

## **Starting A Business? Avoid These Common Mistakes**

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Starting a company is an exciting venture, though it is undoubtedly accompanied by many challenges. At Houser Henry & Syron LLP (“HHS”), we have the pleasure of working with many new and exciting businesses and helping them navigate the Canadian legal landscape.

In our experience, if a company takes care to set-up its corporate structure and the contracts it will need to properly operate its business in the beginning, it will save itself a lot of time and expense (including possibly litigation) in the future.

The following are four common mistakes that businesses make that with some foresight and planning can be easily avoided.

### **(1) FAILURE TO PROPERLY ORGANIZE THE COMPANY**

It has never been easier for an individual to incorporate a company. However, simply incorporating a company does not mean that the company has been properly organized.

When a company is incorporated a business owner should properly issue shares, set up defined share classes and attributes in the articles of incorporation, appoint directors and officers and execute general by-laws.

Completing the above at a later date will cost money and in the interim can lead to unintended consequences. For example, it is common for many start-ups to take on partners and entice employees to join the company through the issuance of shares and in some cases making these persons directors and/or officers. If the company is not properly organized, it can be difficult to determine who exactly owns the company. Further, an owner may inadvertently give up control of the board of directors.

This may sound like a far-fetched scenario, but it can and does happen.

### **(2) OWNERSHIP OF INTELLECTUAL PROPERTY**

When a third party is engaged by a company to develop products and services on behalf of the company, you might assume that since your company paid to have the product developed, your company now owns the intellectual property to that product. This is not necessarily the case.

It is imperative that when a company engages the services of a third party to develop products and services on its behalf, that it requires that party to assign over all intellectual property rights in that product prior to commencing work.

This mistake is particularly common in the case of software start-ups that engage developers and other independent contractors to provide code for use in the business. We have had situations where we recommended clients go back to developers they had previously engaged and ask them to assign their intellectual property rights in certain products for a nominal sum. Fortunately, all parties were in agreement, but this is a situation to be avoided.

Even in the context of an employer / employee relationship, it is not a forgone conclusion that all intellectual property that is developed by an employee will belong to the employer. In determining which party owns intellectual property that has been developed, courts will look at, among other things, whether the product was created in the course of the employee's employment, what tools were used to make the product and what were the employee's responsibilities in the organization.

There is no need to leave this issue to chance. Each employee and independent contractor engaged by the company should sign a contract prior to commencing their work.

### **(3) FINANCING DOCUMENTATION**

Most business owners finance the early operations of their business using their personal capital.

The owner must make a decision to treat these contributions as equity or as a loan. Often, we advise owners to treat their financial contributions as a loan and to document it accordingly.

It is reasonable to expect that the financial contributions you made in the early stages of the company will be repaid to you. You will ultimately have the flexibility to determine whether or not the company will repay the loan, but if the arrangement is not set up at

the outset, it will be harder to reclaim these funds once future investors or business partners are involved.

Accordingly, a loan agreement between you and the company should be executed and should outline at a minimum, the amount loaned, the interest rate and terms of repayment.

Additionally, to secure the loan, we recommend you (as the lender) and the company (as the borrower) enter into a general security agreement, whereby the company grants you security over the assets of the company until the loan is repaid. This security interest will be registered and will give you first priority over the assets of the business ahead of other unsecured creditors.

### **(4) SHAREHOLDERS AGREEMENT**

A shareholders agreement helps outline how a company will be managed.

Without a shareholders agreement, most decisions of the company will be made by agreement among the majority of the directors, who in turn are appointed by the shareholders.

Like many things in law, the true value of the agreement will likely not be noticeable until a problem arises. If you do not have a shareholders agreement and a problem between the shareholders does arise, your options to resolve the situation quickly and efficiently may be limited.

We generally recommend that if a company has two or more shareholders, those shareholders should enter into a shareholders agreement as soon as is reasonably possible. A shareholders agreement, among other things, typically makes provisions for the following:

- Who will be the directors of the company;

- What decisions will require the unanimous consent of the shareholders;
- How will the company be financed (debt, new share issuances, shareholder loans);
- How will proceeds be distributed;
- When may shares be transferred or sold;
- Buy-out provisions between shareholders; and
- What will happen in the event of death, disability or insolvency of a shareholder.

A shareholders agreement often provides a less expensive solution than resolving a problem through other means when the relationship has likely already deteriorated.

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For more information, please contact one of the lawyers with our firm. You may also wish to visit our website, [www.houserhenry.com](http://www.houserhenry.com), for an overview of our team and our services.

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