

CUNNINGHAM SWAN

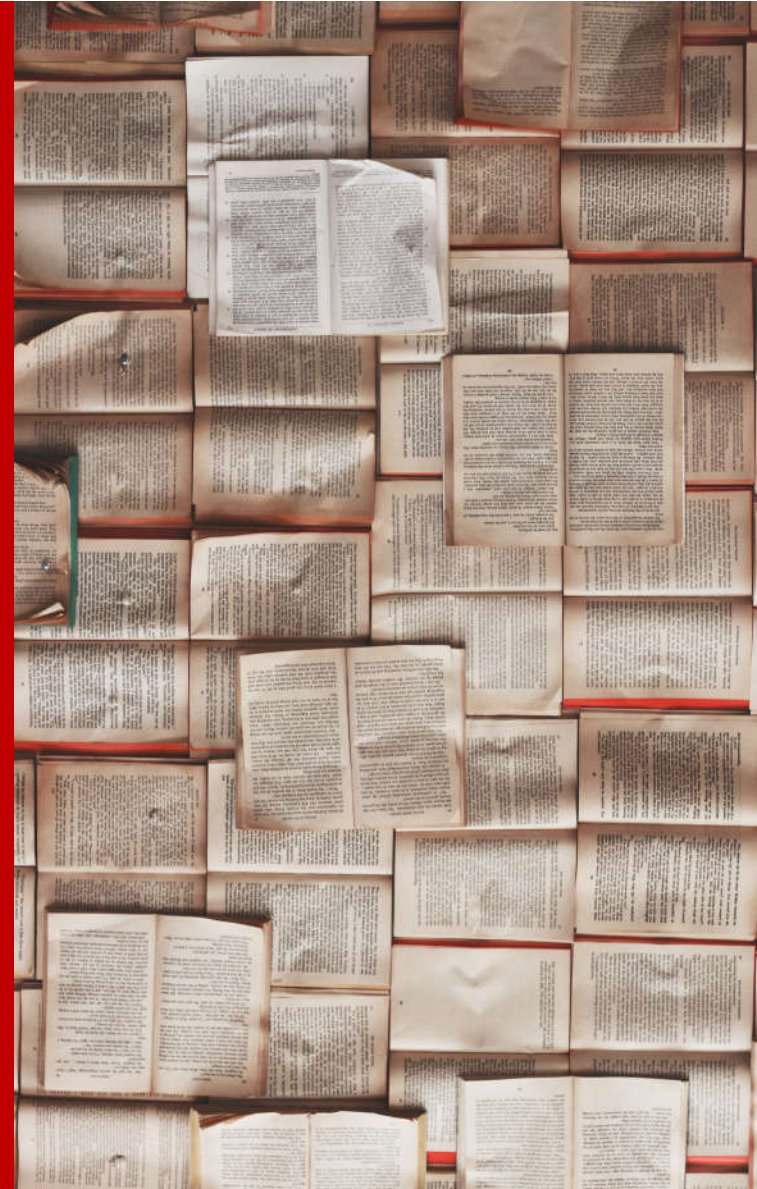
Structuring and Financing a Business

TABLE OF CONTENTS

- Business Structure
- Corporate Finance
- Protecting Intellectual Property



Cunningham Swan
LAWYERS



Business Structure



Sole Proprietorship

- Individual owns business / makes decisions
- Formed when individual starts conducting business
- Taxation – business revenues and expenses on individual's own tax return
- Easy to terminate / dissolve business
- Unlimited personal liability
- No perpetual existence

Business Structure



Partnership

- Partners as agents for each other / fiduciary duty
- Formation – carrying on business in common with view of profit
- Partnership agreement (written/oral/implied)
- Taxation – on partner's tax returns as allocated
- Easy to terminate/dissolve (pending agreement)
- Unlimited personal liability
- Possible perpetual existence (adding partners)

Business Structure



Limited Partnership

- At least one partner has limited liability and at least one partner has unlimited liability
- Formation – filing declaration with registrar
- Passivity requirement – Limited partner can contribute money/property, but not services
- Taxation – on partner's tax return as allocated
- Designated to facilitate investment. Profit sharing with limited risks
- Extent of liability
 - Limited liability for limited partners (unless active)
 - Unlimited liability for general partner

Business Structure



Corporation

- 6 Governing Principals
 - Separate legal entity
 - Managerial power
 - Majority rule
 - Minority protection
 - Limited liability of shareholders
 - Perpetual existence
- Formation – incorporation federally or provincially
- Taxation – taxed as corporation (separate person at law)

The Corporation



Jurisdiction and Costs

- Formation: Articles of Incorporation
- Governing Statutes
- Business Corporations Act (Ontario) – Provincial
- Canada Business Corporations Act – Federal
- Incorporation fees – typically \$1500-\$2000, depending on structure
- Name search
- Drafting of Articles
- Submission of forms
- Payment of government fees
- Preparing organizing proceedings and By-laws
- Minute book

The Corporation



Articles of Incorporation

- “Birth Certificate” of Corporation
- Name – number or given
- Registered address
- Number of directors
- First director(s) name(s)
- Restrictions on business (if any)
- Authorized share capital
- Share rights, privileges, restrictions, and conditions
- Share issuance/transfer restrictions
- Other provisions (e.g. borrowing powers)


The Corporation



Bylaws

- Set out general operational framework
 - Election and appointment of directors / officers
 - Directors' meetings
 - Shareholder meetings
 - Dividends
 - Notices
 - Signing authority
 - Borrowing
 - Banking

The Corporation: Roles, Responsibilities, and Governance



Shareholders

- Own shares - equity interests in corporation
- Common shares vs. preferred/special shares
- Right to information
- Exercise power indirectly through appointment of directors

Directors

- Responsible for policy decisions and direction
- Fiduciary duty owed to corporation
- Shareholders elect directors
- Hires/Fires Officers (e.g. CEO)

Officers

- Manage day-to-day operations / implement policy
- E.g. CEO, CFO, COO)
- Hires/Fires Employees

Shareholders' Agreement



Recommended where:

- Two or more shareholders – even if immediate family
- Strongly recommended for third party shareholders
- When?
- ASAP upon incorporation
- ASAP upon bringing in a new shareholder / equity investor

Shareholders' Agreement



Key Aspects

1. Governance
 - Board of Directors / Decision making
2. Corporate financing
 - Institutional financing
 - Shareholder loans
3. Rules re. transfer of shares
 - Permitted transfers
 - Right of first refusal
 - Drag-along / tag along
 - Shotgun
4. Life events
 - Death, disability, divorce, insolvency, criminal offence, loss of key license, etc.
5. Share transfer procedures
 - FMV valuation

Shareholders' Agreement



Key Aspects

1. Dispute Resolution
 - Mediation – non-binding
 - Arbitration – binding
 - Hybrid
2. Confidentiality provisions
 - Duration
 - Scope
 - Exceptions
3. Non-competition/non solicitation provisions
 - Duration
 - Scope
 - Territory
 - Business
 - Customers

Corporate Finance



Corporate Finance: Capitalizing



When/how to raise finance:

- Key decision for all companies at all stages

Purposes for financing:

- Start-up expenses
- Research and development
- Engineering / testing / prototype building
- Sales / distribution / other commercialization efforts
- Operations or third party manufacturing / services
- Expansion into new jurisdiction or scaling the business
- Acquisitions

Corporate Finance: Raising Capital



Options for Raising / Attracting Capital

1. Gifts (e.g. family)
2. Founder equity
3. Cash from sales / services
4. Sell or monetize assets
5. Borrow money (debt)
6. Issue securities from treasury (equity)
7. Issue hybrid securities products: convertible debt

Corporate Finance: Raising Capital



Debt Financing

- Borrowing money and agreeing to pay it back, usually with interest
- Term / maturity date will stipulate when debt must be repaid
- Interest payments vary depending on:
 - Lender (e.g. major bank vs. private)
 - Borrower (credit history)
 - Risk (e.g. secured vs. unsecured, nature of security)
 - Higher risk = higher interest
- Debt must be repaid in accordance with terms regardless of corporate performance / revenue
- Debt will generally be repaid in priority to equity
- Examples:
 - Promissory note
 - Loan agreement / mortgage
 - Credit card

Corporate Finance: Debt vs. Equity



Debt Financing - Pros

- No dilution of company ownership
- Affordable/low interest rate environment
- Transaction costs may be lower

Debt Financing – Cons

- De-coupled from success/profitability
- Debt must be repaid in accordance with terms regardless of corporate performance or revenue generation
- Lenders typically will require security over company's assets, and personal guarantees from owners
- Recourse / remedies of lender

Corporate Finance: Raising Capital



Equity Financing

- Selling shares in corporation
- Common (voting vs. non-voting)
- Preferred (voting vs. non-voting)
- Options/Warrants
- Convertible debt (convertible notes, convertible debentures, etc.)
- Direct ownership in the corporation
- Potential for dividends
- Growth and dividends will be 'diluted' when new shares are issued

Corporate Finance: Debt vs. Equity



Equity Financing - Pros

- No principal and interest debt servicing obligations
- No maturity date or deadline to repay
 - Exception for retractable preference shares
- Dividend obligations can be crafted (cumulative/non, entitlement/discretion)
- No security interest over the company's assets
- No personal guarantees required
- May avoid prior/existing lender consent requirements or priorities negotiations
- Attracting / retaining new talent
- Aligned with success of corporation

Equity Financing – Cons

- Dilution of founder(s) interests in corporation
- Control/decision making complexities
- Unanimous Shareholder Agreement is imperative

Corporate Finance: Debt vs. Equity



Debt vs. Equity – Which is Better?

- No right or wrong answer. It depends.
- Debt – typically preferable where:
 - Available, and
 - Owner wants to avoid or delay diluting ownership, control, participation in growth, dividends
- Equity – typically preferable where:
 - No lender,
 - Company has no ability to service loan repayment obligations,
 - Investors are known and trusted,
 - Shareholder agreement in place,
 - Interest in attracting/retaining talent as part of a compensation package

Role of Intellectual Property



What is it?

- Ideas, concepts, designs, drawings, processes, code, etc.
- Often the core value of a business

Forms of IP

- Patents
- Trade Secrets
- Trademarks
- Copyright

Role of Intellectual Property



Trademarks

- Protection for brand
- A combination of letters words, sounds, designs, shapes or colours that distinguishes one company's goods and services from others in the marketplace
- Common law (arise upon first use)
- Statutory protection (arise upon registration)
 - Jurisdiction based
 - Exclusive rights across Canada
 - Evidence of ownership
 - Prevents others from registering similar mark
 - Increase value of mark/business
 - Jurisdiction based

Role of Intellectual Property



Copyright

- Protects original works - literary (including software), artistic, dramatic or musical works + performers performance, sounds recordings, communication signals
- Arise moment author creates it and extends for 50 years after death (soon to be 70 years per USMCA)
- Does not have to be new or innovative, but cannot be merely copy of an existing work.
- Not necessary to register, but easy and inexpensive to do (e.g. \$50)

Role of Intellectual Property



Protecting Intellectual Property

- Record keeping - create a document trail of ownership
- Confidentiality Agreements - confidential information and trade secrets must remain secret
- Employment / Consultant Agreements – specify ownership
 - Employment Agreements
 - default is that employer owns copyrights
 - Independent contractor / consulting agreement
 - default is that consultant owns copyrights

MEET OUR TEAM



Lisa Asbreuk
Partner
lasbreuk@cswan.com



Matt Benson
Partner
mbenson@cswan.com



Rob Maratta
Associate
rmaratta@cswan.com



Andrew Sapiano
Associate
asapiano@cswan.com



Mike Brown
Associate
mbrown@cswan.com



Disclaimer

Nothing in this document should be taken to be or relied on as legal advice. Readers are urged to seek professional legal advice on the particular issues which concern them. Members of our firm would be pleased to assist readers with specific legal issues.

OUR WORK

Celebrating more than 125 years in the Kingston community, the lawyers at Cunningham Swan Carty Little & Bonham LLP are the trusted successors to generations of outstanding lawyers.

We offer a broad range of legal services to individual and corporate clients in the private and public sectors in Kingston and southeastern Ontario.



CONNECT WITH US



LinkedIn

Cunningham Swan
Carty Little &
Bonham LLP



Facebook

Cunningham Swan
Carty Little &
Bonham LLP



Twitter

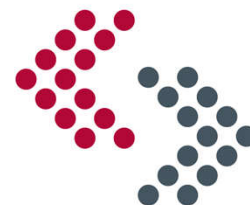
@CunninghamSwan

CONTACT US

FOR ANY QUESTIONS AND/OR
CLARIFICATIONS

MBENSON@CSWAN.COM

613-544-0211



Cunningham Swan
LAWYERS