

PRACTICAL PROPERTY FOR LAWYERS AND REALTORS
BUYING/SELLING REAL ESTATE CONTAINING A SMALL BUSINESS

The purpose of this part of the seminar is to discuss generally the considerations when drafting an agreement of purchase/sale relating to a small business such as a corner grocery store, restaurant, retail store or any small enterprise.

Although at first glance many of these transactions seem straightforward, they are often fraught with many pit falls and potentially serious situations for our clients. Many purchasers of small businesses are not necessarily equipped, at least in the first instance, to adequately assess the viability of the small business. Unlike purchasers of residential property, small business buyers are interested ultimately in whether the enterprise will make money or whether their future plans to improve or expand will be allowable.

It is important in these transactions to get all the relevant information on the table as soon as possible to ensure that there are no surprises half-way through the transaction or upon or after the closing. It is our job to make sure that our clients are going into the transaction with their eyes wide open. In this way our clients can avoid litigation in the future or worse - waking up the morning after the transaction is concluded and realizing they have just completed a "bad deal".

Avoid the temptation to "sign now" and iron out the details later. Take control of the situation. Remember, your client is paying you to give them proper advise. Be wary of the client who wants a "simple agreement". Remember that these same clients will come back to you later when the agreement did not include all of the necessary protections to avoid difficulties throughout the course of the transaction.

Remember that the agreement is the "deal". It is the document upon which creates the legal relationship

between the buyer and seller. It is this document that will be subject to court interpretation if the matter is ever litigated. Make sure that it is done correctly as it may be your advise which may be the subject of the litigation.

The format of my talk this afternoon will be to go through a "check-list" of the items to be "considered" when drafting an agreement. Whether I am advising the vendor or purchaser on the sale of the small business. I have not attempted to delineate the law in any detail in each particular area. The check list is not necessary exhaustive, and I, of course make no representation as to the validity of my advise and would advise those present not to rely on any of the representation or advise included in my talk this afternoon.

Many of the items included in this list may arise before or after the contract is executed. Many items may form conditions in the agreement. However, in my opinion, all of the matters that I have listed should be considered, reviewed and discussed with the parties, prior to executing an agreement of purchase and sale.

My remarks here are to review matters relevant upon entering into an agreement. Once the agreement is executed, there is an extensive list of lien checks and other matters to consider. This is not intended to be included in our discussion this afternoon.

I PARTIES

Describe the parties properly. Make sure you know who the vendor is. It may be that the owner of the real estate and the business may be two separate legal entities; that is the land may be owned by the vendor personally and the business owned by a corporation. Often the vendor will use a firm or style describing his business which is not a corporation. You should ascertain the proper legal identity of the

vendor. I always include the principals of the vendor if it is a corporation to join in the covenants of the vendor. If the deal goes sour, make sure the people who count are bound.

Discuss with your client how he/she wishes to conduct his business, either personally, in partnership or in a corporation. There are pros and cons to each of these alternatives. The purchaser should be receiving specific legal advice with respect to the proper vehicle through which to conduct his business. When representing vendors, I always insist that the principals of the purchaser, if possible, warrant the covenants of the corporate purchaser.

II PROPERTY TO BE SOLD

Include the property description from the vendor's deed in the agreement. Review with the vendor what lands are to be included in the transaction and reference any surveys or plans that the vendor has in his possession which will adequately describe the property. If there is to be a subdivision of lands, ascertain before the agreement is executed whether the subdivision is possible. This is easily done in most cases and should be done before the agreement is executed.

Review with the vendor any easements or right-of-ways that either encumber the property or are necessary to its enjoyment. These are not always obvious in the property description or survey plans.

If there are equipment and chattels to be included, make a list of those to be included in the agreement, including makes, models and serial numbers if possible.

If there is inventory to be included, ascertain generally what is there and discuss with your client when the most convenient date would be to take inventory for valuation purposes. This is not always on the closing date.

III **FIXTURES/CHATELS**

Discuss with your client the importance of the distinction between fixtures and chattels. Without getting into the details of the distinction, in cases where the chattels are not to be included in the sale it is important to be aware of this distinction. If there is any doubt in your mind or that of your client, include specific references in the agreement.

IV **DEPOSIT**

Get a decent deposit. Avoid situations of one dollar deposits even if they are to be increased later. Discuss with your client right-up-front the need for a sizeable deposit, whether you are representing the purchaser or the vendor. This will get rid of the "tire kickers" immediately and may save you a lot of time and effort in the long run dealing with people who do not have enough money to buy what they want.

V **PURCHASER PRICE**

It is extremely important that the purchase price be broken down between land, building, equipment and good will. There are important tax implications both for the purchaser and the vendor. The advise of an accountant or tax advisor is strongly suggested. As well, the implementation of Deed Transfer Tax, Provincial Sales Tax and GST will all depend on this breakdown.

VI **TITLE DOCUMENTS**

Get all title documents from the vendor including deed descriptions, location certificates, equipment warranties and the like. I always include this provision in the agreement. Remember however, a location certificate done for a previous owner cannot be relied upon by a purchaser. Suggesting to your client that a new location certificate not be acquired is not good advise and you will be liable in the event that any

difficulty arises, which a new location certificate would have disclosed.

VII ZONING/BY-LAW/LICENSES/PROVINCIAL AND FEDERAL REGULATIONS

Ascertain the zoning of the property and allowable uses up front. This is easily done by contacting the municipality or town where the business is located. I would suggest that you get this advice in writing, if possible and at the same time, find out what municipal by-laws and regulations are applicable to the business. Discuss with your purchaser any expansion or improvements that they may wish to make to the business after the completion of the transaction. Many older businesses are often "nonconforming" uses, which are not subject to expansion and carry with them extremely limiting land use restrictions. This can cause significant problems for everyone concerned.

Review with your client an specific license requirements for this particular business, such as health permits, liquor licenses in the case of restaurants and other permits required by provincial and federal regulatory authorities.

I always provide in my agreements the necessity that there be compliance with all regulatory authorities and that the agreement includes a condition that the purchaser obtains all necessary permits and licenses. You may wish to specifically refer to compliance with fire regulation and get a fire marshall's report.

Some businesses require special utility needs. Although the present utilities services comply with municipal requirements, they may not be adequate to service the business presently or for its proposed use. If the purchaser cannot satisfy him/herself on this point make specific reference to it in the agreement.

VII SIGNS

Signs are often an intricate part of the success of any business. Insure that your vendor's sign is legally erected and whether the existing by-laws will allow any removal or alteration to the sign. If the sign is located off the premises, insure that the municipality will allow such signs, and if the sign is located on the lands of another owner, insure that permission for a right-of-way easement is in place.

VIII RECORDS/LISTS OF CUSTOMERS/INSPECTION

I always provide in my agreements that the vendor is to provide full disclosure of financial records and customers lists which are to be held confidentially by the purchaser and returned if the agreement is not completed. I also provide for reasonable inspection by the purchaser, prior to closing. The standard one inspection prior to closing included in most residential agreements is not always adequate when purchasing a small business. To avoid surprises, have your vendor's records, client list and financial information, ready and available up-front when the deal is being negotiated, so that there are no surprises later on.

IX NAME/LOGOS

Make sure that your purchaser is getting title to all names and logos which are used by the business. The title of the business may be owned by an individual or corporation, which uses another name in the operation of the business. This name may be intrical to its success. Provision for the transfer of all names should be included in the agreement. Any logos or copyright names should also be included. It is important to review the significance of this with your client.

X **EQUIPMENT WARRANTIES/LEASES/SUPPLIERS**

Check to see if there are warranties or maintenance contracts on any of the equipment that is included in the transaction. Check to see whether those warranties are assignable and whether maintenance contracts can continue after the closing or whether there has been any breaches to the warranty or maintenance contracts. Discuss with your client the possibility of having the vendor give a limited warranty of fitness on the equipment.

Ascertain which items of equipment are subject to leases and what the terms and conditions of those leases are. All of these equipment contracts and leases should be disclosed and available to the purchaser before the agreement is executed.

In some instances you may wish to ensure that the vendor's vital trade suppliers will continue to supply the new purchaser. Unless assurances can be obtained from the suppliers and in the event that these trade contracts are crucial, make specific references in the agreement of this condition

XI **EMPLOYEES**

When buying a small business a purchaser may inherit the employees whether this is planned to or not. As well, certain obligations which are owed by an employer to an employee may be inherited by a purchaser. I always provide that the vendor dismiss all of the employees prior to closing and have the vendor settle any claims which the employees have or may have in the future. The purchaser then may re-hire the employees after the closing.

In some instances, one or two of the employees may be vital to the successful operation of the business. In those cases, I would suggest dealing directly with the employees to insure that those employees will

continue to work for the new purchaser.

I do not recommend that vendors make any commitments to any particular employee who works for the business, unless it is the vendor who is the employee.

XII PARKING

Make sure that the business has adequate parking and that it conforms with municipal regulations. If the parking is off-site make sure that this site is included in the transaction, if owned by the vendor. If owned by a third party, insure the lease or license is assigned.

XIII RESTRICTIVE TRADE

You should always inquire of your client as to the necessity of a restrictive trade agreement limiting the vendor from carrying on the same business within the area. This is common in personal service industries and in certain other retail operations. However, restrictive trade clauses are extremely delicate to draft and reliance upon expertise advise is required. It is important not to be too restrictive and jeopardize the validity of the agreement.

XIV TAXES - PST/GST AND PTT

Know what PST and GST the purchaser will be obliged to pay. Remember that although inventory is exempt from PST and any equipment that is transferred in the sale is subject to PST as well as GST. As we are having a separate seminar on the applications of GST, I will not include any references to GST in my remarks this after. Deed Transfer Tax is the obligation of the purchaser on any commercially assessed "property".

XV OTHER TENANCIES

Do not overlook other tenancies, either residential or otherwise that are included in the sale that are outside the main business which is subject to the agreement. If there are commercial tenancies make sure that the copies of the leases are obtained and that they are assignable. The obligations of the landlord in those leases will be inherited by the purchaser and may affect the future plans that the purchaser has for the building. If the tenancies are residential, make sure that you check to see that the rents are controlled and what they are. All of this information can be obtained up-front before the agreement is executed.

XVI TELEPHONE

Include in the agreement the vendor's obligation to allow the purchaser to use the existing telephone number. This is often important in some businesses. The success of a taxi or pizza business may depend largely on the public's knowledge of its telephone numbers.

XVII BULK SALES

Know the provisions of the Bulk Sales Act and discuss with your clients the necessity of compliance. In most cases only affidavits have to be completed and exchanged, however, in some cases the agreement must be filed in the Registry of Chattel Mortgages and the consent of creditors obtained.

XVIII FRANCHISE AGREEMENTS

If the business is a franchise this opens up a whole new world. The purpose of my talk this afternoon will not include any detailed comments regarding franchise agreements. It is enough to say that if the

transaction involves a franchise agreement legal advise would have to be obtained.

XIX LAW SUITS PENDING

Make inquiries as to whether the vendor is in the middle of or subject to any pending legal actions. The reputation of any business may be quickly destroyed if it is subject to any harmful litigation.

XX OPERATIONS PENDING CLOSING

I always provide in my agreements that the vendor will operate the business in the usual manner until closing. The last thing the purchaser wants is a closed sign on the door or a going out of business sale advertised.

Always include the usual provisions relating to risk pending closing and the covenants for the vendor to continue to insure with the option to the purchaser to elect to accept insurance proceeds and close or record the agreement.

XXI REPRESENTATIONS

Make sure that you are aware of all the representations that have been made by the vendor to the purchaser regarding the business. Those representations should be included in the agreement and a provision providing that all representations by the vendor are included in the agreement and that no others exist. One of the advantages of having all the information pertinent to the business disclosed up-front is that you will avoid "skeletons in the closet" appearing after the parties have invested a lot of time and effort and have prejudiced their legal positions. That is when it is most likely that you will encounter litigation, which you are trying to avoid.

XXII "JUST IN CASE" CLAUSE

I always provide in my agreement that the vendor has disclosed all information relevant to the transaction and that he has no information or knowledge of any facts relating to the business which might have reasonably deterred the purchaser from entering into or completing the transaction. Although this probably is included in the general fiduciary duty that the vendor owes to the purchaser, I always include this specifically as it reminds all parties to be "honest" with one another.

XXIII FINANCING

Agreements are often subject to financing provisions. As much as possible, have your purchaser qualified for financing before the agreement is executed. In this way, the financing conditions can be limited. However, if financing provisions are necessary, be specific and detailed as to the financing required.

Limit the time that the agreement is open to confirm financing. Remember your vendors property and business is effectively off the market until the financing is secured.

Be wary of vendor take-back financing. The purchaser who has little or no money to invest in a small business will be seriously under capitalized. Remember many, many small businesses go under and your vendor should be cautioned about extending financing in such cases.

XXIV CORPORATE REQUIREMENTS

If the vendor is a corporation I always provide in the agreement that the vendor will be obliged to provide all necessary corporate resolutions reasonably required by the purchaser's solicitor upon closing.

XXV ADJUSTMENTS

The usual provision providing for adjustments for taxes, rent, etc. should be included. Remember to discuss with your client the necessity of having the power meter read on the day of closing and the water and the sewer adjusted. In residential transactions these adjustments may not amount to a lot of money and care is not always taken. However, in a commercial transaction they may amount to significant amount of money and more care should be undertaken.

Remember that business occupancy taxes are not adjusted. Vendors are entitled to a rebate of business occupancy taxes after the date the business has been transferred. However, any arrears of business occupancy tax prior to closing must be paid as they are liens on the chattels of the business.

XXVI CONVEYANCE

The usual provision providing for warranty deeds and bills of sale should be included in the agreement.

XXVII CONDITIONS

Many of the provisions discussed above will form the subject of conditions in the agreement. Be clear and specific as to what are the conditions. The agreement should provide for whose benefit the condition is included and the right of that party to waive the condition if necessary. Remember that if there is no waiver provision included both parties would have to agree to have the conditions set aside. Conditions should be specific as possible although as you can see I have recommended general conditions in some incidences. This often depends on who you are representing.

Be sure to detail what happens if the condition is not met and limit the time that the condition is

outstanding.

XXVIII NOTICES

Always provide in the agreement some detail of how notification should be provided to either party.

XXIX CLOSING

Take some time in discussing the time and place for the closing. Remember that a great deal of work must be done between the execution of the agreement and closing date. There are numerous registry and regulatory checks to make or clearances to obtain by the purchaser's solicitors. Make sure that enough time is provided to insure that these certificates can be obtained prior to closing. Remember that a purchaser is not entitled to delay in closing and any agreement that provides for too early a closing may leave the door open for an early exit by an otherwise bound purchaser.

I hope that the foregoing has been an informative and interesting for you. I think that the biggest lesson to be learned is for vendors to have as much information as possible regarding their business available to prospective purchasers prior to negotiations. This will help to reduce the length of negotiations and make the deal easier to complete. When representing purchasers, make sure that as much as possible has been clarified before entering into the agreement. Also, you should discuss your clients financial ability to purchase any business before negotiations get too far along. Don't get trapped into wasting a lot of time with purchasers who can't afford to buy. Make them aware of all of the costs necessary to close a transaction such as adjustments, rent, taxes, deed transfer taxes, provincial sales tax, GST, legal fees and commissions.

Remember that ultimately, it is the client who has to make the decisions based on your help and advise. Do not give business advise. In most cases we are not qualified to give it. Explain to the client his/her responsibilities to do that and explain your role clearly. Remember, if there is any confusion about whether you recommended "the deal" and it goes bad, guess who will be looking for someone to blame. At the same time, if your client's business turns out to be a great success and he/she makes lots of money, do not wait around for him/her to share the profits with you.

Once again thank you for your attendance this afternoon. I hope you have found this informative.