



PURCHASE AND SALE OF BUSINESS AGREEMENTS: IMPORTANT CONSIDERATIONS

The Purchase and Sale of a Business: Important Considerations

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- Road map for the purchase and sale of a business;
- Letter of intent;
- Purchase and sale agreement – certain provisions; and
- What to expect on the closing date – smooth sailing or hidden snags?



Getting to a Prospect (1)

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- Considerations entering into the decision-making of a purchaser
 - ▣ Experience, passion and interests of a purchaser
 - ▣ Management experience of a purchaser
 - ▣ Capital needs



Getting to a Prospect (2)

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- Preparing your business for sale – considerations of a vendor
 - Corporate structure
 - Minute books
 - Share capital issues
 - Shareholder agreements
 - Asset ownership and encumbrances
 - External relationships
 - Intellectual property considerations



Involving the Right Professionals

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- Involve professionals at an early stage:
 - Business consultants
 - Legal
 - Accounting
 - Banking
 - Insurers



Gathering Information and Deciding on a Structure

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- Preliminary Research – Non-disclosure agreement
- Tax planning
- *What* will be bought - asset or share transaction
- *Who* will buy
- Regulatory considerations
- Price and payment terms



Letter of Intent or Term Sheet

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- Sets out understanding of the parties
- Covers basic aspects of the deal at an early stage
- Helps prevent misunderstanding and avoids having to renegotiate key terms at a later stage



Due Diligence

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- Proper due diligence allows a purchaser to understand the risks
 - Financial statements
 - Lists of customer and suppliers
 - List of employees, including a breakdown of salaries and years of service
 - Details of major contracts necessary for the operation of the business, including any lease of premises
 - List of all equipment and assets of the business



Due Diligence

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- ▣ Any related debts and liabilities
- ▣ Licenses and regulatory matters
- ▣ Searches of government databases to disclose liens on business assets, unpaid taxes, ongoing lawsuits or human rights complaints, and ownership of buildings and vehicles
- ▣ Know when to walk away



Contract

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- Builds on Letter of Intent or Term Sheet
- Includes significant details of what the vendor and the purchaser are agreeing to
- Ancillary documents – i.e. Non-competition agreement, Release, etc.
- Contract may be signed before or on the closing date



Closing

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- Closing agenda is typically prepared, listing all documents and other items to be exchanged on the closing date
- Closing documents and items may be executed prior to the closing date, exchanged and held in escrow until their release on the closing date
- Often issues are still being negotiated on the closing date
- “It ain’t over ‘till it’s over”



The Letter of Intent

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1. Purpose
2. General Contents
3. Important Terms
4. Is it Binding?
5. What to Take Away



1. Purpose

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- Often the first written step in negotiating an agreement
- Defines the parties to the eventual agreement
- Broad outline of terms in the eventual agreement



1. Purpose

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- Includes material terms and conditions
- Clarifies the intentions of the parties
- Assess the chance of success and commitment



2. General Contents

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- Material terms of the eventual agreement
- Can include:
 - ▣ Identification of the assets or shares being purchased and sold
 - ▣ Allocation of the purchase price (in an asset sale)
 - ▣ Conditions of the non-competition covenant



2. General Contents

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- ▣ Deadline for drafting a final agreement
- ▣ Target closing date
- ▣ Security for the transaction
- ▣ Due diligence requirements
- ▣ Conditions of the transaction



3. Important Terms

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- The fundamental terms of the agreement should be laid out, but “subject to the terms of the final agreement”
 - ▣ *United Trust Co. v. Dominion Stores Ltd.* [1977] SCT 915
- Parties do not intend to be bound



4. Is it Binding?

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- The “agreement to agree”
- Contracting into a duty to negotiate in good faith
 - ▣ *Molson Canada 2005 v. Miller Brewing Co.* 2013 ONSC 2758
- Drafting language
 - ▣ Conditional
- Subject to negotiation



4. Is it Binding?

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- Determining the intent of the parties
- Conduct of the parties
- Sophistication of the parties
- The “entire agreement” clause in the final agreement



5. What to Take Away

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- The LOI should specifically state that the parties do not intend to be bound
- Should state that the parties will be negotiating a final agreement, to which the terms of the LOI are subject



5. What to Take Away

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- Conduct of the parties should make it evident that terms are not settled, that they are in the process of negotiating
- Always have legal counsel draft the LOI, or at a bare minimum review the LOI before execution to avoid being bound before you are ready



Purchase Agreements

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- Purpose:
 - ▣ to set the framework and obligations to complete a transaction

- First Issue:
 - ▣ Sign in advance vs Sign and close



Basic Elements of a Purchase Agreement

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- Subject matter – example, share vs assets
- Payment/Adjustments – how price gets paid and perhaps adjusted: deposit, timing of payments, adjustments, earnouts or targets



Representations and Warranties

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- Largest part of the agreement
- Statements about ownership, quality, business, clients, assets
- Watch qualifications – representations and warranties are an allocation of risk



Example 1

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- Simple incorporation and Existence Representation
 - ▣ The Vendor is a corporation incorporated and existing under the laws of the Province of Ontario



Example 2

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- No Options Representation
 - ▣ Except for the Purchaser's right in this Agreement, no person has any option, warrant, right, call, commitment, conversion right, right of exchange or other agreement or any right or privilege (whether by law, pre-emptive or contractual) capable of becoming an option, commitment, conversion right, right of exchange or other agreement for the purchase from the Vendor of any of the Purchased Assets



Example 3

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- Condition of Assets
 - ▣ All material tangible personal property included in the Purchased Assets is in good operating condition, repair and proper working order, having regard to its use and age, except only for reasonable wear and tear



Example 4

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□ Litigation

- There are no actions, suits or proceedings, judicial or administrative, (whether or not purportedly on behalf of the Vendor) pending or threatened, by or against or affecting the Vendor, at law or in equity, or before or by any Regulatory Authority. There are no grounds on which any such action, suit or proceeding might be commenced with any reasonable likelihood of success. There is not presently outstanding against the Vendor any judgment, injunction or other order of any Regulatory Authority



Example 5

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□ Customers

- Schedule X sets out the major customers and suppliers of the Business (being those customers and suppliers of the Business each accounting for more than ●% of sales of or to the Business for the period ● to ●) and there has been no termination or cancellation of, and no modification or change in, the Vendor's business relationship with any major customer, supplier or group of major customers or suppliers since ●. The benefits of all relationships with the major customers or suppliers of the Business will continue after the Closing Date in substantially the same manner as prior to the date of this Agreement



Conditions/Covenants

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- What must be done in order to close
- Other obligations of the parties



Example 1

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□ Insurance

- ▣ The Vendor shall continue to maintain in full force and effect all policies of insurance or renewals now in effect, and shall take out, at the expense of the Purchaser, such additional insurance as may be reasonably requested by the Purchaser, and shall give all notices and present all claims under all policies of insurance in a timely fashion



Example 2

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- Preserve Goodwill
 - ▣ The Vendor shall use its best efforts to preserve intact the Business and the Purchased Assets and to carry on the Business as currently conducted, and to promote and preserve for the Purchaser the goodwill of suppliers, customers and others having business relations with the Vendor



Other Possible Specific Considerations

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- Financing obtained by the Purchaser
- Consent obtained from third parties where required
- Vendor-specific concerns
 - ▣ Settling litigation
 - ▣ Terminating certain employees, etc



Indemnification

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- Teeth of the representations, warranties and covenants
 - ▣ Vendor indemnifies Purchaser for certain matters, such as
 - (i) losses related to breaches of representations, warranties or covenants,
 - (ii) losses related to liabilities that are not accepted by the Purchaser
 - (iii) certain matters occurring prior to closing



Some Negotiable Issues in Indemnification

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- Cap
- Timeliness
- Deductible vs tipping basket
- Adjustment due to insurance or tax benefits
- Adjustment due to other recoveries



Common (and Uncommon) Closing Issues

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- Neglected Corporate Records
- Third Party Issues
- Liens & Encumbrances
- Unresolved Key Agreements
- Deal Fatigue
- *Some things are just out of your control...*

Neglected Corporate Records

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- Minute Books
 - ▣ Shareholdings
 - Holder names
 - Trusts
 - Missing shareholders
 - Missing share certificates

- Corporate Filings
 - ▣ Does the company exist?

Third Party Issues

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- Landlord Consents & Approvals
- Bank
- Purchaser's Lender's Requirements
- Contracts Requiring Third Party Consents or Approvals
- The Rogue Shareholder
- The Rogue Employee

Liens & Encumbrances

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- PPSA Registrations
- The Bankrupt Vendor
- Executions

Unresolved Key Agreements

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- Employment Agreements
- Restrictive Covenants
- VTB Issues
 - ▣ Intercreditor Agreements
 - Subordination
 - Standstill
 - Priority

Deal Fatigue

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- Document Production & Compilation (Schedules)
- Business as Usual
- Last Minute “Asks”

Some things are just out of your control...

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- *Sickness*
- *Accidents*
- *Natural Disasters*
- *Tendering*

More questions?

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For more information about contracts, or how our firm can help with such matters, please contact:

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