

LIDSTONE & COMPANY

Barristers and Solicitors

MEMORANDUM

TO: Craig Pryor, Manager, Valemount Community Forest Company Ltd.
AND TO: Adam Davey, CAO, Village of Valemount
FROM: Lindsay Parcels
DATE: February 27, 2018
RE: Valemount Economic Development Corporation and Partnership
FILE: 10149-105

BACKGROUND

You have asked us to provide our comments summarizing the main points of the draft corporate articles for the proposed Valemount Economic Development Corporation (“**Newco**”) and Limited Partnership Agreement.

The need for Newco stems from an opinion letter provided by KPMG LLP to Craig Pryor dated December 7, 2016 (the “**Letter**”). That Letter reviews the business activities and assets of Valemount Community Forest Company Ltd. (“**VCF**”), identifies potential threats to its income tax exempt status and also provides recommendations to ensure that the business activities and assets of VCF retain their income tax exempt status. As the Letter indicates, VCF is presently a tax exempt corporation under s. 149 of the *Income Tax Act* because it is owned by the Village of Valemount (“**Valemount**”) and earns at least 90% of its income from sources located within municipal boundaries. The Letter also indicates that VCF’s acquisition of other forestry tenures and industrial lands outside the boundaries of Valemount threaten its income tax exempt status under s. 149 of the *Income Tax Act* by potentially increasing the income it earns from assets located outside municipal boundaries to more than 10% of its total income.

To address the threat to VCF’s income tax exempt status, KPMG proposes two solutions. The first is to incubate VCF by transferring all of its assets that are outside municipal boundaries to the proposed Newco. The second measure is to establish two new Limited Partnerships consisting of one Limited Partnership between VCF and Valemount (the “**VCF LP**”) and another between Newco and Valemount (the “**Newco LP**”). As described below, almost all of the income from VCF LP and Newco LP will flow through to Valemount and not be subject to income taxation given Valemount’s income tax exempt status.

SUMMARY OF CORPORATE ARTICLES

The corporate articles for a corporation are its constitution and the articles and the *Business Corporations Act* provide the rules for how the corporation is governed. The proposed corporate articles for Newco are largely based on the existing

corporate articles for VCF. As discussed, it is anticipated that although VCF and Newco will be separate and distinct legal and commercial entities, they will have the same, or nearly the same directors, officers and employees to help ensure consistency and ease of administration for each of VCF and Newco. The articles are also subject to approval by the provincial Inspector of Municipalities (the “**Inspector**”) and based on past experience, we expect the Inspector to require some revisions or additions to these articles before they are approved.

Newco, like all corporations, will be a distinct legal entity that will be owned by its shareholder(s). In Newco’s case, the sole shareholder will be Valemount and Valemount as shareholder will appoint the directors and must approve any changes to the corporate articles or other significant changes to the corporation. Among other things, the *Business Corporations Act* requires an annual general meeting at which the audited financial statements of the corporation are approved and the directors are appointed by Valemount. As the shareholder of the corporation, all decisions made by Valemount must be in the form of shareholder’s resolutions. As Valemount is itself a municipal corporation, the resolutions must be passed by Valemount’s municipal council. The directors of the Newco will be answerable to Valemount as the shareholder and Valemount may appoint or dismiss directors in its discretion. The directors are in turn responsible for the strategic direction of the corporation and their decisions are made collectively at the board level by means of resolutions. The directors appoint the officers of the company such as the president and secretary and it is the officers who are responsible for hiring and firing employees and for the day-to-day business of the corporation. The corporate articles are based on these general principles and while the articles are mostly self-explanatory, the following summary describes key provisions in the articles:

- 1.1 “Special resolution”, “ordinary resolution” and “unanimous resolution” are defined in s. 1.1(j). An “ordinary resolution” means a resolution passed by a simple majority of shareholders. A “special resolution” means a supermajority of shareholders to ensure that there is widespread support by a large majority of shareholders in respect of significant decisions and it is further defined in s. 12.2 as two-thirds of shareholders. A “unanimous resolution” means, as the name implies, approval by all shareholders. So long as Valemount is the sole shareholder of the corporation, an ordinary resolution will have the same meaning as a special resolution or a unanimous resolution which means in effect, approval by Valemount. The requirement for special or ordinary resolutions imposes some reasonable restraints on the directors. Sections that require ordinary resolutions include: ss. 4.1, 11.4, 14.1(b), 14.8, 15.8, 22.1, 26.2(b) and 29.4. Sections that require special resolutions include ss. 10.2, 10.3, 10.4, 12.1 and 15.8. Sections that require unanimous resolutions include ss. 11.2 and 15.1(b).
- 2.1 This section summarizes the company purposes for Newco. This can be revised by Valemount by an amendment to the articles if circumstances change.
- 3.1 Valemount, as the sole shareholder of Newco will own all of the issued

and outstanding shares. Any class and number of shares can be created by Valemount (for example, Class A Common Shares and Class B Preferred Shares). As the sole shareholder, Valemount will determine the classes and number of shares that may be issued. It is anticipated that Newco will be incorporated with an unlimited number of Class A Common shares without rights or restrictions. The classes and number of shares may be revised at any time by Valemount and typically, this would be done on the basis of accounting or legal advice that necessitated a change.

- 11.1 Consistent with the *Business Corporations Act*, annual general meetings of the shareholders are required. Typically, the annual general meeting is held during a municipal council meeting and at the meeting, the financial statements for the previous year are approved, auditors are appointed for the coming year and directors are appointed. It is also typical for the corporate directors or officers to provide a report to council with respect to the activities of the corporation for the past year as well as those anticipated for the coming year. In connection with this report, council may be also called upon to pass resolutions in respect of other significant decisions. The Inspector typically requires an annual information meeting that is open to the public and to address this requirement, the annual general meeting is often open to the public and the public given an opportunity to ask questions in respect of the corporation's activities.
- 11.2 Annual general meetings may be waived by written resolution of Valemount's municipal council; however, the items under s. 11.1 above should still be presented to council for its consideration and in any event, as noted in s. 11.1, the Inspector typically requires an annual information meeting that is open to the public.
- 14.1 Valemount will determine the number of directors it wishes to have on the board of directors and required qualifications for directors are set out in s. 14.1(c) - (e).
- 14.5 Subject to s. 14.6, remuneration of directors will be subject to Valemount's approval. This also applies to ss. 14.7 and 14.8.
- 15.1 This section establishes a staggered schedule for the election of directors. The intent is to provide for a healthy balance of experienced and new directors; however, as s. 15.1(c) indicates, Valemount is not bound to replace directors and any director is eligible for re-election or reappointment if Valemount desires.
- 23 This section requires Valemount to indemnify the directors and this is a typical provision to encourage prospective directors to serve. The *Business Corporations Act* permits the corporation to indemnify a director or officer against expenses, judgments, and settlements that may be reasonably incurred by reason of being or having been a director or officer of the corporation, if the director or officer acted honestly and

in good faith in the best interests of the corporation, or in the case of an administrative or a criminal matter, if that director or officer had reasonable grounds to believe that his or her conduct was lawful. Any conduct outside of those bounds by a director would disqualify the director from indemnification. The *Business Corporations Act* is also clear that the corporation has a mandatory obligation to pay expenses actually and reasonably incurred by a director or officer, if the director or officer has not been reimbursed for such expenses and is wholly successful on the merits of the proceeding.

23.5 Under s. 165 of the *Business Corporations Act*, the corporation is entitled to purchase and maintain directors' and officers' liability insurance. The policies vary but generally cover the directors and officers against third-party claims that arise while they are performing their duties as directors or officers.

29 These provisions are typically required by the Inspector as a condition of approval for the corporation.

SUMMARY OF LIMITED PARTNERSHIP AGREEMENT

A limited partnership is a type of partnership where the partners are comprised of one or more persons who are general partners and one or more persons who are limited partners. The general partner manages the business of the partnership and assumes all liability on behalf of the partnership. The limited partners invest in the partnership and do not play an active role in the management of the partnership. So long as they retain their passive role, the liability of limited partners is limited to their investment in the partnership. Limited partnerships are typically governed by a partnership agreement that details the respective rights and obligations of the general partner and limited partners. In most cases, the limited partners own almost all of the interest in the partnership and they have an entitlement to almost all the income earned by the partnership which flows through the general partner to the limited partners. Limited partnerships are established in accordance with the requirements of Part 3 of the *Partnership Act* (British Columbia).

Under KPMG's proposal set out in their Letter, the VCF LP will consist of VCF as the general partner responsible for carrying on the business and management of the VCF LP with Valemount as the limited partner. As a limited partner, Valemount will play a passive role as investor in the VCF LP and receive almost all of the income from the VCF LP. The parties will enter into a limited partnership agreement that will govern the affairs of VCF LP and ensure that VCF acts in accordance with the agreement and that most of the income from VCF LP flows through to Valemount. Likewise, under a separate limited partnership agreement, the Newco LP will consist of Newco as general partner and Valemount as the limited partner. The VCF LP will carry on the business activities currently undertaken by VCF under its provincial forestry tenure and the Newco LP will carry on business activities with respect to new forestry tenures and industrial lands.

The limited partnership agreement is based on these general principles and while the agreement is mostly self-explanatory, the following summary describes key

provisions:

- 2.1 This section confirms the establishment of VCF LP and the name under which it will operate.
- 2.2 The purposes of VCF LP are set out in this section.
- 2.4 Management principles are set out in this section.
- 2.10 This section provides that VCF LP continues until such time as Valemount, as the sole shareholder of VCF and the sole limited partner, decides to disband it.
- 2.12 This section confirms that Valemount as the limited partner in VCF LP must not take an active role in the affairs of VCF LP in order to maintain its limited liability protection; however, it may do indirectly in its role as sole shareholder of the general partner, VCF.
- 3 Article 3 details all of the powers and duties that VCF has as a general partner in the VCF LP, including the specific powers listed in s. 3.2.
- 3.12 The agreement requires VCF LP to indemnify VCF in respect of its duties as general partner, provided such duties were performed honestly and in good faith and were not performed or omitted to be performed fraudulently or in bad faith or as a result of the negligence of VCF and only if such losses, costs, expenses, liabilities and damages do not arise out of any act, omission, or judgment, which is adjudged to be in contravention of the partnership agreement. Also noteworthy is the fact that Valemount as a limited partner is not obligated to indemnify any amount that exceeds its investment in the limited partnership.
- 4.2 This section permits Valemount to remove VCF at any time as the general partner and to replace VCF with another general partner.
6. Article 6 sets out the “unit” ownership for VCF LP. “Units” are equivalent to “shares” in a corporation. VCF as general partner will hold only a Class A Unit which does not give it the right to vote. Valemount will hold only Class B Units that entitle it to vote on any matter. Even if VCF were not a wholly-owned municipal corporation, this effectively gives control of the limited partnership to Valemount, without the responsibilities that are assigned to VCF.
- 8.1 As noted in this section, the unit ownership is structured so that Valemount receives 99.99% of the net income from the limited partnership.

CONCLUSION

The advantage of a limited partnership will be to ensure that any income flowing from the limited partnership to Valemount will be exempt from income taxes. The

limited partnership structure will also protect Valemount with limited liability protection and limit Valemount's exposure to its investment in the partnership. The steps to establish the limited partnerships will include the following:

1. For Newco, approval will be required from the Inspector of Municipalities pursuant to s. 185 of the *Community Charter*. To obtain approval, a letter and draft corporate articles will be submitted to the Inspector's office with the letter detailing the reasons and purposes for which the corporation is required as well as any relevant background information. In our experience, approval by the Inspector's office typically takes one to two months.
2. After approval for Newco is received from the Inspector and the new corporation is incorporated, Valemount and Newco will enter into the Newco LP and VCF LP will be established in accordance with Part 3 of the *Partnership Act*. As well, Valemount and VCF can also enter into the VCF LP at any time and it will be established in the same way as Newco LP. Because Newco will be, and VCF is, wholly-owned by Valemount, we anticipate that this process will be fairly straightforward.
3. Once the limited partnerships are established, the other forestry tenures and industrial lands will be transferred from VCF to Newco and the general partners of the respective limited partnerships will undertake their respective businesses. Valemount will be able to appoint and remove directors as it deems necessary and take whatever steps it considers reasonable to ensure the respective general partners remain accountable; however, Valemount will not take an active role in the management of the limited partnerships as that would potentially cause it to lose its limited liability protection under the *Partnership Act*.