RISK, LAW, AND CONTRACTS

Recommended study material for the Landscape Industry Certified Manager exam

Business Management Training Manual for Landscape Professionals

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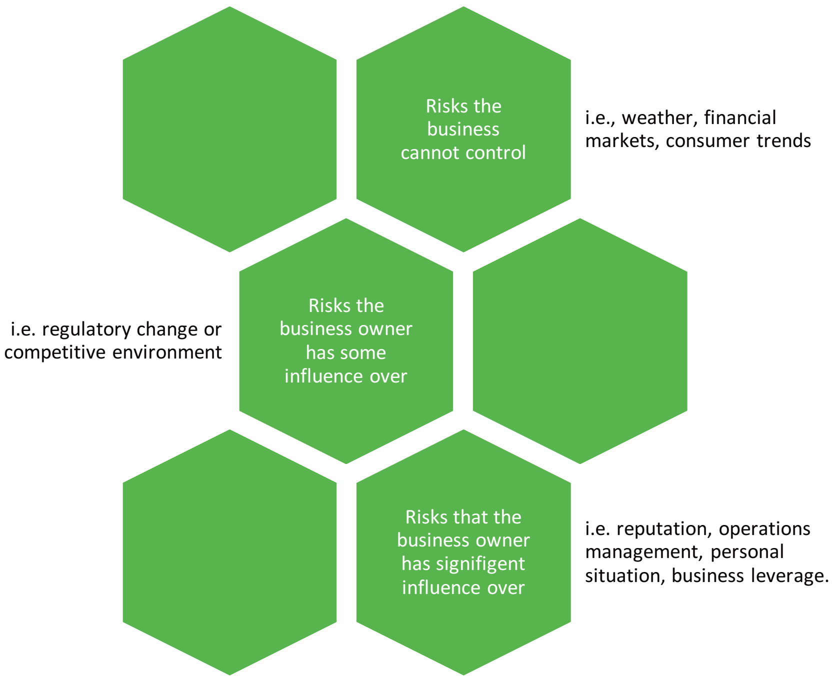
Chapter 1

Managing Risk

Risk is defined as “a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for.” In business, including the green industry, the outcomes of unmanaged or poorly managed risk produce losses in company assets, earnings, reputation, and/or employee productivity, employee safety and well-being; it can also be a “black hole” consuming huge amounts of management time. Business risk presents itself in many ways; the typical examples of risk that most businesses think of are fire, natural disasters, theft, damage to assets (property, offices, trucks), and third-party liability. It is important to remember that there will always be risk, and it is equally important you learn to manage your risk in order to maximize your profit-potential.

There are a number of ways that risk can be classified to make it easier to develop risk mitigation strategies. One way is to categorize the risk by the amount of influence the business owner has over the risk—see Figure 1 for a breakdown.

FIGURE 1: LEVELS OF OWNER'S INFLUENCE OVER RISK



The more influence a business owner has over a potential risk, the more options exist to control or manage the risk.

Another way to look at risk is to use an asset-oriented approach and divide risk into four categories, further outlined in Figure 2:

- Customer risk;
- Personnel risk;
- Property risk;
- Market risk (including economics, business structure, pricing, marketing, competitors, etc.).

The emphasis in this chapter will be on areas where a business has significant influence, customer, personnel, and property risk and some ways to manage these categories of risk. Market risk is risk associated with the marketplace and competition and how to position your company to deal with competition. This area is well covered in the "Managing Marketing and Sales Manual" and in the "Strategic Planning Manual."

FIGURE 2: EXAMPLE CATEGORIES OF RISK

Risk Management Techniques

Risk management techniques require business owners to understand the risks they are managing and mitigating. Just as risks can be arranged in groups, risk management techniques are based on three basic strategies, which create the foundation for your risk management strategy:

- Avoiding the risk;
- Living with the risk;
- Transferring or sharing the risk with another party.

Each of these risks have their own characteristics.

Although *avoiding the risk* may sound like a simple solution, it assumes two critical factors:

1. That you know what the risks are and;
2. That you can avoid the risk and still stay in business.

It may also result in you burying your head in the sand or being too risk-averse, both being bad for your business.

Living with the risk also assumes that you know what risks are relative to you (ignorance is not bliss in this circumstance). It also assumes that the owner understands the consequences of those risks and that the business is able to survive through those consequences.

Transferring or sharing the risk usually involves purchasing insurance, but more innovative methods, such as having joint-venture partners on high-risk projects or including specific contract terms, can spread some risks to other parties.

Before providing details on the various risk management techniques, the type of risk that businesses encounter will first be described.

Customer/Public Risk

Product Liability

Examples of product liability risks include:

- Inadvertent impact of pesticide spraying;
- Failure of specific products, such as a retaining wall collapsing;
- Plant mortality.

TABLE 1: RISK MANAGEMENT FOR CUSTOMER RISK

Risk Management Techniques	
Avoidance	Don’t use pesticides Use properly trained/certified staff Implement a quality control system
Live with	Provide free replacements
Sharing Risk	Purchase liability insurance Credit-proof your company

On-Site Injury

Customer Liability

If customers are allowed on to company-owned sites, such as retail yards or landscape material yards, and they are injured while on-site, they can bring legal action against the company.

Public Liability

Risk to the general public comes in many forms, such as:

- Injury from inadvertently entering a job site;
- Auto accidents during traffic control procedures (or lack of traffic control) around job sites;
- Injury caused by the improper installation of landscape components;
- Slip and fall injuries blamed on poor maintenance or poor snow or ice clearing.

TABLE 2: MANAGING PUBLIC LIABILITY

Risk Management Techniques	
Avoidance	Restrict public access to specific areas Hire/train security/traffic-control staff Ensure that areas are properly maintained, especially in the winter Post highly visible signs in the winter months
Live with	Accept the financial consequences
Sharing Risk	Purchase liability insurance Consider co-insurance with property owners

Bad Debts

Bad debts are usually the result of one of the following occurrences:

1. Contract dispute:
2. Financial distress of customer (temporarily or more long term);
3. Fraud

Almost all businesses have experience with bad debts. Managing this risk should include credit procedures that minimize the probability of a customer defaulting on a large debt. The "Corporate Financial Management Module" provides details on credit policies.

Debt Collection

Most companies, at one time or another, will find themselves in the position of having to collect on an overdue invoice. As with so many aspects of business, how this is done reflects on your company's image. You may not feel that worrying about what a "deadbeat" thinks of you is important, but if you end up in a legal situation because you have not followed the laws, your company could suffer, pay a lot in legal fees and you could end up spending a lot of your time dealing with it.

According to the National Association of Credit Management, there are generally four types of credit and collection policies:

1. Strict analysis of risk and liberal collections;
2. Liberal analysis of risk and heightened collection effort;
3. Liberal analysis of risk and liberal collections;
4. Strict analysis of risk and strict collections.

Often, bad debts are the result of the company's decision on credit policy and the types of clients selected. Unfortunately many landscape companies don't have the time or the staff to carry out credit checks on their clients.

From the moment you initiate the collection process, regardless of how first contact was made (phone, email, letter, in-person, etc.), your actions are governed by a strict set of rules:

- **United States:** The Fair Debt Collection Act is the legislation that applies to this situation (see www.ftc.gov/os/statutes/fdcpa/fdcpact.htm).
- **Canada:** There is no all-encompassing legislation, but http://www.canadabusiness.ca/eng/page/2645/ provides some guidelines.

Remember, if you involve a third party (e.g., collection agency or bailiff), they will be bound by the same guidelines, and if they recover any money, you will only receive an agreed-on portion of it.

In the end, you should handle debt collection the same way you handle all other aspects of your business: proactively, professionally, legally, and with a focus on customer service.

TABLE 3: MANAGING COLLECTIONS

Risk Management Techniques	
Avoidance	Establish a credit policy (refer to the Corporate Financial Management Module and the short section below) Use properly worded and signed contracts Obtain personal guarantees from companies Use liens Obtain letters of credit
Live with	Take an "if a client defaults on a small contract it's not going to sink my business" attitude On larger contracts, include provision for progress payments
Sharing Risk	Use factoring companies—companies that buy accounts receivables for a discount and pay you cash for the accounts Offer creditor insurance (covers creditor in the event of death or injury) Allow consumers to pay by credit card

Credit Policies for Managing Credit Risk

The following questions must be asked and answered appropriately prior to granting credit:

- Can the buyer pay as promised?
- Will the buyer pay?

- If so, when will the buyer pay?
- If not, can the buyer be forced to pay?

For credit to be approved, the answers to the first two points and the last should be "yes," and the answer to the third point should be "on an agreed schedule."

To further determine a customer/buyer's creditworthiness, evaluate on the "4 Cs of Credit," outlined in Table 4.

TABLE 4: THE 4 CS OF CREDIT

Character	The fundamental honesty and integrity of the customer
Capital	The customer's cash and other assets. Customers need to have sufficient capital to carry on their operations
Capacity	The customer's ability to conserve assets and follow financial plans
Conditions	The factors of the present business cycle that impact the customer's profits, and therefore, their ability to pay

Personal Guarantees

Another method to reduce the risk of bad debt is to obtain a personal guarantee from the client. This guarantee allows you to access the personal assets of the business owner in the event of the insolvency of the company. Many owners refuse to sign these types of guarantees; however, if there is significant risk of default or the customer has a history of defaulting on debts, this is a good method of providing additional risk mitigation.

Letters of Credit

The two types of letter of credit are issued by the client's bank: the Commercial Letter of Credit and the Standby Letter of Credit. Both represent the irrevocable obligation of the issuing bank to make payment to the beneficiary (you) on presentation of the required (usually completion) documents. The main difference between the two is that the parties involved do not expect that the "Standby Letter of Credit" will ever be drawn on, it is there just in case.

Credit Insurance

Insurance can be purchased to protect against abnormal bad debt losses. This type of insurance does not cover normal bad debt losses that should be predictable or preventable, but covers bad debts from customer insolvency due to unusual conditions, such as natural disasters.

Personnel Risk

Personnel risk in most businesses consists of risk related to:

- Competition from former employees;
- Loss of key employees;
- Employee dishonesty, such as theft or fraud.

Competition from Former Employees

Many landscape businesses have experienced the risk associated with competition from former employees. This occurs generally with senior-level employees that the companies have typically invested time and money in training and promoting within their organizations. They may leave unexpectedly and often attempt to take existing customers with them.

Loss of Key Employees

Key employees are normally senior personnel on whom the company is significantly dependent for its operations. Loss of these personnel through death, injury, or resignation can have a significant impact on sales and profits.

Managing this type of risk can be achieved through purchasing life insurance on key employees. The non-insurance method is to ensure that your company has enough depth of trained personnel to fulfill the roles of the lost employee.

TABLE 5: LOSS OF KEY EMPLOYEES

Risk Management Techniques	
Avoidance	Establish a succession plan for key positions Train employees to perform multiple roles
Live with	Accept the consequences
Sharing Risk	rchase insurance on key employees

Employee Dishonesty

Theft by employees is a significant problem for small businesses; theft can include stealing equipment, inventory (plants or hard goods), or cash. Forgery is a common method of stealing by the bookkeeping or accounting personnel who have access to company checks and financial instruments.

TABLE 6: EMPLOYEE DISHONESTY

Risk Management Techniques	
Avoidance	Provide good supervision to remove all easy opportunities for theft
Live with	Take whatever the financial consequences
Sharing Risk	rchase insurance

Financial Fraud or Embezzlement

Companies should ensure that they have adequate supervision of inventory management and bookkeeping or divide financial management tasks in such a way that there are checks and balances in the system that require two or more employees to be involved to complete a task, the so-called *Segregation of Duties*. This ensures that no employee has enough authority to make fraud or theft easy to carry out.

TABLE 7: FINANCIAL FRAUD

Risk Management Techniques	
Avoidance	• Most schemes to defraud a company or embezzle funds require that inventory and accounting procedures are poorly organized and sloppy. If your accounting and inventory is always up-to-date and you are using modern accounting software, it is much harder to embezzle or steal inventory. • Shifting responsibilities from one person to another allows them to check one another's work for accuracy and suspicious activities. It also makes collusion between employees or between an employee and an outside source, such as a distributor, considerably less likely. • Carry out random audits of physical inventory levels versus book levels. • Carry out random audits of bookkeeping. • Have your accountants carry out full audits rather than just a notice to reader. • Bringing in outside personnel when accounting staff take vacations provides an outside check of accounting procedures. • Ensure that applicants for key administrative positions are thoroughly screened.
Live with	Live with financial consequences
Sharing Risk	Purchase insurance against fraud

General Employee Theft

One of the most effective means of reducing theft is working closely with your employees and having committed employees who would immediately bring internal or external theft to management's attention. Workers are also less likely to steal if they think there is a high risk of being caught either by management or by other employees. Training and employee awareness programs can inform workers about stealing problems and keep them on the lookout for theft of any kind. Nurturing a Company culture where theft is unacceptable lays the foundation for minimizing Employee theft.

TABLE 8: EMPLOYEE THEFT

Risk Management Techniques	
Avoidance	• Implement security measures. • Provide alternatives to stealing: Very often employee theft occurs when workers are in desperate financial straits. Problems, such as heavy medical expenses, loss of a spouse's income, or divorce can temporarily put people into situations where stealing seems the only way that they can obtain enough money for themselves or their families' survival. To avoid theft under these types of circumstances, have policies in place, that employees are aware of, that provide financial assistance during personal or family emergencies. The best defense against employee theft is honest employees but the second line of defense is good supervision that removes all easy opportunities for theft. • Another typical cause of employee theft is substance abuse or gambling Develop a method of screening employees for drugs and alcohol. • Provide support for employees who wish to enter addiction rehabilitation programs. • Set and communicate clear unambiguous policies. All companies should have policies on ethical behavior that is expected from employees. Company owners and managers must lead by example. If management is found taking cash under the table to avoid taxes, inflating expense accounts, or using company equipment for their personnel use, employees see this as a green light for them to do the same.
Live with	Accept the consequences
Sharing Risk	rchase insurance

Property Risk

Risk to property is one of the most common areas of risk that small businesses understand, since it involves risk to highly visible assets, such as equipment, buildings, vehicles, and inventory. Typically, property is at risk by:

- Fire;
- Natural disasters;
- Accidents;
- Theft.

As damage to property is often very visible and readily understood and quantified, there are many types of insurance coverage available to transfer some of the risk to another party. However, there are other strategies that a business owner can also employ to manage this risk.

TABLE 9: PROPERTY RISK

Risk Management Techniques	
Avoidance	Install security measures to reduce theft Train employees to use equipment properly and safely Construct buildings that are less combustible or are built with safety measures Insist practices that minimize the risk of fire
Live with	Small tools and equipment will break—less costly to purchase new ones than insure
Sharing Risk	Purchase insurance Ask employees to provide their own tools

Insurance

The most common method of managing negative risk outcomes for small businesses is purchasing insurance. Insurance is a means for a business to transfer some of the costs associated with a specific risk to another party—the insurance company, for a cost, the premium. It needs to be noted, however, that the higher risk your company is perceived to have, the higher your insurance fees. The following section provides details on the many types of insurance available to companies. The question that all companies face is how much insurance should be purchased, what kinds of insurance to purchase, and what should be covered?

How Does It Work?

To help individuals and businesses offset damages from risk, insurance providers have ways of determining what degrees of risk clients face. To do this, insurers rely on the basic principle of grouping together similar risks. By examining the risks faced by a variety of individuals and businesses, insurers can establish common risk profiles (patterns of characteristics). With this information, an insurer can determine what kind of insurance to offer someone applying for a policy and estimate the cost of insuring the client's risks. Many times, an insurance company will then reinsure itself by buying insurance as a way of managing *their* risk on the insurance it has sold.

Virtually all insurance companies are profit oriented, so when an act of God occurs (e.g., hurricanes that impact large urban populations, World Trade Centre 9/11) and payouts are large, premiums can rise across all insurance categories to compensate. Premiums for specific categories and geographic areas can change dramatically (as risk profiles change) and, in extreme cases, companies may refuse to sell certain types of insurance.

Fundamental Principles

The following are four fundamental principles for obtaining insurance:

1. The risk must be calculable
    - The total overall losses from all insured risks by the insurance company must be calculable by actuarial tables. This allows the insurance companies to determine the insurance rates that will be charged.
2. The risk must exist in relatively large numbers
    - The risk must occur in sufficient numbers and be geographically spread out such that the law of averages will work. For example, with hurricane insurance, the probability of all insured property in North America being hit by a hurricane is small and it is, thus, calculable.
3. The insured property must have commercial value
    - To obtain insurance, the asset in question must have value that can be measured in monetary terms.
4. The policyholder must have an insurable interest
    - The holder of the policy must have an ownership interest in the asset being insured.

Building a Sound Insurance Program

A sound insurance program must take into account the following factors.

- **Identify the business risks that you must insure**
    - There are some risk management techniques that all companies know they must have, such as worker's compensation (insurance) and vehicle liability insurance. Others, such as property insurance and general liability, are usually carried, but questions often arise on how much insurance should be purchased and what the deductibles should be.
    - The insurance coverage a company purchases will be the difference between security against unforeseen losses (including lawsuit defense and judgment) and responsibility for such losses out of the company's cash flow. If the possibility of risk of loss is much less than the dollar amounts of yearly premiums, then going without insurance may be the best option. The decision could also be made to accept a policy with a larger deductible amount. If, however, the dollar amount of the loss would be catastrophic to the business or severely hurt a business, then the premium cost is worth the peace of mind against sudden and accidental losses.

- **Limit coverage to losses that have a significant impact**
  - Due to the high cost of insurance, it is important to evaluate the impact that a loss will have on your company. Often companies will insure only those losses that will have a significant impact on the profits and survival of the company.
- **Compare insurance to the probability of loss**
  - Insurance is normally carried were the probability of occurrence is low but the impact is high. If the probability of occurrence is high or certain, then the cost of insurance will usually be so high that it is not affordable.

What to Look for in an Insurance Policy

All insurance claims turn on five principles that involve the people, property, peril, exclusions, and conditions related to the loss:

- Is the person involved in the loss or accident an insured person under the policy?
- Is the property being claimed listed on the policy declarations?
- Is the peril (cause of loss) a covered loss under the policy?
- Is the event causing the loss or accident excluded under the policy?
- Does the loss or accident meet the conditions set forth in the policy?
- Is it limited in any way by the conditions set forth in the policy?

Insurance Evaluation

The following list outlines the factors that should be considered prior to the purchase of an insurance policy or prior to renewing existing policies.

Identify Areas of Risk

- Employees (e.g., workers' compensation, EI/UC, both of which are mandatory, key employee insurance);
- Owned equipment (excavators, skid steers, computers, or office equipment) and rental equipment, if it is not covered in the rental agreement;
- Inventory;
- Buildings, land, or fixtures;
- Liability;
- Business interruption;
- Vehicles registered to the business;
- All vehicles under the owner's name;
- Vehicles owned by employees but used for business purposes.

Determine the Value of Each Area Above and Be Careful Not to Underestimate.

Decide what kind of coverage you need. What is it you would like to be protected from?

- Everything possible;
- Fire;
- Theft;

- Earthquake;
- Flood;
- Sewage backup in owned/rented buildings;
- Loss of income.

Determine whom you would like to be covered.

- All employees;
- Only full-time employees;
- Anyone.

Find a professional insurance agent who will shop around for the best prices on a package that fits your needs. CNLA and NALP have association policies that provide insurance needs for their members. It is worth contacting these association insurance providers to get quotes prior to purchasing or renewing your insurance.

Make sure your agent clearly explains all exclusions and conditions that exist in the policies of the insurance companies that are recommended. Determine if any of these exclusions or conditions will cause your business problems if you have a claim.

Types of Insurance Coverage

There is a multitude of insurance coverage available for purchase depending on your business needs and your insurance agent can tailor a package to fit your particular business. The most common forms of insurance businesses carry are:

- Property coverage;
- Liability;
- Business interruption.

For those operating home-based businesses, do not be lulled into a false sense of security by your homeowner's policy. Most homeowner policies rigidly limit, or flat out exclude, coverage for any business-related equipment. The usual limitation in homeowner policies is $2,500 for business equipment in your home and $250 for equipment that is not on the premises, if there is coverage at all. This includes personal computers, fax machines, laptops, inventory, and more.

Commercial Property Coverage

Commercial property insurance provides protection from losses due to damage or loss of property. Typically, property loss or damage is a result of fire, theft, vandalism, or natural disaster. Normally, business owners take coverage for the value of the assets that could be lost but may not think of carrying business interruption insurance. This type of insurance provides coverage for the loss of income and other expenses while a business, which is damaged by an insured risk is being rebuilt. For example, if your office was destroyed by fire and you were unable to operate for a period of time, business interruption insurance would cover the lost income during that period. *Personal injury protection* (PIP) and *medical payments* (MedPay) are part of property coverage (in the United States). These exist to cover medical expenses, regardless of who is deemed at fault. For business policies, MedPay is usually available to pay for medical expenses incurred due to an injury occurring on the premises of your business, regardless of fault.

Commercial Vehicle Policies

Auto/truck insurance policies normally include the following types of coverage. Be aware that each state and province has different laws with respect to mandatory insurance coverage and optional coverage, so make sure that you understand the requirements in your area.

Liability Insurance

This is probably the most important type of automobile insurance, and most state and provincial auto insurance laws require it. Liability insurance **protects you against the cost of damage and injury that you cause to another in an automobile accident**.

It is actually made up of two different policies—bodily injury liability and property damage liability. As you might guess, bodily injury insurance protects you from the cost of personal injury to others, and property damage insurance protects you from the cost of damage you cause to any physical property.

Auto liability insurance usually has what are called split limits of liability insurance. Under the following example auto liability insurance policy, your coverage would include:

- $1 million for bodily injury caused to another person;
- $2 million for bodily injuries caused to everyone;
- $250,000 for property damage.

Your state or province automobile insurance laws will require certain levels of auto liability insurance. Even though it may be tempting to save money by going with the minimum liability required in your area, it is always worth investing in additional protection, given the size of liability awards.

Medical Payments Insurance

This policy provides for the *immediate treatment of injuries* caused by an auto accident. You, your employees, and other passengers in your vehicle are covered, regardless of who is at fault for the accident. Depending on the specifics of the policy, medical payment coverage may also compensate for lost wages or services of a person injured in the car accident.

PIP, or personal injury protection, is similar to medical payments coverage, but usually provides broader coverage. Many PIP policies provide compensation for lost wages, funeral expenses, and pain and suffering.

Most states and provinces that require personal injury protection are “no fault” states/provinces, but Maryland, Delaware, and Oregon also require personal injury coverage. **Check with your insurance broker**.

Underinsured and Uninsured Motorist Insurance

Both of these types of insurance protect you against injury caused in an automobile accident where the at-fault driver’s liability car insurance coverage is inadequate. Though they are often lumped together, they are really two distinct policies.

- Uninsured motorist insurance is needed when the other driver has no liability coverage.
- Underinsured motorist coverage pays for the cost of your injuries that exceed the other driver's maximum liability coverage.

Most states and provinces do not require either type of coverage, but some require one or the other, and a few even require both. More often, one or the other type is required in no fault states.

Collision Insurance

Collision insurance coverage pays for damage caused to your vehicle in an automobile accident when you are "at fault" or in any accident in those jurisdictions that have "no-fault" insurance. A standard collision automobile insurance policy will pay for any repairs up to the fair market value of your car. It is important to remember that this value can be significantly lower than the cost of replacing your vehicle (or your loan balance). If your car is financed or leased, you will need gap insurance to reimburse you for the difference between what you owe and what the car is worth. This is sometimes called "new value" insurance.

Collision coverage usually also comes with an insurance deductible. The deductible is the amount of money you pay toward repairs before your collision insurance kicks in. The higher the deductible you are willing to pay, the less the collision policy will cost. Make sure you understand the possible future impact of the decisions you make in regard to deductible levels.

Collision insurance coverage is not required by law in any state or province. However, if you are driving a car financed through a lender or auto manufacturer, you may be required by the dealership or lender to carry collision insurance (just to be sure, you should get gap insurance).

Comprehensive Automobile Insurance

Comprehensive is very similar to collision insurance, the main difference being that comprehensive covers damage caused to your vehicle by any unknown party or an "act of God." Vandalism, flood, hurricane, theft, and fire are all events usually covered by comprehensive automobile insurance. Make sure to read your comprehensive insurance policy for exact coverage details.

Like collision automobile insurance, comprehensive coverage will pay up to the fair market value of your car (less your insurance deductible). Comprehensive coverage is not legally required by any state or province, although you will probably need it if your car is financed.

Automobile Insurance Endorsements

Automobile insurance endorsements are those policy extras like towing insurance, auto glass insurance, daily rental insurance, and emergency roadside insurance. These policies are never required by any state, but many drivers value the security and convenience they provide.

Here is what you get for your money:

- Auto towing insurance pays for towing your car anytime you need it.
- Auto glass insurance gives you a lower deductible (or no deductible) when it comes to repairing any broken window on your car.

- Daily rental insurance covers the cost of a rental car while your car is being repaired because of a covered incident. You will usually need both comprehensive and collision insurance to qualify.
- Emergency roadside assistance covers repairs done on the spot. Changing a flat on the roadside may be covered, but you will have to pay for any repairs at the garage. This policy is often combined with auto towing coverage, and called roadside emergency towing insurance.

Commercial Liability Insurance

Commercial liability can be separated into two categories: general liability and unemployment compensation.

General Liability Insurance

It is not mandatory to carry general liability insurance in most jurisdictions, but it is very advisable to have significant liability coverage in today's litigious climate. The size of claims on issues like slips and falls can easily bankrupt a small business if it does not carry liability insurance.

This type of insurance provides protection to the company for customers or the public injured on the company's premises and work sites or injured by products sold to customers. It covers claims that are a result of the actions for which your business is legally liable. This includes people acting on your behalf, paid or volunteer (under the doctrine of respondent superior). Under this doctrine, businesses can be held vicariously liable for its employee's misdeeds if the employee is operating within the scope of his or her duties. If the owner or an employee is at fault, you are expected to reimburse the cost of damages to the injured person for his or her injuries or loss of property.

The following is an example of how commercial liability insurance works:

You own a landscape maintenance company. One of your employees, who was watering a planting bed, left for lunch, forgetting to turn off the hose, and water covers the sidewalk. A neighbor, Mrs. Jones, is walking her dog and slips and falls, breaking her arm and her tailbone. The neighbor across the street (Mr. Smith) witnesses all of this, including the employee leaving the hose on and driving off to lunch. Mrs. Jones receives extensive surgery to the arm and has to be away from work for six months.
You receive a letter from a top litigation office in the city stating that Mrs. Jones wants your company to pay $20,000 in medical bills, $40,000 in lost wages, and $250,000 in pain and suffering. If you have liability insurance, your insurance company should already be handling the demands of the attorney, and if a suit is filed, the insurance company will handle your legal defense. If you do not, this is going to be an expensive experience.

There are many situations where your business could become liable for damage claims due to your actions or those working on your behalf. If you have liability insurance, the insurance company deals with the situation, takes the problem off your hands, and pays the damages (up to the limits of your policy). In addition, if you are served with a lawsuit, the insurance company absorbs all defense costs.

Liability insurance takes care of claims, up to the limit on your policy, for injury and damage to property caused by you or your employees to other people not associated with your company.

Employment Insurance/Unemployment Compensation

Although law mandates both programs, unemployment insurance (called Employment Insurance or EI) in Canada is regulated at the federal level. In the United States unemployment compensation is based on a dual program of federal and state statutes. In the United States, even if you are not required by law to take part in the program, there are instances where you can voluntarily contribute to cover your employees. The programs in both countries have rules that can change frequently.

Basically, each program is designed to provide a safety net for individuals who become unemployed through no fault of their own after having worked for at least a specified minimum period of time. Benefits are paid, for a limited time, to individuals who are able and available for suitable work but who continue to be unemployed while looking for another job. In Canada both the employer and employee contribute to the plan. There are many aspects with which you will need to be familiar, such as:

- Reporting part-time work;
- Minimum work hours for an employee to qualify;
- Maximum wages covered;
- Reporting layoffs and dismissals.

For information regarding these issues, you can start with the following websites and then, in the United States, you can go to state websites. Consulting with your legal resources will ensure that you handle this subject in a professional manner while, at the same time, understanding and protecting your rights as an employer.

In Canada, go to: https://www.canada.ca/en/services/benefits/ei.html

For an overview of policies in the United States, visit:

www.law.cornell.edu/topics/unemployment_compensation.html

Workers' Compensation

As with EI/UIC, workers' compensation is mandated by law and managed by the government, normally at the state/provincial level. Employers are obliged to pay mandated premiums that guarantee coverage of all employees and remove the right of the employees to sue employers for injuries suffered on the job. However, if an employer is negligent and has ignored safe work practices, employees can still sue that company.

In the United States, premiums paid by companies into workers' compensation insurance plans are based on the annual payroll, the claim rate of the industry sector (called the rate), and an "experience modification factor" (EMF). Thus the formula used is:

$$Assessment = \left(\left(\frac{Annual\ Payroll}{100}\right) \times Rate\right) \times Experience\ Modification\ Factor$$

The rate, sometimes called the "base rate," is evaluated on an annual basis by reviewing the total claims for the rate group and the total assessable payroll. On the basis of this assessment, the base rate is adjusted up or down for the forthcoming year. Base rates for industry sectors can range from $0.25 per $100 payroll to more than $10 per $100 payroll.

The EMF allows for adjustment of each employer's assessment on the basis of their claim cost experience. Depending on the jurisdiction and the sector, the experience adjustment can add or subtract up to 50 percent of the base rate! A lower claim cost experience lowers your premium costs and provides a financial incentive to proactively manage the safety of your employees.

An example of the way workers' compensation is calculated is shown below:

- Joe's Landscape Company has an assessable payroll of $200,000.
- The base rate for landscape construction is $3.50 per $100 of payroll.
- As Joe's company has had a good safety record over the last five years, the experience modification factor (EMF) is 75% (or a 25% reduction).

Therefore, Joe pays $5,250.

$$Joe's\ Assessment = ((\frac{\$200,000}{100})\times 3.5)\times 0.75$$

If Fred's Landscaping had the same assessable payroll but a 25 percent surcharge (therefore paying 125%) due to a poor EMF, then it would be paying $8,750.

$$Fred's\ Assessment = ((\frac{\$200,000}{100})\times 3.5)\times 1.25$$

Using the simple example above, we see that benefits of operating in a risk-mitigating manner by having a better EMF. The underlying goals of EMF adjustment ratings are to:

- Create long-term financial incentives for employers to invest in safety;
- Encourage appropriate return to work for injured workers;
- Enhance the equity among employers in the same rate group.

Protecting Yourself When You Deal with Your Insurance Company

Insurance companies go out of their way to advertise how fast, neighborly, generous, kind, understanding, patient, and friendly they are—especially when they are trying to sell you one of their policies. This approach continues to be true for as long as you make your insurance premium payments on time, without asking for anything in return. However, policyholders forced to present a large claim often learn there are limits to their insurer's congeniality.

Here are some survival tips that you may find useful when dealing with your insurer about an insurance policy.

Before You Buy

Always take careful notes when you buy an insurance policy. Write down what you are told by the insurance agent concerning the coverage you are buying. Save your notes in a file with your policy. Also, save any promotional material you are given or shown when you buy the policy. Insist on reading the completed application form yourself instead of allowing the agent to read it to you.

Be certain that your answers to application questions are truthful, thorough, and complete. If they are not, it will come back to haunt you. The insurance company can rescind your policy entirely after you make a large claim if they find some basis for asserting that you misrepresented a significant fact on the application.

Before you buy the policy, insist on seeing it. Make sure that you really understand the key points, things like deductibles, exclusions, and limitations. Once you have signed the policy, you are bound by its contents.

When You Have a Claim

Now is the time to get out all those papers you saved so carefully. Review your policy and notes before you speak with a company representative**. If you are not prepared, you might say something that the company could twist into a basis for denying the claim.** That is a possibility because the coverage, exclusion, and limitation provisions contained in all insurance policies are so complex, but a few legal rules are on your side when it comes to deciphering a policy. If a dispute over what should be covered goes to court, the coverage provisions will be construed broadly, although the limitations and exclusions will be interpreted narrowly. Since the company wrote the policy, any ambiguities in it will be interpreted in your favor and against the company. The goal is to honor your reasonable expectations.

A policyholder should **never**:

- Exaggerate any aspect of a claim.
- Accept the insurance company's expert's evaluations of their losses without getting their own expert's estimates. The two can vary widely.
- Submit to an "examination under oath" by the insurance company without first obtaining legal advice.
- Sign an insurance company release or check unless they certain that the amount they are receiving is full and correct.

Start gathering materials to help you prove your claim.

Photograph your loss and keep records of it. For example, if you are making a damage claim that is based on fire and smoke damage to your business or residence, you should photograph the fire-damaged areas and items before they are discarded.

It is also good to start a log concerning your claim. Write down the date, time, and a summary of every telephone or written communication with insurance company representatives. Note the name, title, and direct telephone number of every person with whom you have contact. This is important because insurance companies often switch adjusters on claims, sometimes more than once. You will need evidence of what was said or done when, and by whom, throughout the handling of the claim. Among other things, it can make it more difficult for the insurer to blame any delay on you when complete and accurate records are kept.

Remember, the main factor that will set your future insurance premiums is how you manage and settle any claims you might have.

Security Measures for Managing Risk

With careful thought and analysis, most business owners and managers can identify most of their company's security weaknesses. The first steps are to determine exactly what requires protection in your:

- Office;
- Holding yard;
- Job sites (example: equipment left on job sites).

Use common sense. For instance, do not spend a lot of money on alarms and access control for a soil storage area that would have a low probability of major theft. For areas such as this, good gates with sturdy locks should be sufficient.

Step back and look realistically at the area where your office or yard is located and realistically assess your personnel. Do not go overboard by surrounding your building with security dogs or, conversely, take unnecessary risks with valuable resources by depending only on trust for security. Evaluate how well your existing security arrangements address the highest probability threats. Be sure to go over every detail, from the types of locks you install and your system of key distribution to employee identification and after-hours use of the facility. Even simple things, like adding lighting, can be extremely effective.

Avoiding Fraud

The payment landscape is rapidly changing; 10 years ago, checks made up nearly 60% of all transactions. By 2016, they made up less than 7% of transactions. However, most of the cash purchases were under $50, and once purchases were above $100, consumers switched to other methods (notably debit or credit cards, and now a movement towards payment apps like Apple Pay, Android Pay, or PayPal Mobile). Nonetheless, for many companies in the residential green industry, checks remain the most common form of payment for services. Various banking associations estimate that about 500 million checks are forged annually, contributing to losses totaling more than $20 billion. With online payment technology becoming safer, less expensive, and more widespread, moving to an online payment system is an obvious choice; this is discussed further in the "Marketing and Sales Management" module.

The Uniform Commercial Code has shifted the responsibility of check protection from banks to the party in the best position to initially prevent the fraud. The responsibility for detecting fraudulent checks lies with the business owner; do not expect the bank to compensate you for fraudulent checks.

In general, residential landscape contractors deal with homeowners directly, and the likelihood that a check is fraudulent is relatively small. However, if you are operating a supply yard to the general public, this risk increases significantly. It is safer to accept credit cards and debit cards from the general public, since the credit card company or the bank has the responsibility to pay if the card numbers have been verified. A more common problem in the landscape industry, especially in Canada, is the issuance of personal checks with insufficient funds in the bank. If you think this may be a problem with a customer, or the customer has a history of this behavior, insist on cash, credit card, certified check, or set up online payment.

Hiring Security Consultants

If you are uncertain about the vulnerable points in your business and how best to protect them, consider calling in a security professional to conduct a comprehensive evaluation of your physical sites and daily operations. Proper analysis will require the consultant to observe typical personnel activity and to thoroughly examine the various access points to buildings and storage yards. Ensure that the consultant provides a complete report of the evaluations and recommendations in addition to explaining them to you in a face-to-face consultation.

Before hiring consultants, ask if they have products to sell or if they are just selling professional advice. If they have products to sell, be careful that their advice is not being given specifically to sell their products.

Use of Bonds for Risk Management

Financial instruments referred to as surety bonds are often used on large contracts to reduce the owner's risk. Landscape contractors will typically have to deal with bonds if they are bidding public or large private projects. If you have high-value subcontractors working on your projects, you may want to consider having them provide you with performance bonds and materials bonds.

Basically, a bond guarantees the fulfillment of a legal obligation. In the landscape industry, this is typically the landscape contractor's obligation to perform the work and supply the materials that they have bid on and has been contracted to carry out. The bond is a three-party agreement; the third party (surety company) guarantees to a second party (owner of the project or government body) the successful performance of the first party (principal; i.e., landscape contractor). The bond at its most basic level is an extension of credit by the surety company on behalf of the contractor. The surety company assumes that the legal obligation (landscape contract) will be fulfilled. The bond premium paid to the surety company covers the underwriting exposure of the surety company.

The types of bonds that landscape companies will deal with are normally classified as "contract bonds." These include bid bonds, performance bonds, and labor and material bonds.

Bid Bonds

On larger private and public jobs, a landscape contractor will often be required to provide a bid bond with the quotation for the job. When supplying a bid bond, it is assumed that the owner's acceptance of the landscape contractor's bid forms the contract, with both parties obliged to execute under the terms of the bid documents. The bond guarantees that the contractor bidding for a contract will, if the bid is accepted, enter into a contract and furnish all bonds required to complete the project, including performance, payment, and maintenance bonds. If the landscape contractor, then, refuses to sign the contract on the basis of their bid, the owner may cash the bid bond (usually 10 percent of the bid price) and offer the contract to another contractor. In such a case, the surety (bonding company) will be liable to pay the amount of the bid bond.

Bid bonds are used to protect the owner from low bidders that have no intention of meeting the obligations of the bid document. It helps to give all bidders an equal playing field, since all bidders have been forced to provide a financial obligation to guarantee their bid price.

Performance Bonds

Performance bonds guarantee that the work will be completed according to the contract terms and conditions. The performance bond requires that the surety company be liable for the performance obligations of the landscape contractor if the contractor does not perform the contract. If the landscape contractor refuses or cannot complete the contract (often due to bankruptcy situations), the bonding company is obliged to pay for the completion of the work. This completion is generally achieved by finding a contractor who will complete the work for the bid amount, or if it is in excess of the bid amount, the bonding company must pay the difference up to the face value of the bond.

Typically, performance bonds are 50 percent of the contract price, since losses would normally not be in excess of this amount. The cost of a bond to the contractor is based on the surety's assessment of the contractor's loss experience, assets, and finances. Bond terms are usually 12 months.

Labor and Material Bonds

Labor and material bonds guarantee that all suppliers of labor or materials for the project are promptly paid and that no liens will be filed against the owner. In the event that the contractor cannot pay, the surety (bonding) company is liable to pay unpaid workers, material suppliers, and subcontractors who have provided labor and materials. The contractor is not off the hook, though; the surety company will want to recover the money it has paid out. This usually means that they will initiate legal action to recover it.

Usually labor and material bonds are valued at 50 to 100 percent of the total contract value.

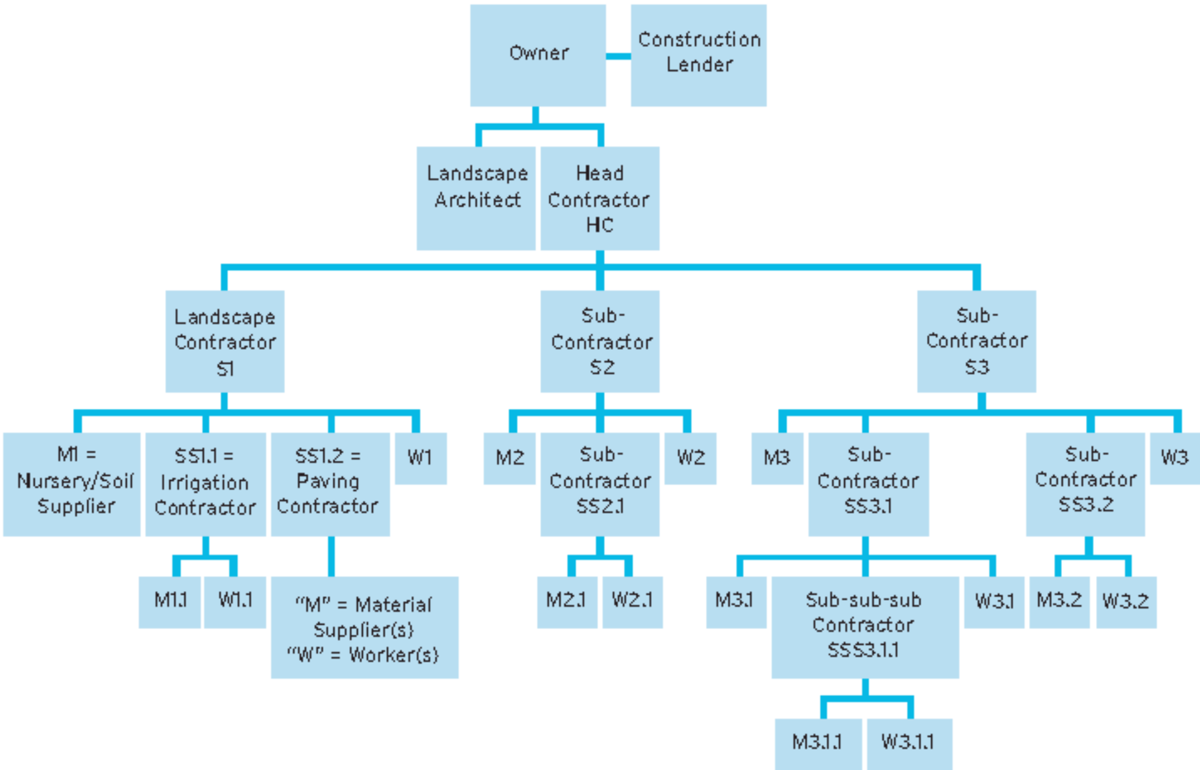
Using of Liens in Risk Management

Lien Acts vary between provinces and states and are referred to as "builder's liens" or "mechanic's liens." It is vital that you understand the provisions of the act and how it applies to your business on the basis of your own state or province requirements. The process of actually filing a claim for lien is subject to a rigid timeline, so you should have a clear understanding of the requirements in your legal jurisdiction. For example, if the claim must be filed within 45 days of completion, and you have given the client 30 days to pay, there will only be a small window of opportunity for action.

Overall, *Lien Acts* are relatively straightforward. Liens provide a form of security for the payment of money owed to persons such as contractors, subcontractors, workers, and material suppliers who add value to a building that is under construction. In providing this security, *Lien Acts* are generally sensitive to the need to accommodate the legitimate interests of the owner/developer, the construction lender, and other participants in the project.

Lien Acts generally aim to encourage the prompt payment of creditors throughout the project and ensure that money intended to finance the construction is, in fact, used for that purpose. All *Lien Acts* refer to "holdbacks" that are retained by the owner under "single holdback" schemes or that are retained through the pyramid of relationships (see Figure 2) in "multi-holdback" systems.

FIGURE 3: RELATIONSHIPS WITHIN A CONSTRUCTION PYRAMID



An important feature of all liens is the ability to remove lien claims from the owner's title through a payment into court. The amount that an owner, contractor, or subcontractor must pay into court is determined with reference to the "limited liability principle." In most cases, a person can clear liens from the title by paying an amount equal to the holdback retained from the contractor or subcontractor under whom the liens arise. Make sure that this is, in fact, the case in your jurisdiction, since there are variants on how Lien Acts are written and enforced.

Dealing with Bankruptcy

Bankruptcy law in the United States and Canada is set up in a manner that provides for the development of a plan that allows a debtor who is unable to pay his creditors to resolve his/her debts through the division of his assets among his creditors. This supervised division also allows the interests of all creditors to be treated with some measure of equality.

If you are creditor and are trying to obtain funds from a bankrupt firm, you must file a valid claim with the trustee. If the claim is accepted, you may share in the distribution of assets, providing there is enough money to pay claims ranked before yours. This is usually the major problem in obtaining funds from a bankrupt company. If you are an unsecured creditor, your claim will fall after all secured creditors, which typically include any taxes due, payment of loans to banks, secured vehicle loans, and so forth. If you have the personal guarantee of the owner of the bankrupt company, then you will have legal recourse against the owner's assets.

The best way to deal with the risk of your debtors going bankrupt is to have good credit policies and ensure that they are followed! The following section provides some details on bankruptcy to give you a basic understanding of the process.

A company can be placed into bankruptcy by:

- A creditor petitioning the company into bankruptcy through the courts;
- The directors assigning the company into bankruptcy;
- The defeat of a proposal to the creditors at the first meeting of creditors;
- A proposal by the trustee on creditor instructions being annulled for noncompliance.

Some reasons for placing a company into bankruptcy are as follows:

- A landlord distrains and seizes the company's assets, causing the company to pay the rent arrears or settle with the landlord. The landlord may sell the assets five days after the seizure. An assignment into bankruptcy or a notice of intention to file a proposal within the five-day period causes a stay of proceedings, which stops the rent distrain.
- The company is no longer viable and has free assets (no security) that are available for the creditors.
- The company would not be viable even if a proposal to the creditors were filed.
- The priority of statutory creditors needs to be rearranged.
- The company must be brought to an end and supply a full accounting to the creditors, so they do not suspect the principals of any wrongdoing.

In a corporate bankruptcy, the trustee takes possession of all the company's assets and deals with all of the creditors. The directors cooperate with the trustee and might assist him in his duties but are relieved of all the pressures and frustrations of operating the company and dealing with customers and creditors.

In the United States, bankruptcy in a business requires filing for bankruptcy under "Chapter 11." Individual consumers do not commonly use Chapter 11, since it is far more complex and expensive to pursue. It allows businesses to reorganize themselves, giving them an opportunity to restructure debt and get out from under certain burdensome leases and contracts. Typically, a business is allowed to continue to operate while it is in Chapter 11, although it does so under the supervision of the Bankruptcy Court and its appointees.

One of the issues small businesses always deal with if they are creditors trying to obtain funds during a bankruptcy is the security of their debt. Section 506 of the U.S. Code Collections defines secured creditor status.

Contingency Planning

A risk management plan for your business details the probability and potential cost to the business in the event that something negative or unplanned impacts your business. As part of this overall plan, contingency planning identifies alternative courses of action that might be taken in the event of a problem. An example of a simple contingency plan would be providing the instructions to employees on the correct procedures to follow in the event of a minor injury that occurs on the job. A complex contingency plan might involve the procedures following a major disaster, such as a tornado or the death of a key manager/owner.

Contingency plans proactively attempt to detail what might happen and what each person's responsibilities in certain circumstances. By working through this process, the emergency plan will be developed under less stressful conditions and can be implemented much more quickly.

Contingency planning can also be thought of as doing your best to determine what foreseeable harm may be caused in the case of an unexpected event, such as a petroleum spill, chemical spill, pesticide spill, or fire, and then making plans to deal with that unexpected event. Think of contingency planning simply as another method of reducing your risk. You buy insurance to protect your company in case of an emergency such as theft, fire, or an accident. Having a contingency plan will help minimize the impact in case of an environmental problem or another type of emergency.

The simplest and easiest part of a contingency plan is making sure you have all the phone numbers needed in an emergency. There should be a common person as the first point of contact, and they should know the order in which to contact other members of the company. Even though you have a list, review it regularly and see if anyone is missing or if numbers have changed. Post it and let all your employees and family know where it is. Though we often think of contingency planning in terms of environmental emergencies, such as pesticide spills, companies should also have a detailed contingency of what to do in case of major or catastrophic events. This includes everything from natural disasters to theft and vandalism.

Creditor-proof Your Company

One of the best contingency plans is setting up your company properly at the onset. In today's world where litigation is common, take the following steps to creditor-proof your business:

- Get professional advice before the business commences. This is the time to put a creditor-proofing plan in place.
- Incorporation not only has income tax benefits, but it also provides for a level of creditor protection. Consider incorporating, if the size of the business warrants or the nature of the business is litigious.
- Only one spouse should be a director or officer. The other can still be a shareholder or employee but should not be a director or officer. This should minimize the risk of joint and several director's liability for certain statutory debts.
- Always pay statutory debt on time (i.e., source deductions, GST, wages, and PST). Directors and officers can be personally responsible for these debts.
- Do not have significant assets in your personal name. If possible, consider having assets in a spouse's name or a family trust. One should be cautious of the Family Relations Act when placing assets in the name of a spouse.
- Do not give a personal guarantee to suppliers or a landlord unless it is absolutely necessary. Do not give your spouse's guarantee to a lender. Simply state "a personal guarantee is not available."

- Have only the corporation borrow funds from the bank. Do not let the bank lend the funds to a client personally, with the client then lending the funds to the company. This will ensure the bank is the first person paid in the event of a liquidation of a business. This will continue to apply even if personal security is required for the loan.
- If a family member or a principal of a company lends money to a company, have that person take back security. Ensure proper documents are prepared and register the security. If the loan is not documented and registered, a trustee may be able to recover any preferential payments made to the family member or principal (payments within a year of the bankruptcy could be considered fraudulent preferences under the Bankruptcy and Insolvency Act).
- Be cautious of rapid business expansion. Recognize the risks of expansion as well as the opportunities. Many businesses fail because they underbid a job, expanded too quickly, or did not have the resources to finish a project.
- Plan for succession well in advance. Too many businesses ignore this aspect of planning or at best give it lip service. A successful business requires development of succession skills and employees who are informed as to how the company is going to evolve.
- If the business incurs financial difficulty, seek professional advice early. Many businesses wait too long; early advice may have saved them. Proposals to creditors made under the Bankruptcy and Insolvency Act are very effective and usually accepted.
- Know when to quit. If a business is in financial difficulty, decide on the amount of personal funds that will be expended to attempt to save it.
- On a personal level, invest in retirement savings plans that are "judgment proof." If the worst happens, you will still have retirement funds.

10 outlines the things you should think about when assessing the degree of risk you and your company are willing to take.

TABLE 10: RISK MANAGEMENT CHECKLIST

Risk Management Checklist
1. What is my risk tolerance? Explain that to the professionals who assist you in risk management strategies.
2. What are the risks that will keep me from reaching my goals and which risks are most likely and most damaging?
3. What are the trends in my business?
4. What is the level of my financial risk?
5. What can I do to reduce my lender's risk exposure?
6. Do I have the right insurance coverage for the risks that I want to share?
7. Do I need to perform an environmental audit?
8. Do I have a succession plan, including a will, and do the key people in my company know where it is located?
9. Does my risk management plan provide adequate cash flow during any disruptions?

Chapter 2

Contract Law

Common Law

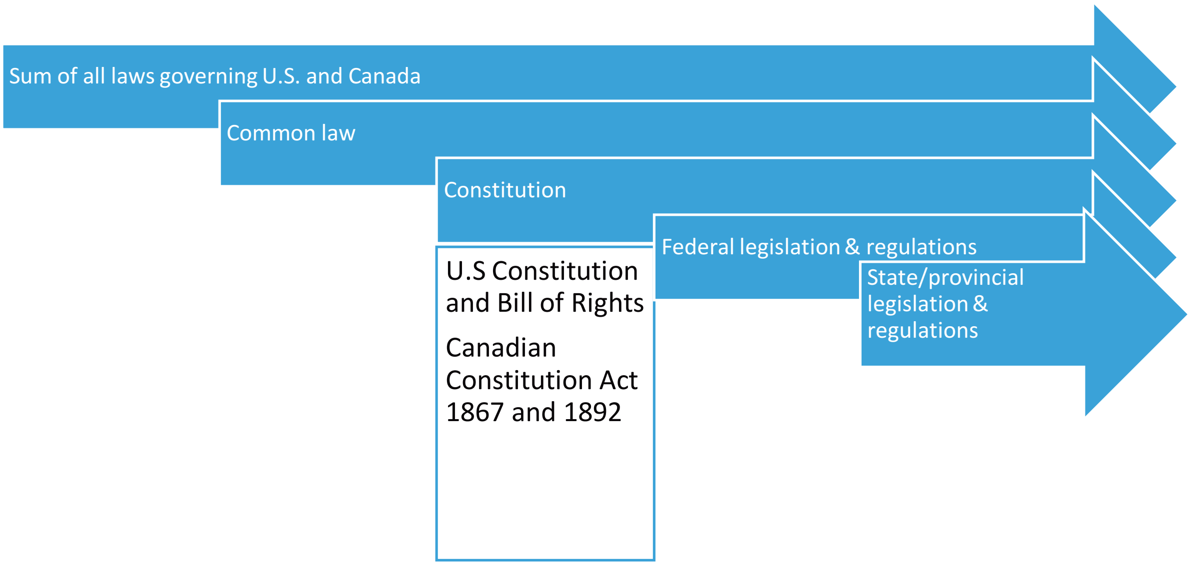
Common law is the system shared by the United States, Canada, Australia, New Zealand, Great Britain (not Scotland), and other countries that were at one time colonized by the English. The UCC (Uniform Commercial Code) used in the United States has codified much of American contract law, but it is based on fundamental common law principles of contract.

Contract law in the U.S. and Canada flows from either common law or statute law. Both countries have legal systems that are based on English common law, supplemented by statute law that flows from their constitutions (see Figure 3). Be aware that if you are doing business in or with companies from Quebec or Louisiana that the jurisdictions use Napoleonic or Civil code; if you are conducting business in or with companies from these jurisdictions, talk with your lawyer, as there are substantial differences from common law. Contracts are the foundation on which business is conducted, and properly drafted contracts will help you avoid unnecessary and costly disputes.

The following section gives the basic principles than an owner or manager should understand with respect to contract law. **If there are any doubts about entering into contracts, writing contracts, or negotiating contracts, seek appropriate legal advice!**

The three most important portions of common law to understand as it relates to contracts are, common law of contracts; common law of liability without negligence or fault; and the common law of negligence.

FIGURE 4: SIMPLIFIED BREAKDOWN OF LAWS IN U.S. AND CANADA



Common Law of Contract

Simply put, the common law of contract means a person or company is liable for the loss caused to another for failing to fulfill the obligations of a contract.

Common Law Liability without Negligence or Fault

This refers to cases in which someone may be found liable for harm even without direct fault or negligence. The most common example is employers being found liable for the action of their employees.

Common Law of Negligence

This is the most common application of negligence. You are liable for harm caused to another, whom you have the duty not to harm. For example, if you are operating a skid-steer loader and you hit a parked car, you are negligent and will be liable for the damage to the car.

Statute Law

In both Canada and the United States, statute law is made by the federal, state/provincial, and local governments. Under the U.S. Constitution, the federal government makes regulations (laws). It also divests authority to the states to make regulations, and the states pass authority to local cities and towns to make further regulations. In Canada, the same flow of lawmaking takes place, with authority flowing from federal-to-provincial and, finally, city and municipal lawmakers by way of the Constitution Acts of 1867 and 1982.

For a business owner, these statutes and regulations set out the parameters that a business must operate within. They set the boundaries and control what business must do to carry out their operations legally within Canada or the United States.

What is a Contract?

A contract exists when two or more parties agree to *exchange* either property (including money) or promises of future performance. Contracts can be verbal or written. Contracts can be part of an invoice or a purchase order, or they can be drafted as separate documents.

Contracts do not have to be in writing; they can be verbal. However, verbal contracts are risky because the parties' memories or understanding of the deal may differ. Also, if a contract is verbal, it may be unenforceable due to a law known as the Statute of Frauds (Canada and the US). This statute outlines that verbal contracts which cannot be performed within a specified time period (such as one year) or which involve more than a specified amount of money (such as $500) are not enforceable. An exception to the statute may arise if one or more parties have partially performed their responsibilities under the contract. However, even if the exception applies, proving that your understanding of a verbal contract is correct may be difficult. Regardless whether a contract is written or verbal, to be an enforceable contract, it must meet each of the contractual principles outlined below.

General Contractual Principles

The principles reviewed below are based on common law. Each of these principles must be met for a contract to be legally binding. These principles are: offer and acceptance; consensus; consideration; capacity; legality; intention; and the reasonable person test.

The Principle of "Offer" and "Acceptance"

Ideally, the offer contains all the important factors that will be contained in the contract, and the offer must be accepted without any change by the person to whom the offer is made. This is what is known as the "mirror image" rule. If the acceptance does not "match" the original offer, it is a counteroffer, and no contract is formed until the other party indicates acceptance of the revised proposition. This situation can arise when parties (say, a buyer and seller) each use their own standard form contract, the seller offering to sell on his/her form and the buyer "accepting" on his/her own standard form. This is described as the "battle of the forms," and there may be no enforceable contract as a result, because the parties have failed to meet the mirror-image rule.

Another common difficulty is identifying an offer. It is quite common in business for a quotation to be made, either in a catalog or in an advertisement. Generally speaking, this is not considered an offer, but it is simply an *invitation* to do business. In this instance, it is the buyer who must make an offer on the basis of the information contained in the advertisement or quotation. The best test in this situation is to examine, if possible, the intention of the person making the quotation or placing the advertisement. There should be evidence of a clear intention that the "quotation" was an offer.

Some things to remember:

An offer may be revoked at any time *before* it is accepted, unless a specific commitment has been made to keep the offer open for a specified period of time.

- Revocation must *always* be communicated to be effective. The common law provides that an offer can be revoked at any time before acceptance, even when the person making the offer has stated that it will remain open for a specified period of time.

- An offer should normally contain all the essential terms of the contract.
- Essential terms generally mean "who" will do "what" by "when" (as they refer to both parties). If additional clarity is required, then exclusions should be inserted as well. There may be situations where the parties have left out important terms of a contract. The more important the term is that is missing, the less likely it is that the parties have an enforceable contract. If the parties have considered another agreed-on method to provide for the missing term, the contract may well be effective. This is quite common where price is missing and there is an established mechanism for determining the going price of a commodity or item on a specific date.

Consensus

Parties involved in a contract need to reach a mutual agreement that they are committed to the transaction. It is assumed they are both in equal bargaining positions and free to do as they choose. At this point, the conditions of offer and acceptance, as discussed above, have been met.

Consideration

Consideration is the price that each party is willing to pay to enter or participate in the contract. It is not necessary that the consideration be fair to both parties. Contract law assumes that both parties are free to bargain. Courts will assist in the enforcement of the contract, but they will not release either party just because one of the parties thinks it is a bad deal.

Contractual Capacity

The parties to the contract must be legally capable of understanding and entering into the contract. For example, contracts are void if entered into with children and infants, those with mental impairments, or intoxicated persons or individuals not authorized to sign on behalf of the company

Mental impairments apply if a person, by way of their mental incapacity, did not understand what they were doing and the other party knew, or ought to have known, of the incapacity.

Persons who lose their ability to properly reason due to intoxication by drugs or alcohol are treated much the same as the insane. For defense of intoxication, it must be shown that the person was so intoxicated they did not have the capacity to understand the nature of the transaction. The other party must be shown that he or she knew, or should have known, of the incapacity of the first party. The person contesting the contract on the basis of intoxication must also show that they immediately tried to repudiate (cancel) the contract upon attaining sobriety.

Legality

The actions within the contract must be legal in the jurisdiction where the contract is taking place. Contracts to commit illegal acts are not only void, but also illegal. An example would be entering into a contract to spray a prohibited chemical with a city moving to make pesticides illegal. In such a case, the courts would find the contract void, but they would not restore either party to its original position if both parties were aware of the illegal nature of the contract.

Intention

Both parties must be serious when striking the bargain and intend that legally enforceable obligations will result. In the instance of commercial relations, the courts will presume that both parties intended to be legally bound by their agreement. Difficulties with respect to intention can arise with respect to exaggerated claims. For example, a landscape company claims that the new variety of grass it is seeding will not require any mowing, since it is a dwarf variety. The homeowner finds that they must still mow the lawn weekly. In some cases, the courts expect some "enthusiasm" from vendors; the question is always where to draw the line. The courts in such a case will apply the "reasonable person" test to determine if the customer should have taken the exaggerated claim seriously.

Reasonable Person Test

The reasonable person test is used by the courts to establish a standard of socially acceptable behavior. When faced with the problem mentioned above, in exaggerated claims, the court will ask, "What would a reasonably prudent person, in possession of all the facts of the case, have done in this situation?" A reasonably prudent person is expected to be particularly careful; a level of behavior considerably better than the average.

Performance of Contracts

If one party to the contract fails to live up to its obligations, the other party is usually entitled to damages for breach of contract. On rare occasions, a court will order the defaulting party to honor the contract by performing it. This is known as *specific performance* and is rare in the common law system. In unusual cases where the performance of a contract becomes impossible for the performing party due to no fault on its part, the contract is said to be "frustrated," and there is no liability on the part of the party that fails to perform. Most commercial project managers will try to avoid finding themselves in this situation by insisting that the contractor place a performance bond.

Key Contract Provisions

Even if your contract is in writing, you should make sure that it includes all the necessary provisions. Typically, contracts have the following:

Names: Your contract should correctly state the full name and address of each party. For example, if you or your customer has an incorporated business, the contract should state the entire names and addresses of the corporations.

Obligations: Make sure that your contract fully and completely states all the obligations of each party, including all deadlines for delivery and payment. If you are making several deliveries, consider requesting progress payments and specifying time periods for approval of each partial delivery. If your contract refers to other writings, copies of those writings should, whenever possible, be attached to the contract.

Personal Guarantee: You may deal with people who have incorporated their businesses and, in these instances, only their corporations may be responsible to perform under the contract. If you also want them to be personally responsible, you should indicate that fact in the contract, and they should sign it in both their personal and corporate capacities. This is often difficult, since one of the reasons to have a corporation is to limit personal liability.

Excuses for Performance: Many contracts also have a provision known as a *force majeure* clause. This excuses performance due to events beyond someone's control, such as strikes, natural disasters, and so on. For example, if you were unable to complete a job due to a lack of information from your client, your contract should excuse your delay for that reason. A situation that often arises is one where unforeseen underground impediments (e.g., large boulders) cause delays. You might consider adding a provision that allows you to terminate the contract if conditions that excuse performance persist for longer than a specified time.

Damages for Unexcused Failure to Perform: What happens if either party's failure to perform is unexcused? Your contract should specify the types of damages that will accrue, so that each side will know them in advance. For example, damages for nonperformance can include the cost of goods purchased or delivered and lost profits. The exact amount of damages (liquidated damages) can be specified in the contract to avoid the costs of proving actual loss later on. In deals involving unique property for which there are no reasonable substitutes, such as real estate or rare objects, the contract can require the other party to deliver that specific property (this is called specific performance). Also, your contract must expressly provide for interest and attorneys' fees if you want to recover those items.

Choice of Law and Jurisdiction in Multi-State Deal: Many business owners have transactions with someone who is not physically located in their state or province or who does not transact significant amounts of business with others in the geographic area. This is becoming more common with the growth of Internet commerce. In those circumstances, your contract should specify which state's or province's laws will govern the deal and the location at which the parties must appear to resolve disputes. Otherwise, you may be forced to litigate a dispute in a distant forum under unfamiliar laws.

Arbitration: Arbitration can be an expeditious and inexpensive way to resolve disputes. Unlike in court, arbitration does not necessarily require the assistance of a lawyer, and the procedural rules are relatively simple. If you have a complicated deal, arbitration may not be a good alternative, because the process may be too streamlined. If arbitration is a possible conflict resolution tool that you may want to consider, you should state that in your contract.

Battle of the Forms: Often business owners exchange purchase orders and invoices that contain conflicting terms. Without a prior agreement, resolving these conflicts can be extremely costly. Generally, the courts will compare all the forms. They will ignore all conflicting terms and will apply the terms that do not conflict. This can result in a very different outcome from the one you intended. So, you or your attorney should promptly read all the fine print in the contracts, invoices, and purchase orders you receive from your customers and vendors. It is a good idea to exchange forms before either side performs. Whenever the forms contain provisions that you do not like or that conflict with your own forms, you should resolve the conflicts with the other side as soon as possible. This should help everyone avoid the expense and adverse results that can otherwise arise.

Work for Hire: If you hire an independent contractor to create any work that is subject to copyright laws, generally the contractor will own the work and you will merely have the right to use it. To change this result, you should have a written contract with your contractor that contains provisions regarding the ownership and future use of the work.

Conclusion

Written contracts can save you time and money. You should consult an attorney to make sure that your contract is properly drafted and contains the necessary provisions. You should carefully read the forms that you receive from your customers and vendors. Whenever they contain provisions you don't fully understand you should consult with your attorney or with the other party before you sign any document.

Hiring a Lawyer

Legal advice is used to prevent problems; to provide advice on contracts, business structure, and incorporation; or to solve problems if you are being sued or have been accused of committing a crime. Using a lawyer from the start on critical business decisions, such as a shareholder agreement or contracts, can save much agony and many problems later on.

To find a lawyer, consult your provincial or state bar association. If you know other businesses in the area that have used lawyers, ask them for their opinion and references on law practices they have used.

Many states and provinces have legal referral services (LRS). A LRS is to increase access to the legal system by referring the public to lawyers in private practice or legal aid organizations for a nominal fee. Check to see what kind of LRS your region offers.

Some LRS operate with low-fee or no-fee panels, whereas others cooperate with independent local *pro bono publico* ("for the public good") or free programs. Also consider talking to the local law school, as students and practicing lawyers may provide advice through a legal clinic.

Before you meet a lawyer, it is advisable to do some "comparison shopping." Make a list of several lawyers and phone each lawyer on your list and ask for information that will help you make a decision. Some lawyers, however, may want to meet briefly with you instead of discussing your problem on the telephone. In this case, many will not charge for the first meeting. Questions you should ask are:

- How much experience have they had in similar matters and have they handled any recent cases in this area?
- Will they charge to meet with you to discuss your case before you decide which lawyer to hire?
- Is there is a fee and how much will it be? In any case, lawyers have commitments to clients, so you should not expect a long first meeting; 15 minutes to a half-hour is average.
- What are their fees for their regular services?
- Write down everything you learn from each lawyer. Take some time to think things over. Then make an appointment to talk further with the lawyer who seems best for you.

Making the Decision to Hire a Lawyer

Ask to hear about cases like yours that the lawyer may have handled. Remember that age may have nothing to do with the lawyer's ability to help you. A lawyer who has practiced 20 years may have less experience with your type of issue than a lawyer who is three years out of law school but who has more comfort with your concerns.

You may want to ask if the lawyer will work on your case personally. If the lawyer intends to have another member of the law firm handle all or part of your case, you should talk with this lawyer as well. You should know that most lawsuits and other legal work are not "sure things." You should be cautious of a lawyer who guarantees results. However, a lawyer should be able to tell you the strengths and weaknesses of your case.

If you do not understand everything the lawyer tells you, ask for an explanation in simpler language. Find out how long the lawyer expects your case to take, what steps will be involved, and how you will be charged. You can decide to hire the lawyer at your first meeting, or you can take time to think about it. You might want to ask yourself these questions:

- Will you be comfortable working closely with this lawyer?
- Do you believe the lawyer has the experience and skill to handle your case?
- Do you understand the lawyer's explanation of what your case involves?
- Does the fee seem reasonable?

If your answer to one or more of these questions is "no," you probably should talk with another lawyer. If all your answers are "yes," you may have found the right lawyer for you.

Fee Agreements

Make sure you understand the fee agreement before retaining the services of a lawyer. Your fee agreement should set out the services the lawyer will perform for you and the type and amount of fees you will be expected to pay. The agreement should also state how costs (the other expenses of your case) will be handled and explain the lawyer's billing practices. The agreement should specify if the lawyer is going to add interest or other charges to unpaid amounts.

A fee agreement may also include your obligations as a client. For instance, you may need to agree to be truthful, to cooperate, to abide by the agreement, and to pay your bills on time. You make a fee agreement in the same way that you would make an agreement with a contractor or another business person. Tell the lawyer what services you will want and ask questions to find out what the charges will be to cover these services. You may want to ask a friend or relative to come with you if you are not sure what to ask.

Some suggested questions include:

- How will the lawyer bill for their time? (See section on 'Types of Fees Charged by Legal Firms' for a list of the different kinds of fees lawyers charge.)
- Who else will be working on the case—an associate lawyer, a legal assistant, or a paralegal?
    - How will that time be billed?

- What can be done to reduce fees and costs?
- What is the lawyer's estimate of the total charges?

Areas of Legal Specialization

Lawyers specialize in much the same way as doctors. In most jurisdictions lawyers can be found who specialize in:

- Appellate law;
- Business and bankruptcy law;
- Creditors' rights;
- Criminal law;
- Estate planning,
- Trust and probate law;
- Family law (divorce, custody, support, and related issues);
- Immigration and nationality law;
- Personal and small business bankruptcy law;
- Taxation law;
- Workers' compensation law.

Types of Fees Charged by Legal Firms

Fixed Fee: This way of charging, sometimes called a standard fee, is used most often for routine legal matters. For example, a lawyer may charge all clients the same set amount to draw up a simple will or to handle an uncontested divorce.

Hourly Fee: Some lawyers charge by the hour; the amount varies from lawyer to lawyer. To know approximately how much your total bill will be, ask the lawyer to estimate the amount of time your case will take.

Retainer Fee: This kind of fee can mean different things to different people, so be sure you understand the fee agreement. A retainer fee can be used to guarantee that the lawyer will be available to take a particular case. If the fee agreement says that the retainer is not refundable, you may not be able to get your money back—even if the lawyer does not handle your case or complete the work.

Contingency Fee: This kind of charge often is used in accident, personal injury, and other cases where you are suing someone for money. It means that you will pay the lawyer a certain percentage of the money you receive, if you win the case or if you settle the matter out of court. If you lose, the lawyer does not receive a fee. Either way, you will have to pay any court costs and other expenses that are involved.

Statutory Fee: The cost of some probate and other kinds of legal work is set by "statute" or law. For certain other legal problems, the court either sets the fee or must approve the fee you will pay.

To make sure you have a good relationship with your lawyer, keep the following points in mind:

- Be sure that you and your lawyer have the same goals.

- Be sure you understand and are comfortable with the lawyer's working style. Be especially certain that you have a clear picture of the expected timetable of your case (when you can expect significant developments, and when and how often the lawyer intends to contact you).
- Be sure that you provide the lawyer with the information and documents necessary to understand your case.
- Be sure you understand and agree with the lawyer's billing practices.
- Be sure that, if you have questions or concerns about your legal matter, you express them to the lawyer and listen to the responses.

Other Points of Legal Interest

Working with Union Agreements

The issue of how your company works in regard to its relationship with union issues can be very important. It is clear that if you have a union representing any of your employees, then you have an agreement/contract whose requirements you must abide by. In the landscape industry, a more common situation is running a nonunionized company and being faced with a project opportunity that has been classified as a unionized site. The major factors influencing the outcome of this situation are the union(s) involved, the legal jurisdiction (state/province), and your ability to meet the requirements laid down by them.

In some instances, the union(s) involved will insist that you pay union rates to your workers, but they will not insist on the unionization of your workers. In other cases, the union(s) will not allow non-union workers on the site. For companies that do a great deal of both union and nonunion projects, the answer can be two separate legal entities—one unionized, the other not. If there is any doubt in your mind about the legalities of union issues, consult with a labor lawyer.

Contract Specifications

One of the ways to ensure that expectations are the same for both parties in a contract is to include specifications of the work to be done. These specifications can be developed internally project-by-project, or using documents such as industry standards. Examples include documents such as the Canadian Landscape Standard or California Contractors Association Standards, or are a combination of both; they clearly spell out how the work is to be done. If you have a design/build firm, you should know that written specifications are viewed by the courts as being more legally binding than any accompanying drawings or designs.

Pesticide Posting Requirements

This is one of a number of appropriate procedures for working in public environments when the health and welfare of the public is at risk. As the public becomes more aware of pesticide and other environmental issues, the need to ensure you are following regulations has never been more necessary. At this point in time, most provinces and states require posting of signs whenever pesticides are going to be or have been used. These requirements vary from area to area, so ensure that you are up-to-date on all regulations in your jurisdiction. Not following the law increase your risk of fines and other charges and provides an opening for civil lawsuits by parties who believe they were negatively affected by pesticide spraying that was not properly advised.

As with pesticide use, the guidelines for the use of equipment, as it relates to public safety, is clearly laid out in virtually every jurisdiction. It is your responsibility to be informed about all issues that relate to public safety. Ignorance of the law is definitely not an excuse for unsafe procedures on the part of your company.

Chapter 3

Business Structures

There are many commonalities of possible business structures between Canada and the United States. Where there are differences, they will be described in the specific sections below. In both Canada and the United States, business structures can be classified as sole proprietorships, partnerships, or corporations. Although this manual will describe each model, you should consult with legal and financial counsel before deciding which is best for you.

Sole Proprietorship

The sole proprietorship is the oldest, most common, and simplest form of business organization. A sole proprietorship is a business entity owned and managed by one person. The sole proprietorship can be organized very informally; is not subject to the level of federal, state, or provincial regulations that corporations are and is relatively simple to manage and control.

The normal legal requirement in establishing a sole proprietorship is to obtain certain licenses that are required for specific types of businesses. These licenses can range from a vendor's permit for collection of the retail sales tax to a municipal/city permit for the operation of a home-based business. Licensing requirements vary, depending on the specific region in which the business will operate.

If the sole proprietorship is operating under a business name other than the owner's, the business name normally must also be registered under the Business Names Act, Register of Companies, or equivalent. This registration is usually relatively simple to complete and must be renewed every five years. Although there is no formal legal requirement to conduct a search of a proposed business name, it is a good idea to do so to be sure that the name that you want to use is not identical or confusingly similar to another business name already registered. This will avoid potential lawsuits down the road.

The fundamental characteristic of a sole proprietorship in all jurisdictions is that the owner and the business are the same. As they are the same entity, the owner of a sole proprietorship has complete control over the business and its operations as well as being financially and legally responsible for all debts and legal actions against the business. Another element of the "same entity" aspect is that taxes on a sole proprietorship are determined at the personal income tax rate of the owner. In other words, a sole proprietorship does not pay taxes separately from the owner.

A sole proprietorship is a good business organization for an individual starting a business that will remain small, does not have great exposure to liability, and does not need outside financing.

Advantages of the Sole Proprietorship

- **Ease of formation**: There is little formality or costs in forming a sole proprietorship.
- **Sole ownership of profits**: The proprietor is not required to share profits with anyone.
- **Control and decision making vested in one owner**: There are no co-owners or partners to consult.

- **Flexibility**: Management is able to respond quickly to business needs in the form of day-to-day management decisions that are governed by both law and good sense.
- **Relative freedom from government control and special taxation**: For example, there is no double taxation (which will be discussed later under corporations).

Disadvantages of the Sole Proprietorship

- **Unlimited liability**: The individual proprietor is responsible for the full amount of business debts that may exceed the proprietor's total investment. This liability extends to all the proprietor's assets, such as house and cars. Obtaining proper insurance coverage may lessen additional problems of liability, such as physical loss or personal injury.
- **Unstable business life**: The enterprise may be crippled or terminated upon the illness or death of the owner.
- **Less available capital than in other types of business organizations:** For small businesses, this is not important, since the owner's personal assets and guarantees are required by banks for financing.
- **Relative difficulty in obtaining long-term financing (cannot issue shares).**
- **Relatively limited viewpoint and experience level**: This is more often the case with a one-owner operation than with several owners.

Partnerships

Partnerships are much like sole proprietorships, but there are a number of individuals involved in the business. Partnerships are not seen as separate legal entities from the individual partners.

The Uniform Partnership Act, adopted by many states, defines a partnership as "an association of two or more persons to carry on as co-owners of a business for profit." Though not specifically required by the act, written Articles of Partnership are customarily executed. These articles outline the contribution by the partners into the business (whether financial, material, or managerial) and generally delineate the roles of the partners in the business relationship. The following are example articles typically contained in a partnership agreement:

- Name, purpose, and legal address;
- Duration of agreement;
- Character of partners (general or limited, active or silent);
- Contributions by partners (at inception, at later date);
- Business expenses (how handled);
- Authority (individual partner authority in conduct of business);
- Separate debts;
- Books, records, and method of accounting;
- Division of profits and losses;
- Draws or salaries;
- Rights of continuing partner;
- Death of a partner (dissolution of partnership, winding up);
- Employee management;

- Release of debts;
- Sale of partnership interest;
- Arbitration;
- Additions, alterations, or modifications of partnership;
- Agreement;
- Settlements of disputes;
- Required and prohibited acts;
- Absence and disability.

Some of the characteristics that distinguish a partnership from other forms of business organization are the limited life of a partnership, unlimited liability of at least one partner, coownership of the assets, mutual agency, share of management, and share of partnership profits.

General Partnerships

Most partnerships fall under the category of "General Partnerships," in which an unlimited number of general partners are allowed, there is unlimited personal liability, and all profits flow through to the partners.

Special Types of Partnerships

Limited Liability Partnerships

Limited Liability Partnerships (LLPs) are organized to protect individual partners from personal liability for the negligent acts of other partners or employees not under their direct control. LLPs are not recognized by every state, and those that do recognize them sometimes limit LLPs to organizations that provide a professional service, such as medicine or law, for which each partner is licensed. Partners report their share of profits and losses on their personal tax returns. Check with your Secretary of State's office to see if your state recognizes LLPs and, if so, which occupations qualify.

Limited Partnerships

Limited Partnerships (LPs) have complex formation requirements and require at least one general partner who is fully responsible for partnership obligations and normal business operations. The LP also requires at least one limited partner, often an investor, who is not involved in everyday operations and is shielded from liability for partnership obligations beyond the amount of his or her investment. LPs do not pay tax, but they must file a return for informational purposes; partners report their share of profits and losses on their personal returns.

Types of Partners

There are many different types of partners that can be involved in a business. These are listed below. If you are forming a partnership, it is critical to obtain legal advice on the tax and liability implications of all partners. It is also very important to have legal partnership agreements that outline the roles, expectations, and exit strategies for all partners.

- **Ostensible partner:** Active and known as a partner.
- **Active partner:** May or may not be ostensible as well.
- **Secret partner:** Active but not known or held out as a partner.

- **Dormant partner:** Inactive and not known or held out as a partner.
- **Silent partner:** Inactive (but may be known to be a partner).
- **Nominal partner** (partner by estoppel): The nominal partner is not a true partner in any sense, not being a party to the partnership agreement. However, a nominal partner holds him or herself out as a partner or permits others to make such representation by the use of their name or otherwise. Therefore, a nominal partner is liable as if they were a partner to third persons who have given credit to the actual or supposed truth of such representation.
- **Sub-partner:** One who, not being a member of the partnership, contracts with one of the partners in reference to participation in the interest of such partner in the firm's business and profits.
- **Limited or special partner:** Assuming compliance with the statutory formalities, the limited partner risks only their agreed investment in the business. As long as they do not participate in the management and control of the enterprise or in the conduct of its business, the limited partner is generally not subject to the same liabilities as a general partner.

Advantages of the Partnership

- **Ease of formation**: Legal informalities and expenses are few compared with the requirements for creation of a corporation.
- **Direct rewards**: Partners are motivated to apply their best abilities by direct sharing of the profits.
- **Growth and performance facilitated**: In a partnership, it is often possible to obtain more capital and a better range of skills than in a sole proprietorship. This is because each partner brings in capital and a separate skill set.
- **Flexibility**: A partnership may be relatively more flexible in the decision-making process than in a corporation, although it may be less than in a sole proprietorship.
- **Tax relief**: Relative freedom from government control and special taxation (again, not subject to double taxation).

Disadvantages of a Partnership

- **Unlimited liability of at least one partner:** Insurance considerations such as those mentioned in the proprietorship section apply here also.
- **Unstable life:** Elimination of any partner constitutes automatic dissolution of partnership. However, the operation of the business can continue on the basis of the right of survivorship and the possible creation of a new partnership. Partnership insurance might be considered.
- **Relative difficulty in obtaining large sums of capital:** This is particularly true of long-term financing when compared to a corporation. However, by using the individual partners' assets, the opportunities are probably greater than in a proprietorship.
- **Firm bound by the acts of just one partner as agent** (i.e., all the partners can suffer the repercussions of poor judgment exercised by one partner).
- **Difficulty of disposing of partnership interest:** The buying out of a partner may be difficult unless specifically arranged for in the written agreement.

Incorporated Companies

A corporation is a distinct legal entity that can be thought of as an “artificial person” and is treated as separate from the people who own it (i.e., the shareholders). All assets and debts belong to the corporation, not the individual shareholders. In general, incorporated companies provide liability protection to the owners (shareholders). The concept is that if losses or judgments force the company out of business, the shareholders lose their investment but are not personally responsible and will not lose their personal assets.

Small business owners, however, should not be lulled into a sense of comfort in thinking they can totally hide behind the “veil” of the company. In fact, in many cases the protection of personal liability may not be significant. For example, there is personal liability for:

- The individual’s own acts;
- Shareholder liability after a piercing of the corporate veil;
- Personal guarantees;
- Personal liability imposed by law.

Individual Acts

All individuals are responsible for, and thus liable for, their own acts. For example, the corporation does not provide protection from their personal actions, such as sexual harassment or violence. In small service businesses, such as landscaping, where the owner (shareholder) provides the service and is negligent in the provision of the service, they may be deemed personally liable.

Piercing the Corporate Veil

The “corporate veil” refers to the fact that, under law a corporation is a separate individual and independent from its shareholders; this means that shareholders are not liable for debts and obligations incurred by the company. However, the corporate veil may be “pierced” if the separate entity status of the corporation is not properly maintained. For example, if the finances of the corporation and the shareholder are not separate, the corporation must be adequately capitalized and the formalities of having corporate authorization of business activities must be observed.

If a corporation has no significant assets, the plaintiff will often be able to convince the court that the corporate entity should not be respected and that the principals of the company should be personally liable. In these cases, the plaintiff will make all efforts to access the personal assets of the shareholders.

Personal Guarantees

In many cases, in small business, the business owner must provide personal guarantees either to banks or to suppliers. In this case, the corporation provides no protection.

Personal Liability Imposed by Law

Governments in many jurisdictions have passed statutes that make business owners personally responsible in certain areas. For example, in both the United States and Canada, the individual who is responsible for employee taxes has personal liability for those taxes. In some jurisdictions, owners can be held personally liable for environmental infractions.

In Canada, when a limited company goes bankrupt and there is a shortfall to creditors, the directors in most cases are not liable for any shortfall. The directors are liable for a shortfall only if they have given personal guarantees for debt or, if laws have been passed specifying that directors will be liable if there is a shortfall for certain "statutory" creditors. These statutory creditors are as follows:

Wages of employees: Directors are responsible for wages in accordance with the laws in the various provinces. It is the owner or managers' responsibility to know the law.

Source deductions: Officers and directors are personally liable for unpaid source deductions such as employee payroll taxes.

Goods & services tax (GST): Directors and officers are personally liable for GST owing.

Provincial sales tax (PST): Directors and officers are personally liable for PST owing in some of the provinces.

Under both United States and Canadian law, directors and company officers are expected to act with due diligence and in the best interests of the company. Those interests vary between the United States and Canada; typically in the United States directors are obligated to consider the interests primarily of shareholders whereas in Canada the company is considered to consist of a broader range of stakeholders. This is usually of more consequence in publicly held companies than it is in closely held private companies.

Since a Canadian director's liability issues tend to follow those in the United States, the following discussion is with respect to U.S. director's and officer's liability; however, the general principles also hold for Canada.

Employment Claims

One of the biggest areas of liability claim against directors is in the area of employment claims. To avoid director's liability with respect to employment claims, establish uniform employment policies and procedures and ensure that all management and middle management are aware of these policies and are implementing them in the office and on the job site. To avoid "hostile work environment" claims, management must monitor the workplace for discriminatory or offensive behavior.

Securities Law

In publicly traded companies, the majority of liability claims against directors are security related claims based on federal security laws. Since most landscape companies are privately held, the federal security laws and the actions of the Security and Exchange Commission are not particularly relevant to this industry. There are, however, numerous risks of other statutory claims being brought against directors and officers if the officers or directors have been deemed to have knowingly participated in the corporation's wrongful acts. Examples of the types of statutory violations that a director of a landscape company should be aware of include, but are not limited to, the following examples:

Anticompetitive and Unfair Business Practices

The Sherman Act in the United States prohibits contracts, combinations, and conspiracies in restraint of trade, monopolies, and attempts and conspiracies to monopolize. The Clayton Act prohibits price discrimination among purchasers of goods, exclusive dealing arrangements, corporate mergers, and acquisitions that may substantially lessen competition and tend to create a monopoly in any line of commerce. Directors and officers can be held personally liable for violations of these two acts.

Disclosure of Trade Secrets

Trade secrets are protected under both common law and federal statute. In the United States, the Uniform Trade Secrets Act codifies common law principles of liability for improper disclosure of trade secrets. Directors or officers who leave a company and disclose trade secrets are liable under this act.

Environmental Liability

There are increasingly comprehensive environmental laws in both the United States and Canada. In both countries, directors and officers can be subject to personal liability under environmental laws. In the United States, the main acts that are of concern to directors and officers are:

- The Comprehensive Environmental Responsibility, Compensation and Liability Act, which deals with the release of hazardous substances into the environment. This could include substances that landscape contractors use or store, especially pesticides.
- The Resource Conservation and Recovery Act, which imposes cradle-to-grave regulations over the generation, transportation, and disposal of hazardous wastes.
- The Clean Air Act/Clean Water Act, which sets standards for pollutants in the air and water.

There are numerous other acts, particularly at the state and provincial level, that may imply personal liability on directors and officers. It is important that you consult with your legal advisors to seek advice on how to best protect yourself as a director or officer of a privately held company in your specific jurisdiction.

Use of Due Diligence as a Defense

Various forms of liability imposed on corporate directors and officers in both privately and publicly held companies can often be avoided through a due diligence defense. With a due diligence defense, directors or officers may protect themselves by demonstrating that, they have developed and implemented appropriate controls and systems in the company to monitor and ensure that proper policies are adhered to, and that periodic reports are produced and reviewed in a proper fashion. It is important in due diligence defense that appropriate action is taken when a problem is brought to the attention of directors and officers of the company.

When applying a standard of due care to corporate directors, the courts are concerned about the process that the board of directors has followed, rather than the result. If directors make a decision that is debatable from a business perspective or that turns out badly, the courts will not hold the directors personally liable. This principle is referred to as the “Business Judgment Rule.” Directors must discharge their duties with the same level of diligence as a reasonably prudent person in comparable circumstances.

Corporate Structure in the United States

In the United States, there are four distinct types of corporate structures, which are:

- General Corporations (Inc., Ltd., Corp.);
- Limited Liability Corporations (LLCs);
- Close Corporations (“C” Corporations);
- Subchapter Corporations (“S” Corporation);

The General Corporation is the most common corporate structure. The corporation is a separate legal entity that is owned by stockholders. A General Corporation may have an unlimited number of stockholders that, due to the separate legal nature of the corporation, are protected from the trade creditors of the business. A stockholder’s personal liability is usually limited to the amount of investment in the corporation and no more.

Advantages

- The owners’ personal assets are protected from business debt and liability (see discussion above).
- Corporations have unlimited life extending beyond the illness or death of the owners.
- Tax-free benefits, such as insurance, travel, and retirement plan deductions, are available.
- The transfer of ownership is facilitated by the sale of stock.
- A change of ownership need not affect management.
- It is easier to raise capital through the sale of stocks and bonds.

Disadvantages

- General Corporations are more expensive to form than a proprietorship or partnerships.
- There is more legal formality.
- Such corporations are affected by more state and federal rules and regulations.

Limited Liability Corporations

Limited Liability Corporations (LLCs) are the newest form of corporation in the United States, first being formed in 1977 but not given flow-through tax status by the Internal Revenue Service until 1988. All 50 states now recognize and offer the ability to form LLCs in their jurisdictions. The LLC combines the best attributes of single taxation of partnerships (where the shareholders take the tax liability personally) with the limited liability of corporations.

LLCs have no limit on the number of shareholders involved, unlike Subchapter Corporations, which are limited to 75. Also unlike other forms of corporations, LLCs do not have a perpetual life. Depending on the state, they must dissolve in 30 or 40 years. In addition, technicalities may require dissolution when a member dies or retires.

Advantages of LLCs

- Limited liability.
- Tax simplicity. Profits and losses are reported on the owner’s individual tax returns; there is no separate corporate tax return.

- Flexible management. A “member” (shareholder equivalent) can be a person, partnership, or corporation.
- Flexible distribution. Profits and losses do not have to be distributed in proportion to the money each person puts in.

Disadvantages of LLCs

- No stock issued: If you have multiple investors or want to raise public money, you cannot offer stock certificates.
- Fewer incentives**:** Unlike a “C” Corporation, you cannot deduct the cost of employee benefits, and since there is no stock, you cannot offer stock incentives to employees.
- Paperwork: LLCs file articles of organization with State Corporations Commissions or Secretaries of State and must draft an operation agreement listing member’s rights and responsibilities.
- Taxes: LLC members pay self-employment taxes on all profits, unlike an “S” Corporation, where self-employment tax is due on salary only, not your entire profits.

Close "C" Corporations

There are a few small, but significant, differences between “C” Corporations and General Corporations. In most jurisdictions, “C” Corporations are limited to between 30 and 50 shareholders, and often the statutes of a “C” Corporation require that the first offer of new shares be to existing shareholders. This type of corporation is very well suited for a group of individuals who want to own the corporation with some members who are actively involved in the management and others who are only involved on a limited or indirect level, typically as investors.

Subchapter "S" Corporations

With the Tax Reform Act of 1986, the “S” Corporation became an interesting and desirable business entity for corporate tax purposes. Other than its tax treatment, an “S” Corporation is significantly different from a general corporation.

“S” Corporations have a special tax designation applied for, and granted by, the Internal Revenue Service to corporations that have already been formed. Many entrepreneurs and small business owners are partial to the “S” Corporation because it combines many of the advantages of a sole proprietorship, partnership, and the corporate forms of business structure.

“S” Corporations have the same basic advantages and disadvantages of general or close corporation with the added benefit of the “S” Corporation special tax provisions, which resemble a partnership or sole proprietorship. When a standard corporation (general or close) makes a profit, the company pays a federal corporate income tax on the profit. If the company declares a dividend to move money from the company to the shareholders, the shareholders must report the dividend as personal income and pay more taxes, thus the “double taxation” occurs. The corporation pays tax, and the individual pays tax on the dividend he or she receives.

“S” Corporations avoid “double taxation,” since all income or loss is reported only on the personal tax returns of the shareholders. However, like standard corporations and unlike sole proprietorships and partnerships, the “S” Corporation shareholders are exempt from personal liability for business debt. As in most decisions with respect to business formation, it is important to have sound legal and accounting advice prior to determining the type of corporate structure that is best for your business.

Corporate Structure in Canada

In Canada, there is the choice to incorporate provincially or federally.

Federally Incorporated Companies

Under the Canada Business Corporations Act (CBCA), to form a Federal Corporation you must have one or more competent individuals who are 18 years of age or older and who are not in a current status of bankruptcy.

A company can be incorporated under the laws of only one jurisdiction. You must decide whether to incorporate federally under the CBCA or under the laws of a province or territory instead of the CBCA. Requirements vary, and you should contact the jurisdiction under which you wish to incorporate for precise details. Almost any type of business may incorporate under the CBCA. However, banking, insurance, loan, and trust companies as well as nonprofit corporations are incorporated under different statutes.

There are no restrictions on businesses, such as minimum company size, that may incorporate under the CBCA. Although all provinces and territories have similar legislation for companies operating within their borders, only the CBCA is national in scope.

Many small businesses incorporating under the CBCA have the intention (either now or sometime in the future) of operating in more than one province or territory. They may choose to incorporate under the CBCA now in order to simplify their business relations later if they decide to expand operations or grow larger.

Even if you incorporate federally, you will most likely be required to register your business in any province or territory where you carry on business. You will, however, not have to incorporate under provincial law except only to register. This allows companies in a number of provinces to decrease the paperwork and the costs of filing corporate papers for each province they do business within.

Provincial Incorporated Companies

Most businesses incorporate in the province they are carrying out the majority of their business. All of the factors that have been discussed under the Incorporated Companies section apply to Provincial Incorporated Companies. See 11 for a comparison of federal and provincial incorporation.

TABLE 11: FEDERAL VS. PROVINCIAL INCORPORATION

Federal Incorporation	Provincial Incorporation
Corporate name protection is second only to trademark protection	Corporate name is only protected in the province of incorporation
Federal name granting guidelines are very strict, and many proposed names are rejected	It is the incorporator's responsibility to ensure the proposed corporate name is available for use. Usually 3 names are submitted through your lawyer for review. Names are not usually rejected unless they conflict with another confusingly similar name already in use
Can operate across the country as a right, subject to extra-provincial filing requirements	Can only operate within the province of incorporation as a right. Must register extra-provincially if operating in other provinces

Depending on which province you are located in, the actual incorporation process will be through one of the following methods (Table 12).

TABLE 12: PROVINCIAL INCORPORATION PROCESS

Type	Provinces
Registration: Accomplished by filing a memorandum and articles	British Columbia & Nova Scotia
Letters of Patent: Based on the practice of the monarch granting a royal charter; this method of incorporation involves an applicant petitioning the government to grant them letters of patent. The government representative, acting by statue, grants a charter of incorporation to the applicant	Quebec & Prince Edward Island
Articles of Incorporation: This system was developed in the U.S. It is based on filing articles of incorporation and being granted a certificate of incorporation.	Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Newfoundland, and Federal Government

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