

TALES FROM THE TRENCHES™

BY BARRY C. MCGUIRE

June, 2013

SOME DEALS HAVE IT ALL

This Tale is all about opportunity lost. The story talks about dealing with family and friends, failing to deal promptly with trouble, lack of documentation, no professional advice taken, greed, loss of profit, and—maybe more importantly—loss of relationships.

This is a classic Tale. It illustrates so many of those 'Basic' situations all of you must understand and guard against. This Tale is in our member's own words. Let's have a read.

"Hi Barry:

5 years ago, I was approached by one of my best friends and he asked if I wanted to participate in a land deal with him and his cousin. My friend, along with his brother and sister, had inherited the land from his mother. The idea was that his cousin would buy out my friend's brother, I would buy out his sister, and the 3 of us would proceed as equal partners. The property was a half section of land near Edmonton, including a house and yard site. The idea was that the 3 of us would market and perhaps develop the property over time and eventually we would sell off the parcel and divide the proceeds equally amongst the three of us.

Each partner had to put up approximately \$300K into the entire project.

As we were close friends and family, we basically proceeded into the partnership on a handshake and did not have a formal joint venture (JV) agreement in place. One of the partners (cousin) kept all of the paperwork including a ledger that tracked of any expenses incurred, income from the property that was disbursed, as well as any funds that changed hands amongst the partners.

Approximately 1 year into the partnership, we had a potential buyer who wanted to buy the entire property for a total of \$4M. The purchaser offered to put up a deposit of \$1.3M. We agreed to provide vendor financing by way of a VTB mortgage due in 4 years.

The initial deposit covered all of the initial capital investment for all of the 3 partners so we were happy to wait out the 4-year term as we were receiving income from two sources. The house and yard were rented to a tenant. The land was leased to a local farmer. Once again, the cousin documented this proposal on behalf of the JV. The initial deposit paid by this purchaser was sent to the lawyer representing our partnership.

Unfortunately, the lawyer released the funds to the cousin (the partner that had kept the documentation) even though my friend and his cousin were both on title (my interest in the property was identified using an irrevocable assignment of proceeds signed with my friend as I was never added to title initially).

Over the course of time, the cousin decided to move away from the original agreement of equal thirds ownership in the property. He felt that since he had spent some time and money on the house, that he was now entitled to ownership of the house and yard site.

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He had prepared documentation supporting his position on the ownership of the yard site. My friend and I indicated to him verbally that we did not agree with his position, however we did not produce any documentation to refute his claim nor did we seek legal advice at the time. We both felt that since we were family/friends that we could work something out in the end. The cousin-partner also wanted to shift the percentage of ownership in the land itself whereby he owned 50% of the land, as well as the house and yard site 100%, while the remaining two partners owned 25% of the land only. Once again, my friend and I were not in agreement with this but did not produce any documentation to refute this claim either.

The 4-year term for this deal was up on March 30th of 2012 whereby the purchaser did in fact pay the balance of the funds and the remaining funds were held in trust until Nov 2012 while the partners discussed the distribution of funds. The cousin was firm in his position in that he owned the yard site outright (even though this was never subdivided and registered with land titles) as well as 50% of the lands and the other 2 partners were entitled to 25% each of the land-only proceeds.

My friend and I always thought we could set aside our difference in opinion with the cousin and reach some agreement that would be a win-win for all three partners and would be more in the spirit of the equal partnership that we had initially agreed to. The cousin held fast in his position so we had to bring in a lawyer to act as a quasi-mediator in order to try and reach an agreement.

At the end of the day, the lawyer indicated that while the cousin's documentation was sloppy and unprofessional, we did not have any documentation of our own to support our position and as a result, the lawyer felt that a judge would side with the cousin. He advised that we could move to litigation in order to try and reach a settlement, however the litigation process would be costly and due to our lack of supporting documentation, would not likely turn out in our favor. In light of this, we reached an agreement whereby my friend and I received approximately \$600K each and the father-in-law received approximately \$2.8M.

Here are the lessons that I have taken away from this deal:

- 1) **Always** have a proper, written JVA in place for any partnership. I would suggest that it is even **more** important to have a written agreement when dealing with friends and family as there may be a tendency to think that you do not require the same level of diligence when dealing with friends/family as you can always work something out. This is not always the case.
- 2) Seek a lawyer's advice at the beginning of a deal, not the end of a deal. Legal fees may seem costly, however in this case, we left a large sum of money on the table due to lack of documentation and legal guidance.
- 3) Always register your interest in a property on title. Had the title accurately reflected the equal ownership in this case, perhaps a more equitable settlement would have been reached.

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- 4) When creating documentation including correspondence between partners, be mindful of how that documentation would be seen by a lawyer/judge should the deal or partnership require litigation or mediation in the future. In this case, simply refuting the cousin's claims in writing would have helped support our position when a settlement could not be reached amongst the 3 partners.
- 5) If you have a concern or uncertainty about any matter related with a deal or partnership, deal with it sooner rather than later. Even though we were in disagreement with many of the cousin's claims, we chose to address these concerns at the end of the deal as opposed to earlier in the term. The longer we waited to address our concerns, the more documentation the cousin created in order to support his position, which ended up costing us a lot of money!"

LESSONS LEARNED:

As set out above in # 1-5 with a couple of extras. Let's go over them again.

1. Dealing with family and friends is tough. You need more rather than less paperwork. Deals that go bad destroy relationships and cost you money (\$700K in this case).
2. Greed exists. Don't pretend it doesn't.
3. Always consider getting professional advice. Do it early. Your Team should be available to discuss new deals at least briefly. Do you need to go further?
4. Document your deal. A Joint Venture Agreement or other contract is best. Detail and confirm changes.
5. Register your interest on title.
6. Don't wait. Time does not improve a bad situation. It always gets worse
7. Lawsuits are expensive, stressful, lengthy, and not guaranteed to solve your problem.

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