with, to avoid regulatory problems and shareholder disputes in the future.

Perhaps the most important points about the ongoing management of the corporation are practical: the corporation should use a competent accountant and keep proper business and accounting records. There will inevitably be questions, and even disputes, about the business. Few things escalate

simple questions into disputes and litigation more quickly than the inability to provide proper accounting documentation.

Another important point is that the business people should clearly communicate both among each other and with those with whom they have business dealings. When difficulties arise there is a natural tendency to keep silent in the hope the situation will somehow resolve itself. Nothing breeds suspicion more quickly than silence. Many disputes can be avoided or ameliorated by simple, honest communication.

The business people should keep accurate, contemporaneous records of their communications: notes of telephone conversations, minutes of meetings, and letters confirming important communications. When disputes arise, and the parties put forward different versions of events, contemporaneous documents are the most persuasive factor in resolving those differences, whether informally or in litigation.

3. **New Transactions**

When a business is contemplating a new transaction, it should consider the same kinds of issues as when business people consider a new venture. Agreements concerning the new transaction should be documented. The business should ensure that the documents actually reflect its agreements. It should ensure any contracts have dispute resolution provisions and should consider arbitration as a dispute resolution mechanism.

In addition, the business should ensure any contracts are either for specific terms, perhaps with rights of renewal, or have termination provisions. If they do not, the likely result will be that the contracts continue indefinitely, unless one party gives reasonable notice of termination. Depending on the circumstances of the transaction, reasonable notice of termination can be up to a year, during which time the contract, and the parties' obligations under it, will continue.

As with the general ongoing management of the corporation, for any particular transaction the business should keep good accounting records, the business people should communicate, and they should keep accurate, contemporaneous records of their communications.

4. **Disputes**

Inevitably, disputes will arise, either among those involved in the business or between the business and those with whom it deals. The most important point here is to seek legal advice as soon as it

becomes apparent there may be a problem. It is important to understand the full range of available options in response to a problem, before reacting to it. Those who react first and seek legal advice later will likely find that some of their options have been foreclosed by their reaction.

A common mistake is to believe that another party's breach of a contract entitles the innocent party to disregard its own obligations under that contract in response. That is incorrect. Except in very unusual circumstances, where a "fundamental breach of contract" has occurred and the innocent party has taken specified steps in response to it, the only legal effect of a breach of contract is to give the innocent party the right to sue the breaching party to recover the damages caused by the breach. The contract remains fully in force. The innocent party remains legally required to honour all its own obligations. If it does not, it will have itself breached the contract. It will have exposed itself to a counterclaim. It will also have lost the moral high ground and much of its negotiating leverage.

5. **Conclusion**

Considering these issues may seem pessimistic or a waste of time. But to ignore them would be a classic case of "penny wise, pound foolish". The author has litigated the consequences of ignoring virtually every piece of advice in this article. The wisdom of his experience is to minimize the risks of being involved in commercial litigation by considering at the outset the negative as well as the positive possibilities, agreeing on how to deal with them, ensuring those agreements are implemented, clearly communicating and keeping accurate records. Those steps will go a long way to ensuring that the business people can devote their time, energy and financial resources to ensuring their business is successful, rather than dissipating them in litigation.

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