



OCTOBER 2008

The Business Legal Checkup: *Preventive advice for the legal health of your Business*

This article first appeared in the October 2008 Newsletter of the Better Business Bureau of Central and Mid-western Ontario. It is intended as information only and not legal advice. For further information, please contact Igor Ellyn at iellyn@ellynlaw.com or 416-365-3750.

*Igor Ellyn, QC, CS and Orié Niedzwiecki, Partners
Ellyn Law LLP, Business Litigation Lawyers, Toronto*
www.ellynlaw.com

More than 250 years ago, Benjamin Franklin famously said, "An ounce of prevention is worth a pound of cure". He was advising Philadelphia homeowners to insure their homes against fire to avoid catastrophic losses. Franklin's advice is just as applicable today to the legal issues of your business.

In this article, we explain a new legal service, *Canadian Business Legal Checkup*, an audit of legal matters affecting your business. *Business Legal Checkup* is a diagnostic tool most small and medium size businesses could use to verify if legal aspects of their operation comply with the law and to minimize risk, litigation and expense. When the *Business Legal Checkup* is completed, the business owner receives a lawyer's report red-flagging matters which need correction, improvement or further legal advice.

A closer look at the Business Legal Checkup

Your business is built on a foundation of laws and legal procedures. As a prudent business owner, you have probably considered the following legal matters:

- You had to incorporate your business. The corporation has been properly set up. All shares are properly issued. Directors and officers have been appointed. The corporate minutes and register are up-to-date.
- You and other directors of the corporation know exactly what your duties and liabilities are. All directors are protected from liability by sufficient insurance coverage.
- You have a shareholders' agreement so that all shareholders know their roles. All partners are treated fairly. There is an orderly method for valuation and termination of the corporation. You understand the minority shareholders rights requirements of the Business Corporations Act.
- You filed a business registration and have a system to renew it before expiry and you have registered any business names that you are using.
- You filed trademark, patent and copyright applications to protect the intellectual property of

your business.

- Your URL (web address) is trademarked. You have audited your website to check for breaches of privacy law, defamation and technology law issues. Your online sales portal is set up to avoid legal problems with privacy law, identity theft and contract issues.
- Your licencing and registrations are up-to-date. If your salespeople have to be registered or licenced, you have a system to ensure that their registrations are up-to-date and that their regulatory requirements are being monitored.
- You have a long term lease for your plant or office. You had your lease vetted by a lawyer. You know what it says, including the extra rent the landlord can demand. You know the deadline for your right to renew.
- You use several legal standard forms and contracts in your business. These have all been vetted by a lawyer to comply with applicable laws including the PPSA, the Interest Act, the Consumer Protection Act, the Sale of Goods Act, the Mercantile Law Amendment Act and the Bills of Exchange Act and contract law.
- If you extend credit, you know that your service charges don't exceed the "criminal rate of interest".
- You know prohibitions against misleading advertising and unfair competition in the Competition Act.
- You understand the privacy legislation and you have a system to ensure that you comply each time you collect, use, or disclose personal information.
- Your employees have signed agreements which spell out the length of notice they are entitled to receive if you terminate their employment. You know who is entitled to how much and what to do if you decide to terminate an employee, whatever the reason. You understand your obligations under the Employment Standards Act.
- Your employees have all signed non-competition covenants and non-solicitation agreements to prevent them from taking away your best clients, business procedures, best employees and trade secrets if they leave to set up shop on their own.
- You have a procedure to prevent violation of the Human Rights Code and you know the protected grounds of discrimination. You also understand all of the elements of sexual harassment and you know how to deal with it.
- You know your company's rights and obligations under the Workplace Safety Insurance Act and the Occupational Health and Safety Act.
- You have liability and multi-peril insurance and you know what it covers.
- Your manufacturing and distribution processes are set up to avoid potentially devastating product liability and class action lawsuits. You have minimized risks.
- You keep up-to-date with changes in the law which affect the corporate, contractual, insurance and employment law issues in your industry.
- You have complied with the filing requirements for income taxes, sales taxes and GST. You have had your business and municipal tax assessment vetted.

- You know what precautions to take to help prevent litigation.
- If you are about to get involved in litigation, you have an action plan to maximize your chances of success and to keep the cost in check. When hiring a lawyer, you know what you need and what to expect.

Stop the presses - before we continue - do we hear you saying there are many items on this list that you haven't looked after, that you haven't thought of or which could be updated?

We're not surprised. In our experience, small and medium-sized business owners don't get around to dealing with many important legal issues involved in organizing their business relationships with partners, shareholders, customers, employees and government and in preventing or managing the risk of expensive litigation. Often, agreements are not fully thought through.

Small business owners tend to do only what they absolutely have to do to comply with the law and are reluctant to spend money for top drawer legal services when an inexpensive shortcut appears to do the trick. Your focus is getting your business up and running, getting your product to market, making sales and keeping costs down. You could be lucky and run your business for years without anything going wrong.

Fair enough, but if you disregard preventive legal measures like the ones mentioned, your business is like a driver without a seatbelt in a car that has never been serviced ---in other words, a catastrophic accident waiting to happen.

Here are two examples of business legal nightmares that could have been easily avoided with a program of preventive law such as the Business Legal Checkup. These are actual cases, decided in Ontario courts:

- A Toronto RV dealer sold a motor home to a customer. After using it for a couple of weeks, the customer complained that the salesperson had misled him about a "rental program" and brought the motor home back and refused to make any payments. The dealer sold the motor home as a used vehicle and suffered a \$25,000 loss for which it sued the customer.

The Ontario Court of Appeal decided that customer was entitled to return the RV and cancel the contract because the salesman's Motor Vehicle Dealers Act registration expired and was not renewed. This made the contract illegal. The RV dealer didn't have a system to check if all their salespersons' registrations were current. The dealer not only lost \$25,000 but also had to pay about \$30,000 to their own lawyer and almost that much in legal costs to the customer's lawyer. A Business Legal Checkup could have saved this business most of the \$100,000 and a lot of aggravation.

- A southwestern Ontario company was a wholesale distributor of car alarm systems, which started as a basement operation and developed into a successful business. The owner used contract forms he found on the internet. Why pay a lawyer when forms were right there for the taking? His standard form contracts had statements that he didn't fully understand but if they were on the internet, they must be OK. He didn't have a lawyer check them. The standard form agreements didn't create a problem for several years.

The distributor extended credit to CAG, a company owned by a Mr. Don for more than \$90,000 worth of car alarms. He wasn't worried about payment because Mr. Don signed the standard form contract --- the one he found on the internet for free --- which stated that Mr. Don was personally liable for everything CAG ordered. When CAG went out of business, the distributor sued Mr. Don. The Ontario Court of Appeal dismissed the claim against Mr. Don because the personal liability clause in the standard form agreement was unclear and was capable of two meanings. The distributor didn't recover his \$90,000 and had to pay legal fees to his own lawyer and costs to Mr.

Don's lawyer. A Business Legal Checkup could have saved him almost \$150,000 and possible financial ruin.

These examples are the tip of the iceberg. As you read this article, you can probably think of other examples that affected your business. In each case, it's more than the legal expenses that are at stake. The business owner has to devote time and sleepless nights to the legal dispute and loses time from running the business.

How does a Business Legal Checkup work?

- You will be asked to complete some forms to provide confidential information about your business.
- You will have a discussion with the lawyer to assess the scope of the Business Legal Checkup. For example, it doesn't cover tax law, environmental law or succession planning unless special arrangements are made.
- A basic Business Legal Checkup will provide a diagnostic review of the legal status of the following issues in your business: (1) Set up and governance of your corporation; (2) Relationships among the owners of the business; (3) Relationships with employees; (4) the contracts and forms used in the business; (5) Competition Law and Illegal Advertising; (6) Intellectual Property, Trade Secrets, Confidentiality and Privacy; (7) Safety and risk management; (8) Risk analysis and efficient management of existing litigation; (9) Internet Issues; (10) Regulatory licencing issues.
- A Business Legal Checkup can also be customized to meet the business owner's specific requirements. This may require consultation with outside legal experts.
- In preparation for the Business Legal Checkup, you will be asked to provide documents and information concerning each category of the analysis.
- After the documents have been reviewed by a lawyer, consultation may be required with other lawyers. Further clarifications may be required from you and other senior officers of your business.
- A report will be prepared explaining the status of each topic and red-flagging issues which require attention and indicating their level of urgency.
- When the Business Legal Checkup report is ready, the business owner may prefer to have the Business Legal Checkup lawyer or legal team present the findings orally. An oral presentation followed by a Q&A session can assist the business owner to plan the next steps efficiently.
- The Business Legal Checkup legal team will facilitate referrals to lawyers who are specialized in resolving the legal problems identified by the Business Legal Checkup.

How much will a Business Legal Checkup cost?

For a small startup business with less than five employees, operating out of a single location and having only one business entity, a Business Legal Checkup can usually be completed for about \$5,000 if there are no unusual problems.

Who needs a Business Legal Checkup?

Every business needs to know whether its legal processes are efficiently compliant with the law. Public corporations are obliged to provide certain levels of legal compliance to government and regulatory bodies. A small private corporation does not have the same levels of mandatory compliance but failure to do so voluntarily is like the proverbial ostrich with its head in the sand.

A Business Legal Checkup is also useful for a business owner who is considering the sale of his business or for a prospective purchaser of a business. Minority shareholders could insist on a Business Legal Checkup annually or bi-annually to ensure that management and the majority shareholders are meeting their obligations to the corporation.

A Business Legal Checkup may also be a credibility tool for a business seeking financing or government contracts. Unlike a financial audit, ISO9001 and ISO 14400 compliance standards, the Business Legal Checkup is a confidential report to management only and expressly excludes reliance by outside parties. If an outside party, such as a lender or investor, will receive a copy of the report, the Business Legal Checkup legal team must be informed in advance so that concerns relevant to these outside parties can be taken into account.

Where can my business get a Business Legal Checkup?

So far as we know, the Business Legal Checkup, as a fixed-price legal diagnostic tool for private small and medium-sized businesses is a new legal service in Canada. Interested business owners are invited to contact us for information.

Benjamin Franklin's famous advice has evolved. A Business Legal Checkup can be much weightier than an "ounce of prevention". It could provide "tons" of preventive advice to save your business from damaging or catastrophic expense. The Business Legal Checkup will also provide the business owner with peace of mind which, as another saying goes, is "worth its weight in gold".

October 2008. © Igor Ellyn and Orie Niedzwiecki



Igor Ellyn, QC, CS and Orie Niedzwiecki are partners of ELLYN LAW LLP Business Litigation Lawyers, a Toronto law firm specializing in dispute resolution for small and medium businesses and their owners.

Igor Ellyn is a Specialist in Civil Litigation and a past president of the Ontario Bar Association. He has practiced as a business litigation lawyer for more than 30 years. He is a chartered arbitrator and mediator and the author of many legal articles, some of which may be downloaded from the firm's website.



Orie Niedzwiecki has practiced as a business litigation lawyer for more than 10 years. His practice includes commercial disputes, employment law, libel and slander, construction litigation and estate litigation. He is also admitted in the District of Columbia, USA.

For more information, please visit www.ellynlaw.com. Business Legal Checkup™ and Canadian Business Legal Checkup™ are registered trademarks.