

BUYING OUT A PARTNER: A CHECKLIST OF ISSUES TO CONSIDER

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All business partnerships end eventually. If nothing else, death or retirement will eventually end a partnership. What follows is a checklist of issues to be considered when buying out a partner. This is a generic issue to get your thinking started. It can be used in friendly and hostile buyout situations.

1 Background and Personal Issues

- 1.1 What kind of business is it? Is it incorporated? How long has it been going? What are its dimensions (annual sales, number of locations, number of employees)?
- 1.2 Who are the partners? What do they each bring to the table now? What have they brought to the table in the past? Who or what is triggering the split up? Why?
- 1.3 The extent to which this will be amicable. Why or why not.
- 1.4 The legal/share structure of the business, including number and type of shares and any special attributes.
- 1.5 Is there a shareholders' agreement? What does it say.
- 1.6 Current company accountant and professional advisors.
- 1.7 Potential mediators or third party intervenors.
- 1.8 Involvement or interference of other third parties (e.g. spouses, family members, friends).
- 1.9 Ability and willingness of partners to talk face to face. Now, or at some future time.

2 Valuation Issues

- 2.1 Current financial situation of the business.
- 2.2 The present value of the business, and the extent to which it is dependent on personal

goodwill.

- 2.3 Particulars of any shareholder loans or unpaid dividends, salary or bonuses.
- 2.4 Potential “fair market values” and “fair values” of each shareholder “investment”.
- 2.5 The amount of cash or cash equivalent resources in the business.
- 2.6 What does the shareholders’ agreement say about valuation? Or the process for determining value?
- 2.7 Other shareholder discussions or agreements on value or the process for determining value.

3 Partner as Employee Issues

- 3.1 Partner as employee considerations:
 - 3.1.1 just cause for termination
 - 3.1.2 wrongful dismissal issues: notice, compensation, benefits
 - 3.1.3 confidentiality obligations
 - 3.1.4 tie-ins to other issues

4 Strategic Issues

- 4.1 The potential for a non-buyout strategy:
 - 4.1.1 informal winding up
 - 4.1.2 division of assets
 - 4.1.3 third party purchaser
 - 4.1.4 formalized winding up on consent
 - 4.1.5 court ordered winding up
 - 4.1.6 legislative “minority rights” remedies
 - 4.1.7 oppression remedy litigation
- 4.2 The relative financial strengths and needs of the partners, and their ability to raise financing.
- 4.3 The likelihood of arbitration or litigation? Who should start? When? Using what approach?
 - 4.3.1 shareholders’ agreement remedies
 - 4.3.2 other contractual remedies
 - 4.3.3 court ordered winding up
 - 4.3.4 legislative “minority rights” remedies
 - 4.3.5 oppression remedy litigation
- 4.4 What kind of deals have been talked about already.

- 4.5 The likely timeframe in which a deal will be done, a likely cutoff date and a likely closing date.
- 4.6 Cost and expense issues – cost follows animosity, time and complexity; who pays what costs.

5 Preservation of Value Issues

- 5.1 The operation of the company in the meantime.
- 5.2 Sharing of physical space in the meantime.
- 5.3 The distribution of salary, bonuses, profits etc. earned in the meantime.
- 5.4 The impact on employees, including who to tell, when, what loyalties will be affected and how they will be managed.
- 5.5 The impact on key suppliers, including who to tell, when, what loyalties will be affected and how they will be managed.
- 5.6 The impact on customers, including who to tell, when, what loyalties will be affected and how they will be managed.
- 5.7 Impact on accounts receivable collection, and management of same.
- 5.8 Impact on work in process, and management of same.
- 5.9 Third party investors and bankers, how they will react, how to manage them.
- 5.10 Other third party approvals e.g. government licenses, landlords, etc.
- 5.11 Third party guarantees that need to be released.
- 5.12 Personal use or special assets that need to be split up.
- 5.13 Non-competition, non-solicitation obligations:
 - 5.13.1 What exists today
 - 5.13.2 What is necessary in the future
 - 5.13.3 How to manage them
 - 5.13.4 What compensation should be paid for them.

6 Purchase Price Issues

- 6.1 Shareholder loans or unpaid dividends

- 6.2 Earned but undistributed profits
- 6.3 Employment payments – severance package
- 6.4 Consulting payments
- 6.5 Restrictive covenant payments
- 6.6 Royalties or earnout issues
- 6.7 Payment for shares
- 6.8 Other types of payments
- 6.9 Timing of payments and contingencies
- 6.10 Purchase price adjustment issue

7 Financing Issues

- 7.1 Leveraged buyout, including “safe income” availability and increasing company borrowings
- 7.2 Buyer funding from own or other resources
- 7.3 Third party financing – availability, terms
- 7.4 Use of vendor take back financing – security for deferred payments:
 - 7.4.1 take the company back/sell the company or its assets/reverse the buyout
 - 7.4.2 shares escrowed
 - 7.4.3 personal guarantees
 - 7.4.4 corporate guarantees
 - 7.4.5 chattel mortgage/general security agreement
 - 7.4.6 payment terms and maturity

8 Income Tax Issues

- 8.1 Who will provide tax advice to the parties
- 8.2 Use of capital gains exemption
 - 8.2.1 Existing ACB of shareholder being bought out
 - 8.2.2 Allocation of funding too no share value issues (see below)
 - 8.2.3 Impact on buyer’s taxes to fund buyout

- 8.3 “Safe income” availability
- 8.4 Deemed dividend issues – impact to seller and buyout
- 8.5 Severance package
- 8.6 Consulting fees, employment income, etc.
- 8.7 Non-competition, non-solicitation payments
- 8.8 Royalty or earnout payments
- 8.9 Change in control – deemed year end, etc.
- 8.10 Change in CCPC status, if applicable
- 8.11 “Association” rule issues for buyer

9 Miscellaneous Legal Issues

- 9.1 What guarantees need to be released
- 9.2 What representations and warranties are required
- 9.3 What special covenants are required
- 9.4 What releases are required, and from who
- 9.5 What indemnities are required, and from who
- 9.6 What resignations are required, and from who
- 9.7 Who needs what representation, including independent legal advice
- 9.8 Company name change required?
- 9.9 Company corporate records updated?

10 Structure Summary

- 10.1 Buyer is _____
- 10.2 Seller is _____
- 10.3 Seller is taking what assets from company at what value

- 10.4 Seller is assuming what liabilities at what value
- 10.5 Seller is being paid what money, by who, when, for what, and characterized as what
- 10.6 Financing is being provided by who and on what terms
- 10.7 Terms of any VTB financing
- 10.8 Terms of any royalty or earnout
- 10.9 Terms of any restrictive covenants
- 10.10 Release of personal obligations
- 10.11 Indemnities and releases
- 10.12 Representations and warranties
- 10.13 Management of other third party issues: employees, suppliers, customers, etc.
- 10.14 Effective date
- 10.15 Closing date
- 10.16 Closing financial statements
- 10.17 Interim management of company
- 10.18 Price adjustment issues, when and why and how managed
- 10.19 Additional security issues re: various obligations
- 10.20 Post-closing obligations not already covered
- 10.21 Implementation strategy: Who is doing what, and by when?
- 10.22 Costs and budgets – how much, when, who pays.