



Portfolio Strategy

North American markets in October continued to slide as two main themes dominated the news cycle; increasing COVID-19 cases around the world and the US Presidential election. Since markets don't typically like uncertainty, the absence of a viable vaccine and a close presidential race were both weighing heavily on investor's minds. In the US, the S&P 500 was down 2.8% in Canadian dollars during the month, while at home the S&P/TSX was down 3.1%.

During October we made a number of adjustments in our North American focused portfolios. On the Canadian side of the portfolio we sold our position in Enbridge and used the proceeds to purchase Canadian Tire. In the US, we sold Lockheed Martin to purchase Aptiv Plc, a vehicle components manufacturer. Later in the month we also exited our positions in Johnson & Johnson and Activision Blizzard.

The bond market also gave back some its recent gains in October with both the Canadian bond universe and the preferred share index each losing close to 1% during the month. We did not make any changes to our fixed income portfolio during the month and continue to hold a diversified mix of positions within the asset class of individual bonds, bond ETFs, bond funds and preferred shares.

On an asset mix basis, with the above mentioned equity sales towards the end of October, we are now positioned slightly overweight cash, underweight fixed income and with a relatively neutral weight to equities. Our equity signals point to an early stage cyclical bull market, which with the cash on hand will allow us to take advantage as opportunities present themselves.

Keeping Business Agreements Current to Ease Estate Surprises

Predictability and continuity are the gold standard of business operations. Nothing is more disruptive than an unplanned event that sends shock waves throughout the enterprise. One of the greatest disruptors is the death of a principal owner or employee. Having solid business agreements in place provides better clarity and certainty for you and all stakeholders, including business partners, family

members, employees, customers and suppliers. Regardless of the size and structure of your business, understanding and strengthening agreements, with contingencies in the case of your incapacity or death, is a vital part of estate planning for all business owners.

Please see the attached document for more details on the importance of keeping business agreements current.

As always, if you have any questions, please do not hesitate to contact us.

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An Ounce of Prevention

Keep Your Business Agreements Current to Ease Estate Surprises

October 2020

Predictability and continuity are the gold standard of business operations. Nothing is more disruptive than an unplanned event that sends shock waves throughout the enterprise. One of the greatest disruptors is the death of a principal owner or employee. Having solid business agreements in place provides better clarity and certainty for you and all stakeholders, including business partners, family members, employees, customers and suppliers. Regardless of the size and structure of your business, understanding and strengthening agreements, with contingencies in the case of your incapacity or death, is a vital part of estate planning for all business owners.

The Shareholders Agreement

A corporation, by definition, is a separate legal entity that never dies. However, the corporate shareholders do not have the same advantage. Any corporation with more than one shareholder should have a Shareholders Agreement in place. The Shareholders Agreement explains how the business will function and what decisions will be made under various circumstances. Without an up-to-date Shareholders Agreement, business continuity may be at risk and shareholders could end up in situations they didn't plan for and do not know how to manage.

The death or incapacity of a shareholder is one of the most disruptive events a business can experience. Although a Shareholders Agreement typically addresses a wide range of business eventualities, this one is of primary importance for all the owners.

Take for example:

A family business is owned by three sisters as equal shareholders. One of the sisters dies suddenly, leaving her entire estate, including her shares in the family business, to her common-law spouse. The surviving sisters now find themselves running the operation together with the spouse of the deceased sister who may have no knowledge of, interest in, or commitment to the venture.

The sisters did not plan for a situation like this, and without a proper Shareholders Agreement defining the process of share transfer in the case of death, the end result is less than ideal.

Buy-sell provisions and insurance

A key component of any Shareholders Agreement is the "buy-sell" provision. Under its terms, if a shareholder passes away the surviving shareholders have the opportunity to purchase the outstanding shares of the deceased owner. This prevents a situation such as the one previously described, and concentrates the shares in the hands of the existing co-owners and ensures some continuity for the business, despite the shock of losing a colleague.

In this situation, the remaining shareholders would execute the terms of the buy-sell clause by paying market value to the deceased shareholder's estate for the outstanding shares. Agreements may contain a formula for valuation, terms and a timeline of payment and, most importantly, an authorization or a requirement for the business to hold a life insurance policy on the lives of its shareholders to fund the purchase of the deceased owner's shares. This protects the owners from any financial hardship associated with finding the resources to purchase the deceased's shares.

Non-incorporated businesses

Not every business operates as a corporation. Many highly successful business ventures are carried out through partnerships, sole proprietorships and joint ventures.

Business owners using these structures enter into commercial contracts and are exposed to the risks of their business in their personal capacity because they are not incorporated. There could also be future implications for the business owner's estate to fulfil the terms of any business contract, or conversely, to reap the benefits of contracts entered into by the deceased principal. The following is an overview of non-incorporated business models:

- **Sole proprietorships** are businesses operated by one individual in a non-incorporated structure.
- **Partnerships** typically comprise two or more individuals carrying on business with a common purpose and a view to profit. Usually the partners will define the relationship among themselves and to their business with a contractual Partnership Agreement. Similar to a Shareholders Agreement for an incorporated business, the Partnership Agreement includes requirements of capital contribution, allocation of profits and losses, operational responsibilities and the burden of risk for the partners¹.
- **Joint ventures** may be any combination of individuals, partnerships and/or corporations that join together for a particular project, and are usually defined by the following:
 - A joint venture is a contractual arrangement for a task and will often disband once the task is completed;
 - Joint ventures are commonly governed by agreements with terms similar to those found in partnerships;
 - Typically, those terms will bind each individual within the joint venture and, in the case of a death, their estates to completion of the project;
 - There may also be provision for insurance relief to facilitate that completion; and
 - Thoughtful planning will ease responsibilities and reduce costs for the estate.

Specific business agreements

In non-incorporated businesses, commercial contracts may personally bind the owners with potential repercussions for their estate and loved ones. Careful negotiation and foresight in such contracts can help to reduce stress and avoid financial hardship. Common business agreements include:

- **Leases** – Renting commercial premises is an important business function; however, the terms can be complicated. Care should be taken to include provisions

for the death of the lessee to ensure a deceased tenant's estate is able to terminate the lease on reasonable terms or negotiate acceptable conditions of withdrawal or sublet.

- **Dealer or franchise agreements** – Many businesses operate as representatives of a parent company from which they receive national marketing support, supplies and standardized operational processes, in return for a fee and share of revenues. Dealership franchise agreements sometimes contain procedures for the death or incapacity of a party; however, this is often overlooked. Consider the following:
 - You should regularly review your agreement to fully understand the rights and obligations of each party;
 - Death can place an unexpected burden on your personal representative to continue the operation of the business until the parent company steps in under the terms of the franchise agreement;
 - Personal representatives are often family members, with little or no business experience; and
 - Naming another dealer/franchisee in the Will or Power of Attorney is recommended to assist your personal representative as an agent to manage the business may be a welcome and efficient solution².
- **Intellectual property ("IP") agreements (licencing and royalties)** – The passing of an owner of intellectual property does not necessarily terminate the rights and financial interest of the estate to receive the benefits of those assets. In these situations, it's important to note:
 - Patent rights in Canada extend for 20 years, and copyright materials are now protected for up to 75 years;
 - The deceased owner's estate and beneficiaries may be entitled to ongoing payments under any IP licence agreements in place at the time of the owner's death, and to licence the IP to additional users, as well as to collect copyright royalties for the duration of the IP protection period; and
 - It is incumbent upon IP owners to ensure that contracts contain carry-over terms after death, that the intended beneficiaries of IP rights are clearly identified in the Will, and that a personal representative is named who will be vigilant in enforcing those rights on behalf of the beneficiaries.

• **Supply or production contracts** – Periodic examination of the terms contained in manufacturing contracts is important to ensure that an unexpected death is managed in a way that facilitates both the estate administration and protects the value of the business. Remember that:

- The Executor may be required to step in to manage operations and fulfill any outstanding contractual requirements; and
- Ensuring that contracts anticipate unforeseen events like the death of one party and choosing the right Executor to handle business matters will reduce anxiety and strengthen business relationships.

• **Business succession agreements** – Purchase and sale agreements can span several years before all obligations of seller and buyer are completed. If either party dies during this transition it can create delays or halt the process prematurely. If the deceased party's Will contains terms that are at odds with the succession contracts there will be inherent ambiguity to resolve. Envision a progressive business sale for the assets of a family business, financed with a vendor-take-back loan over five years. If a vendor dies in year two with a Will that divides his/her estate assets among his/her children, what happens to any remaining assets of the business still owned by the deceased? Do his/her children receive them or does the purchaser continue the payments to his/her estate and eventually receive full ownership? A share purchase of an incorporated business may incur the same fate if the transaction has not been fully concluded.

Specifying a contractual process for completing a business succession in case of death is central to realizing the full value of the transaction for both parties. And, updating your Wills and Powers of Attorney to reflect and incorporate your business succession agreements may also prevent costly ambiguity.

“Key-person” protection

Any business, incorporated or not, can include people whose death would represent a significant blow to the operation, including an owner, employee or even a regular contractor. This risk is often mitigated with an insurance contract on the life of the “key-person” in the business.

The proceeds of the insurance would help mitigate the loss of that individual's contributions to the business until a replacement solution can be found. Frequent monitoring of such protection contracts is necessary to ensure they reflect the current reality in any business environment.

Incapacity

It isn't just death that can throw a wrench into business operations. The mental incapacity of an owner can be just as devastating, if not more so, than his or her death. Naming an experienced replacement decision maker and manager for an indefinite period of incapacity is often overlooked by business owners.

Power of Attorney documents often name a spouse or adult child as attorney without any real consideration of their skills or experience, and ability to replace the incapacitated individual in the business for an indefinite period of time. Serious thought should be given to naming an Attorney for Property when a business is involved. It may even be worth considering a separate Power of Attorney with the required knowledge and skills to look after the business.

Seek professional advice

Whether business agreements are intended to manage the relationship among business partners themselves, or to engage in commercial arrangements with external parties, their relevance and currency will profoundly affect business operations when an owner dies or loses the capacity to manage effectively. Moreover, your named personal representatives will have to manage whatever situation they inherit with all of the agreements, or lack of them, that the deceased or incapable owner negotiated. A periodic review of those business agreements is an excellent investment in the future efficiency of your estate administration and your business operations. And, it is one that your Executor, business colleagues and your family will thank you for down the road.

There is significant complexity associated with business agreements, and professional advice and guidance should be considered when establishing or updating a business or Shareholders Agreement.

For more information, speak with your BMO financial professional.



¹ In the absence of any agreement to the contrary, the legislation in most provinces automatically dissolves a partnership on the death of a partner. Preserving your partnership in such circumstances is key to maintaining smooth business operations. Keeping your partnership agreement up-to-date helps prevent any unexpected dissolutions or asset liquidations.

² If a franchise operates as a corporation, tax advice is required before attempting an agency solution.

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