CCCA Session 202:
Navigating the Family Owned Business:
Tips for In House Counsel

August 15, 2011

Outline of Topics

•Introduction of Presenters

•Introductory Remarks

•Understanding the Family Business – Unique Issues

•Integrating Family Values Into Decision-Making and Strategic Planning Processes

•Succession Planning – Planning for Leadership Transition

•Leadership Structures that Support Sustainable Enterprises

•Unique Ethical Issues for Lawyers in Family Business

•Concluding Remarks

Outline – Leadership Structures

- Barriers to Succession Planning
- Differential Share Terms
- Family Trust
- Shareholder Agreement
- Financial Power of Attorney
- Will/Testamentary Trust
- Family Board of Directors
- Advisory Board
- Family Council
- Family Office
- Conclusion

STEWART MCKELVEY
LAWYERS • AVOCATS

Barriers to Succession Planning

- Fear of death
- Loss of power and control
- Inability to choose between children
- Lack of conflict resolution skills
- Leadership/ownership/control structures can address some of these challenging issues

STEWART McKELVEY
LAWYERS • AVOCATS

Differential Share Terms

- Private company share terms – a bundle of rights
- Can customize each of:
  - Voting or non-voting
  - Redeemable/retractable or not
  - Dividends - fixed, discretionary, cumulative or non-cumulative
  - Equity participation or not
- Flexible tool for estate freeze/succession planning situations
- Different generations of family can have different bundles of rights
- Founder - voting control (for a period of time) plus fixed value redeemable preference shares
- G2 operator - equity growth common shares with some votes
- G2 non-operator - discretionary dividend shares to support lifestyle at founder's discretion
- Consider tax issues relevant to each class of shares

STEWART McKELVEY
LAWYERS • AVOCATS

Family Trusts

- A legal relationship creating separation of legal ownership from beneficial ownership
- Trustees control of the trust property for the benefit of the beneficiaries
- Frequently used to own common shares of a family business after an estate freeze
- Significant tax benefits to using a family trust (i.e. multiplication of the capital gains exemption, income splitting with dividends) that are beyond the scope of this presentation
- Non-tax reasons include:
  - Control of decision-making by trustees (or a principal trustee)
  - Creditor protection of trust property
  - Confidentiality/secrecy
  - Founder's cash flow requirements
  - G2/G3 cash flow requirements
  - Hindsight/ability to "melt" a freeze
  - Ability to transition value to family later in a manner chosen by founder (and likely unequally among G2/G3)

STEWART MCKELVEY
LAWYERS • AVOCATS

Shareholder Agreement

- An agreement among all of the shareholders of the business
- Addresses:
  - Governance of the business – who has day to day decision-making, what share ownership thresholds are required for important or fundamental decisions, etc.
  - Shareholder contributions – when and in what circumstances will the shareholders be required to contribute additional capital to the company

STEWART McKELVEY
LAWYERS • AVOCATS

Shareholder Agreement (Cont’d)

- Restrictions on share transfers – keeps the company private and closely-held
- Rights of first refusal – gives the other shareholders the right to acquire shares of any shareholder wishing to sell to a third party on the same terms and conditions
- Sales on certain triggering events – death or disability of key shareholders (whether funded by insurance or not)
- Sales on notice – ie. buy-sell terms such as a “shotgun”

STEWART MCKELVEY
LAWYERS • AVOCATS

Shareholder Agreement (Cont'd)

- Confidentiality provisions
- Non-competition and non-solicitation provisions for departing shareholders
- Dispute resolution – mediation and/or arbitration

- Greatly preferable to conclude shareholders' agreement <u>before</u> shares are issued to the other party, but can be done any time subsequently as long as all parties agree

STEWART MCKELVEY
LAWYERS • AVOCATS

Shareholder Agreement (Cont'd)

- For succession planning purposes, can include provisions for mandatory partial sales on certain triggering events to "earn in" other family members or professional managers (ie. financial and management milestones that trigger share transfers)
- Can confirm access to corporate owned life insurance for triggering sales involving death of the founder

STEWART McKELVEY
LAWYERS • AVOCATS

Financial Power of Attorney

- Important where founder retains voting rights
- Ensures continuity of decision making in the event of incapacity of founder
- Can segregate decision making for business assets from other assets in separate powers of attorney
- Often overlooked as part of founder’s estate plan

STEWART McKELVEY
LAWYERS • AVOCATS

Will/Testamentary Trust

- Similar to powers of attorney to address founder’s death
- Consider allocation of shares held by founder through will
- If allocate business shares to G2 operator use other assets to equalize among other G2 children
- Life insurance (corporate owned or individual) can be critical in founder’s estate plan
- Use of testamentary trusts created in will can enhance flexibility for founder

STEWART McKELVEY
LAWYERS • AVOCATS

Family Board Of Directors

- Brings G2 and G3 into decision making without direct share transfers/issuances
- Can help G2 operator learn strategic decision making skills
- Can create participation opportunity for G2 non-operator

STEWART McKELVEY
LAWYERS • AVOCATS

Advisory Board

- Provides an outside business perspective to founder
- G2/G3 can sit on Board as well
- Can be an important tool as the family business grows to a significant scale
- Focus is on strategic business decisions, not family decisions

STEWART McKELVEY
LAWYERS • AVOCATS

Family Council

- Involves all family members (founder, spouse, G2, G3, etc.)
- Deals with family issues (of which the family business is only one part) such as a family value statement, use of common family assets such as cottage/vacation properties, philanthropic activities including family foundation, etc.
- An option as families become more diverse, shares in the family business become more dispersed and family moves from G1/G2 to G2/G3/G4

STEWART MCKELVEY
LAWYERS • AVOCATS

Family Office

- Can be single-family office or multi-family office
- A consideration for very high net worth families
- Provides integrated management of business, investment and personal assets among multiple generations and jurisdictions
- Provides specialized expertise for cross border estate/tax planning, charitable initiatives and related matters

STEWART McKELVEY
LAWYERS • AVOCATS

Conclusion

- Each family business is different
- The succession/leadership structure for each is unique
- Various tools are available to maximize benefits and minimize risks
- The technical outcome for each family depends on the values, priorities and needs of each family

STEWART McKELVEY
LAWYERS • AVOCATS

Outline of Topics

- Introduction of Presenters
- Introductory Remarks
- Understanding the Family Business – Unique Issues
- Integrating Family Values Into Decision-Making and Strategic Planning Processes
- Succession Planning – Planning for Leadership Transition
- Leadership Structures that Support Sustainable Enterprises
- Unique Ethical Issues for Lawyers in Family Business
- Concluding Remarks

Questions?