



SMHI LEGAL NOTES

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BARRISTERS & SOLICITORS · TRADEMARK AGENTS

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Is Your Family’s Business Ready for the Hand Off?

“...it is difficult to pass a family business successfully from one generation to the next if family, financial and legal preparedness do not exist.”

Canadian Journal of Policy Research

In 1999 Deloitte & Touche and the University of Waterloo published the results of a survey that considered how ready Canadian family-owned businesses were for the change in leadership that was coming. What they found was that despite the fact that 78 per cent of family business leaders planned to retire over the next 15 year, less than 25 per cent had any sort of long-term strategic plan. In fact most had not even identified a successor.

Unfortunately eight years after that survey, the lack of preparedness for a smooth transition remains high. If you want your family business to survive into the next generation, it is important that you begin thinking about succession now. In fact, proper planning with a long lead time cannot be overemphasized.

In this article we provide you with a general overview of the succession planning process. In a future article we will discuss the importance of integrating the business’s succession plan with tax planning for your retirement as well as the distribution of your estate.

Why Plan?

Most entrepreneurs hope their business will be a lasting legacy. However, this is unlikely to occur in the absence of a well-

thought out plan. A proper plan will lay out what should happen in the event of the business leader/owner’s retirement, illness and death.

The Steps

While every succession plan is unique and will be tailored to the individual business, there are several common steps that go into the creation of any solid succession plan.

1. Information gathering and deciding on the viability of keeping the business in the family.
2. Developing the succession plan, including a timeline.
3. Implementing the succession plan.

Information Gathering

Many owners dream of passing their business onto their children. Therefore, the first step in the succession planning process is to find out if any of the children are interested in taking over the business. (What if none are? What if more than one is interested?) Next you have to determine if they are qualified to take over. These issues require serious family discussion and you may want to bring in an independent advisor to assist in this phase.

If family succession is not going to work, you must consider other options if your business is to continue beyond your leadership.

Developing the Plan

Once you have taken the time to gather the necessary information, you can begin the actual work of drafting a plan. The following are some of the key decisions that will have to be thought out.

- Who is going to take over the leadership reins?
- What additional training and experience will the successor require before taking over the leadership?
- When will the changeover take place; when will the transfer begin and when it will be completed?

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The articles in SMHI Legal Notes are necessarily of a general nature and cannot be regarded as legal advice. Our firm will be pleased to provide additional details on request.

The Construction Lien Act: Protection for Suppliers of Goods and Services

The typical construction project is a tangle of contracts involving a large number of parties, most of whom will have no direct involvement or contract with the owner. If a party does not have privity of contract with the owner, that party cannot enforce its rights against the owner.

To remedy this obvious shortfall, the *Construction Lien Act* was enacted. The Act provides four remedies to construction suppliers:

1. The Act creates a lien in favour of each supplier.
2. The Act mandates holdbacks.
3. The Act imposes a trust against the money used to finance the construction project.
4. The Act provides the right to have a trustee appointed, in certain cases, to protect the premises.

This is a complex and specialized area of the law. In an attempt to provide you with a general understanding of construction liens we provide this primer.

What is a construction lien?

A construction lien is a right given to persons and businesses who supply services or materials to the improvement of real property (the construction project). A lien provides them with an enforceable remedy against the owner of the project, despite the absence of a contract with that owner. Specifically, the lien becomes a charge against the owner's interest in the property being improved.

Who are suppliers?

The right to a construction lien is given only to suppliers of materials and services to the improvement. Determining a supplier of materials is relatively straightforward, but a supplier of services may be less obvious. Although the services that will benefit from a lien need not actually be performed on the construction site, the supplier must have a degree of connection with the making of the improvement. For instance, the brick layer will be entitled to a lien however the trucking company delivering the bricks probably will not.

The right to a construction lien has been narrowly construed by the courts and the onus is on the claimant to establish that he or she is a supplier of services or materials to the project.

When is a supplier entitled to a construction lien?

The right to a construction lien arises and takes effect immediately upon the first supply of materials or services. The lien comes into existence automatically. However, it is essentially

dormant until the lien holder takes the necessary steps to enforce it.

What is a construction lien worth?

The value of a lien is equal to the contract price or the fair market value of the services or materials supplied plus GST and PST. A lien claimant, however, cannot recover from the property owner more than the owner owes to his contractors, even if the contractors did not pass those funds onto the lien claimant. This may be as little as the 10% holdback (see below for more about the holdback).

It should be noted that a lien does not provide for damages for breach of the contract.

When is a lien discharged?

A lien is discharged once the supplier has received full payment for the services rendered or the materials supplied.

Do liens expire?

Generally, a contractor's lien will expire unless it is preserved within 45 days following the earliest of:

- The date the certificate or declaration of substantial performance is published;
 - The date the contract is completed or abandoned;
- and then perfected within 45 days of preservation.

Generally, a subcontractor's lien will expire unless it is preserved within 45 days following the earliest of:

- The date the certificate or declaration of substantial performance is published;
 - The date the subcontractor last supplied services or materials;
- and then perfected within 45 days of preservation.

What are preservation and perfection?

A construction lien is preserved by registering a claim for lien, before expiry, on the title of the property being improved. The lien is perfected by commencing an action to enforce the lien claim and by registering a Certificate of Action on title to the property within the time period prescribed by the Act.

What is a holdback?

A holdback is the second major remedy provided to construction suppliers. Each payer involved in a construction project,

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is under an obligation to hold back an amount equal to 10% of the value of the services and materials that have been supplied to it. These amounts form an “insurance fund” for suppliers. It is also protection for the property owner, who can limit his liability for liens to the 10% holdback, even if some of the contractors do not pay their subcontractors.

There must be a separate holdback for each contract entered into. A payer is also obliged to withhold an amount sufficient to satisfy any lien claim for which he has received notice.

The holdbacks must be maintained until all liens that may be claimed have expired, been satisfied or been discharged.

How do the trust provisions work?


The Act’s third major remedy is the trust, which is imposed on all amounts received by the owner and that are to be used in

the financing of the improvement. The owner becomes the trustee of the fund and he cannot appropriate the money for his own use. The trust will be imposed regardless of whether any money is then owing to the contractor.

A similar trust will be imposed on the net proceeds received by the owner if he sells the property prior to completion of the project.

When can a trustee be appointed?

An application to appoint a trustee can be brought at any time, by any person having a lien. The appointment of a trustee is considered an extraordinary remedy and its primary purpose is usually to complete the construction project.

Although this is a fairly complicated subject matter, our firm has developed an expertise in the area of construction liens. If you have specific questions or require advice about your particular situation please contact us. 

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- What role will the current leader play after he or she is no longer responsible for the day-to-day operations?
- How will the change in leadership be communicated to third parties, including non-family executives, employees, suppliers and customers?
- What will happen to the current leader’s shareholdings?
- How will the current leader’s personal financial situation be secured?
- What is the contingency plan for unexpected events such as the illness or untimely death of the current leader?
- What legal vehicles will be used to carry out the succession?

Implementing the Plan

Once a sound plan has been created you must then implement it. If it sits on a shelf gathering dust, your work will have been for naught.


Your family should be fully aware of the contents of the succession plan. The plan should be available to those who will be directly affected by the transition, including key employees, customers and business contacts.

One of the most important keys to a successful implementation is to ensure that the person chosen to succeed will be ready to take control at the appropriate time. Your successor should participate in the business by working in different areas of it and should be allowed to take part in making business decisions. In addition, your successor should meet the main business contacts.

Another important aspect of a smooth succession is to effectively deal with the principle non-family employees. You want to ensure that they will stay during the transition and that they will respect your chosen successor. You also want to treat these people fairly, though not necessarily equally, regarding compensation and ownership.

Finally, you should review your succession plan at least annually. It should be revised to address the changing circumstances of the key players.

Thorough and thoughtful succession planning is an important, though often overlooked, key to the long term success of a business. Succession planning requires time and commitment and the help of outside professionals.

Our lawyers have many years of experience working with family-owned businesses. We would be pleased to answer your questions and to assist you in this process. 

**For additional information visit our website at
www.smhilaw.com**

Homeowners' Victory Confirmed

In the most recent edition of the *SMHI Legal Notes*, we told you about a couple who had the title to their home stolen by fraudsters. These fraud artists went on to secure a mortgage of almost a quarter of a million dollars. When the couple discovered what had happened, they successfully sued the mortgagee.

Shortly after that case was decided, the Ontario Court of Appeal heard *Lawrence v. Maple Trust Company*, a case involving a similar fact situation.

The Facts

An impostor, posing as Susan Lawrence purported to sell her house to Wright, another impostor. Wright then mortgaged the property for \$291,924. The scam was brought to light two months later when Lawrence decided to actually sell her house.

Lawrence sued the mortgagee, Maple Trust. Following earlier Court of Appeal decisions, the Superior Court Judge ruled against Lawrence and in favour of Maple Trust. The basis for those decisions was that since the mortgages had been given for valuable consideration and without notice of the fraud, they were, once registered, effective and could be relied on. Lawrence appealed.

Court of Appeal Decision

The Appellate Court allowed Lawrence's appeal and set Maple Trust's mortgage aside.

The key to Ontario's land registry system is to guarantee that the person named as property owner has title subject only to any registered encumbrances. In addition, the *Land Titles Act* states that only a registered owner is entitled to transfer or charge land. It also states that a fraudulent instrument that, if unregistered, would be fraudulent and void is, despite registration, fraudulent and void.

Despite all this there remains the question of whether the indefeasibility (cannot be annulled or made void) of title is immediate or deferred. Maple Trust argued that Ontario's is a system of title by registration. In other words, once an instrument is registered, it is effective immediately even if procured by fraud.

Following a lengthy review of the law in this area, the Appellate Court concluded that the theory of deferred indefeasibility is the proper approach in situations like the one described in the *Lawrence* case.

"...By interpreting the Act in accordance with the theory of deferred indefeasibility, the law encourages lenders to be vigilant when making mortgages and places the burden of the fraud on the party that has the opportunity to avoid it, rather than the innocent homeowner who played no role in the perpetration of the fraud."

With respect to the Appellate Court's previous decision, this panel found that both the result and the reasoning in the previous case were incorrect. In particular, the court had failed to recognize that the *Land Titles Act* gives statutory effect to the theory of deferred indefeasibility.

When all was said and done, Maple Trust lost the contest with Lawrence, the true registered owner of the property. Maple Trust had taken a mortgage from Wright, a fraudster, not the registered owner. And unlike Lawrence, Maple Trust had had an opportunity to avoid the fraud.

Homeowners can at last breathe easier knowing that they are not expected to run down to the registry every day to ensure that their home still belongs to them. 📁

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