Legal

The Joys of Partnership

Legal Dilemmas and Issues
by David W. McKay

If you are the sole proprietor/owner of your golf course, you don't know what you may be missing by not sharing that ownership.

Perhaps, after reading in this article about the legal complexities involved in multiple owner situations, you might decide that you are better off on your own. Set out below are some of the partnership dilemmas and issues that as a sole proprietor you don't have opportunity to enjoy.

Let's look at a fictitious golf operation which operates under the name "Red Flag Golf & County Club Ltd." It is owned by four equal partners who each have 25 common shares: Al (the administrator), Paul (the golf professional), Gord (the greenskeeper) and Sam (the silent partner).

Red Flag possesses no corporate documentation other than the original Articles of Incorporation completed by the partners. While they had been operating at break-even for the first five years, over the next year a number of events occur affecting their partnership.

Firstly, Sam has just received the court decision on his divorce case with his wife, Peaches. Being bereft of cash, Sam has been unable to settle property matters and the court orders that 50 per cent (12 shares) in Red Flag belonging to Sam now be registered in the name of Peaches.

At about the same time, Al the administrator has been struggling with banks, suppliers and his partners about diminishing cash reserves and concludes that each partner must ante up an additional $25,000. Subsequently, Paul the pro receives a legal letter notifying him that Peaches, (who happens to have been his first wife before she ran off with Sam the silent partner), is now a partner in Red Flag as a result of her divorce settlement with Sam. Paul still owes alimony to Peaches.

Unbeknownst to anyone at the time, Al's doctor is desperately attempting to contact him with the results of tests for an apparent viral infection he contracted on his last golfing excursion in Mexico. The prognosis is not good.

When Superintendent Gord absorbs all of that dramatic news, the effect is to send him racing off somewhat hysterically in his "gator.". Unfortunately he takes the narrow elevated bridge on the 14th hole at 'Indy' speed and "loses it," breaking each arm and each leg as well as incurring a severe concussion. At this point, Al the administrator pauses in an attempt to digest what is transpiring. Instinctively he senses impending doom.

For one thing, no partner was aware of the potential effects of the Family Law Act of Ontario, providing for the possibility that a third party, especially one's former wife, could become an unwanted partner in their hard-earned business venture. The additional call for capital under stressful financial conditions is equally disturbing when it is quite likely that the partners, who are ostensibly equal, are of unequal means.

When Al is informed of his medical condition, the possibility of his demise raises serious questions for his family with respect to their financial security. They need to know how his shares are converted to cash. Also concerned are his partners who may now face another unwanted partner in the form of Al's estate.

When Gord plunges into the creek to become undeniably disabled, the partners face the conundrum of replacing a greenskeeper and paying his replacement; and Gord's family faces severe income loss.

Unfortunately for the partners there is no mechanism or agreement in place which would mandate and direct the partners to react and solve each of these dilemmas in an organized, economical manner. As a consequence the very existence of Red Flag is continually at risk.

Could anything else go wrong? As a matter of fact, there is a myriad of situations which could inflict additional punishment on this group of hapless entrepreneurs. For instance one of the partners could have held his share in a personal holding company which invests in other projects financed by a bank which has taken the Red Flag shares as a pledge of security. When the project fails and the partner is unable to repay, the bank steps in and suddenly becomes a partner in Red Flag. Or, believing that he has found the solution to all Red Flag's woes, Al receives a third party offer to buy his shares conditional upon all shares being acquired. However the other partners do not agree on the price being offered and refuse to sell, thus defeating the deal.

The partners of Red Flag could have put in place at the outset a unanimous shareholders' agreement which would have contained pre-ordained solutions to the situations illustrated. This commonly used tool outlines pre-determined courses of action that alter the normal legal structure of privately owned corporations. That is, the normal Ôone man, one vote' rule which can often create deadlock (2 vs 2) is pre-empted and the role of the directors of the corporation is assumed by the shareholders who must follow the actions prescribed in the shareholders' agreement.

Let us refer back to Al's predicament. An executed agreement would have prevented Peaches from ever becoming a shareholder, as a Family Law Act clause would have included her release from the outset; or at worst she would have been forced to immediately sell her shares upon acquisition.

A shareholders' agreement often sets out an organized plan for raising additional capital if needed and sets out penalties for shareholders unwilling or unable to carry their share. This can result in the contributing partners carrying on and the defaulting partner(s) dropping out.

Further, the agreement usually contains requirements that the company carry life and disability insurance thus protecting the corporation and the partners against death and disability. The premiums can be paid by the corporation and a pre-designed formula for share value can be set out. Then an estate interest must be paid out and the surviving partners gain an increased interest. Third party offer clauses, piggy-back rights and rights of first refusal are matters commonly covered in the agreement that provide certainty and finality.

Also included in most shareholders agreements is the famous "shotgun" weapon which essentially allows any partner to initiate a process at any time to acquire the other partners' shares at a price set out in the offer procedure. It works because the partners receiving the offer must either purchase the offering partner's shares or sell theirs at the price set out in the offer. As this can be exercised at any time it could be used in any of the illustrated situations.

The nature and usefulness of the shareholders' agreement is both offensive and defensive. It can either be followed to the letter or it can invoke an attitudinal change whereby all partners are willing to negotiate and address alternative solutions to problems with more satisfying results than the shareholders' agreement offers. After all, any agreement can be changed if all partners sign on for the changes.

In Canada, both provincial and federal Business Corporations legislation provides for remedies for "oppressed" minority shareholders allowing them to resort to legal action for court-ordered solutions to shareholders' disputes. As we all know this is expensive and untimely as the business venture may not survive the delay and likewise uncertainties arising out of court actions are bound to wreak havoc on the business.

So let us rewrite our story and assume that Red Flag opened their gates with a shareholders' agreement firmly in place.

Al dies and his family is paid out for his shares. There are now only three shareholders. Gord goes on disability and Red Flag hires a temporary greenskeeper. Fearful of losing their shares, each partner seeks out and finds an additional $25,000 to prop up Red Flag.

Amazingly, after Peaches is paid out, Paul marries her for the second time, but this time Peaches releases her interest under the Family Law Act. Sam is horrified and invokes the shotgun and is bought out. Paul and Gord now own a golf course.

The motto of this tale? All business ventures have every chance of success; except for the fact that the relationships of the partners themselves may constitute their greatest challenge.