# BEFORE THE SALE: TIPS TO GET YOUR LEGAL HOUSE IN ORDER TO MAXIMIZE THE SALE OF YOUR BUSINESS

By Michael Reid, Patrick Webb and Tea Mamic

For most entrepreneurs and business owners, the prospect of selling your business can be equal parts exciting and terrifying. Whether you've built the business with the goal of a sale in mind, or you've been operating for years and are now ready to retire, your sale requires careful consideration and planning to ensure the process goes as smoothly as possible.

Once the sales process is initiated, things may move quickly, so it's essential to get your company in the best position possible beforehand. This article highlights a number of key items to consider and prepare for prior to marketing your business for sale.

## 1. General Corporate Hygiene

### Are your corporate records in order?

A detailed review of a target's corporate records is standard in the vast majority of acquisitions, particularly if you intend to sell the company, as opposed to only the assets. To make sure your records are set up to pass a potential buyer's due diligence review, it is wise to first conduct a self-evaluation. This involves collecting all the information a buyer might be interested in and ensuring it is accurate, complete, up to date and comprehensive.

Corporate records are usually kept in what's called a "minute book", and this is typically what prospective buyers expect to see. A minute book is the "official record" of a corporation's activities and is comprised of documentation which the corporation is required to maintain under corporate law. This may be something you have maintained yourself, or something managed by your corporate lawyer or another service provider, may be in physical or electronic form, and typically includes; resolutions, meeting minutes, registers of directors and shareholders, material agreements and constating documents like Articles, By-Laws and so forth. Having an up-to-date minute book can be a critical element during the sale process.

### Do you have a signed copy of all of your agreements?

As part of a potential buyer's due diligence, they will want a copy of the agreements making up the key elements of your business. Agreements with partners, customers, suppliers and service providers can all be "key" depending on the business. So can loan arrangements, shareholder agreements and employee agreements.

There are some common issues with agreements to watch out for before selling your business. Is the agreement made with the correct party, such as your company, rather than a related party like a subsidiary, holding company, or you personally? Is the agreement dated? Is it executed by all parties, and are you certain the version you have is the final document? Buyers will also review for clauses contemplating term and termination. Is the term fixed or rolling? Has the term expired, or was the agreement extended at some point? Is there a change of control provision? Can the agreement be assigned? Being proactive in reviewing these agreements can help identify any issues that need to be addressed prior to opening up your data room to a potential buyer.

Before selling any business, you should consider whether your key agreements are accessible, executed and in written form. If agreements are unwritten or incomplete, they should be updated prior to engaging in a sales process if possible. If not possible, at least you have a "to do" list to address during the process.

Access to documents in the due diligence phase is typically facilitated through use of a data room — i.e. an index of a business' relevant information which is readily-available and reviewable for interested parties. These documents provide an overview of your company's history and potential, and, in addition to the corporate records and agreements noted above, typically include information regarding financial matters, product details, intellectual property, employees, insurance, compliance, customers and litigation. Having a well-structured data room can facilitate a smooth selling process, and is a key tool used in structuring acquisitions.

## 2. Structure of Your Company

**Is your company ideally structured for sale?**

The structure of your business can influence its attractiveness to potential buyers, and also affect the money left in your pocket when the dust settles. It is highly advisable to seek advice and contemplate restructuring your company's operations and/or corporate setup prior to marketing a sale. There are a wide array of reasons and motivations for contemplating restructuring. Does your company have any non-contributing assets? Do you have asset classes or operations that can be bundled? Do you have subsidiary entities that should be retained post-sale? Can your corporate structure be simplified? Can you restructure to optimize tax efficiency through holding companies, family trusts or other vehicles? How is your intellectual property registered or shared?

Restructuring can be a simple process or a complicated one, all of which largely depends on where you start and where you intend to finish. We generally recommend obtaining at least preliminary corporate and tax advice early in the process so that once a sale is imminent, restructuring does not slow down closing the sale. Even if a restructuring will not be implemented until sale terms are agreed, it is much quicker to implement a restructuring plan than it is to start from scratch while the buyer is waiting to write a cheque.

## 3. Personnel

It is very important to review all employment agreements and understand any rights and obligations associated with employees before the sale of your business.

This is another area where proactively reviewing the agreements in place can be advantageous. If issues are discovered, agreements can be amended prior to engaging in a sales process.

Agreements covering your employees typically contain provisions regarding non-solicitation/competition, confidentiality, termination, intellectual property rights and incentives. These should be executed and in written form, and accessible to prospective buyers. Buyers want some certainty that when they purchase a company, employees won't leave and take others with them, nor be entitled to a great deal of compensation following a change of control nor share industry knowledge or intellectual property with competitors. Employment agreements which are either non-compliant with local law, or otherwise deficient from industry standard may provide an impediment to closing or increase potential liabilities which the buyer will either be assuming (and likely seeking an offset from the sellers) or will require to be fixed prior to closing.

## 4. Intellectual Property

Intellectual property can be a company's most valuable asset. Ownership of a company's IP should be thoroughly reviewed and considered. Is it adequately protected? Is it properly registered? Is it owned in whole or in part by your company? Have employees or contractors retained any rights as creators? Has all IP been properly assigned? These are all items that need to be considered prior to a sale, and a thorough review of all agreements, registrations and instruments evidencing IP should be considered.

To prevent any uncertainty connected to IP, it is best to have express agreements with employees and contractors waiving their rights and making assignment in favour of your company. You will also need to consider whether initial founders and former key employees had agreements waiving IP rights.

For some companies, there are further specific considerations. For example, if you have a software company, documenting the use of open source software and ensuring its proper usage is essential.

You may even want to consider completing an audit of your software assets to identify any open source components to identify issues associated with the use of open source software that may need to be addressed during a sale. Keeping an up-to-date list of open source uses and licensing agreements and obligations can put you in an informed position during a sales process. Having internal controls in place can also be a "green flag" during a buyer's diligence review.

## 5. Shareholders' Agreements

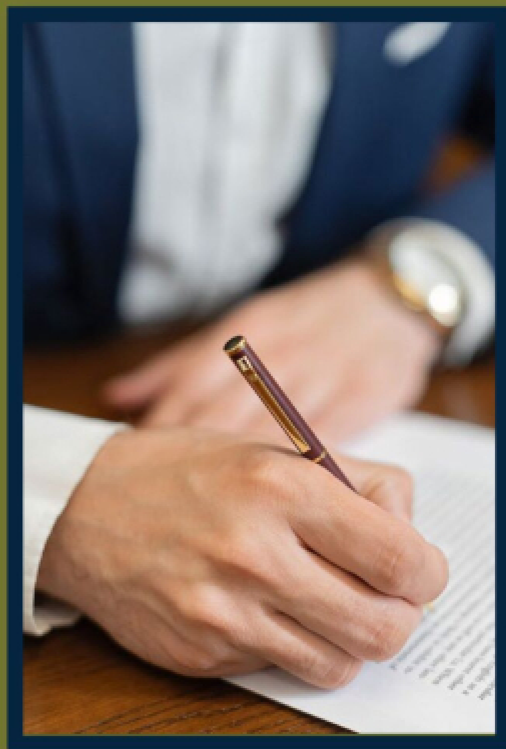
If your company is owned by multiple people, particularly if it is not a family business, it should have a shareholders' agreement that describes how the company operates and the rights and obligations of the shareholders. Shareholders' agreements often contain rights triggered by a sale or potential sale. Some common examples include:

**Shot gun clauses**: When a triggering shareholder makes an offer to other shareholders to buy their shares at a certain price. The other shareholders either have to buy the triggering shareholder's shares at the same price, or accept the offer to sell their shares at the offered price.

**Drag along clauses**: When a majority shareholder wants to sell to a third party, they may be able to "drag along" minority shareholders by forcing them to sell their shares on the terms accepted by a majority shareholder.

**Tag along rights**: When a majority shareholder sells their shares, this allows minority shareholders to tag along and sell their shares on the same terms.

If you do have a shareholders' agreement, it should be reviewed before a sale to ensure you are aware of any rights or obligations that would be triggered by the sale, and to identify any issues that may be brought forth during a buyer's diligence review.



### Voting trust agreements

The use of voting trust agreements can help make critical business decisions more efficient, including during a sales process. A voting trust agreement is a legal arrangement whereby shareholders transfer the voting rights of their shares to a trustee who is obligated to vote the shares in accordance with the agreement. If you have a large number of shareholders, it can be difficult to chase down and collect approval from minority shareholders for major business decisions, like selling the business. It may be advisable to consider whether the use of a voting trust agreement makes sense prior to a sale.

## 6. Change of Control Provisions

Change of control provisions may be found in all forms of material contracts, such as employee, vendor and customer agreements. These provisions are often triggered following a sale of all or substantially all of a company's shares or assets. Issues associated with change of control provisions (e.g. obligations to obtain consents, entitlements owed to employees or others) should be identified prior to engaging in a sales process. The following are some types of agreements where it is common to see change of control provisions:

- Employment or consulting agreements, including those applicable to senior management, often include change of control provisions. These provisions may give the employee the right to resign following a change of control and/or the right to be paid a certain amount of their salary and/or other entitlements as part of their severance.
- Creditor agreements can include change of control clauses to protect the lender when there is new ownership of a company. These agreements can require consent from the lender to change control of the company.
- Leases may include provisions that require landlord consent to change of control of your company or where the sale of your assets includes an assignment of the lease.
- Licenses and regulatory permits or approvals may contain consents required to assign the agreement to a new owner following a change of control.
- Entitlements under shareholder agreements may be triggered upon a change of control.

Many agreements include anti-assignment clauses, which prohibit the transfer of an agreement without consent. Anti-assignment clauses may also be drafted to prohibit a change of control without the other party's consent. This is crucial to know in advance of selling your business, as a failure to obtain the requisite consents can have significant consequences, and may delay or even derail a proposed acquisition. A buyer will want to make sure the rights under the relevant agreement will be retained post-sale. By proactively identifying these provisions, companies looking to sell can amend the agreements, or be prepared to obtain the necessary consents as required, and plan accordingly.

## 7. Choose Good Advisors

You are the expert when it comes to running your business. However, when it comes to selling your business, you're going to need to engage some other experts to help.

### Accountants

Accountants can be key advisors in a business sale in a number of ways. They will help you prepare financial disclosure, consider potential benefits of restructuring, deal with potential tax elections and filings, and plan the post-sale tax impact. You may already be working with an accountant for your annual tax filings, and they may be able to help with some or all of your transactional needs. However, if your accountant is more of a bookkeeper and does not have tax planning expertise, you may need to consider engaging someone that specializes in business sale transactions.

**Lawyers**

A good lawyer is going to be critical to ensuring you not only complete your sale, but that you are protected following the sale. Whether you are selling the assets of the business or the company itself, you will need someone to structure the terms of the sale, prepare the documentation and manage the process. Many business sales have a lot of moving pieces, and can involve a variety of agreements around the sale, including transfer of assets, third party consents, payment terms, vendor take back loans, security filings, employment agreements, earn-outs, and non-competes.

When looking for a lawyer, look for someone who handles business sales as a core part of their practice. Not only will they have the skills you need, but they will also have market insight and experience to help you avoid pitfalls. Keep in mind, the legal issues inherent in any business sale are very similar, no matter what the purchase price may be. Your lawyer will not only need to understand those issues, but should also be able to scale their legal advice and explain risk factors to you in light of the size of your transaction.

**Brokers/Consultants**

Oftentimes when you are selling a business, you will engage some sort of broker or consultant to assist you in the marketing and negotiation of a sale. There can be great value in engaging these advisors to source potential buyers and help you consider issues like the market value of your business.

However you should also be cautious about who you select as a business broker, and what sort of advice you are taking from them. Unlike accountants and lawyers, there is no uniform regulation governing someone who calls themselves a "business broker", so they can theoretically come from any sort of professional background like accounting, legal, banking or consulting. Some are even real estate brokers that have taken to selling businesses!

Given that many business brokers tend to charge scaling rates based on a percentage of the sale (sometimes as high as ten percent of the business you've built with your blood, sweat and tears), it may seem to make sense to heap as much of the work necessary to complete the sale on to the broker team as possible. However, unless the broker actually has an accounting designation, they should not be providing accounting advice. And unless they are a practicing lawyer, they should not be drafting or providing agreements or advising you on legal terms. The mark of a great broker is that they will similarly advise you to seek other qualified experts.

## 8. Conclusion

Preparing to sell your company requires careful consideration and planning to ensure a smooth sales process that will leave all parties satisfied. Being proactive in regards to your corporate hygiene, corporate structure, personnel, intellectual property, shareholders' agreements and other matters will put you in a superior position to engage in negotiations and navigate a buyer's diligence efforts.

Every company and every sale transaction is unique. It is essential to consult with the appropriate advisors that can bring to bear the expertise necessary to craft the right strategic approach based on your specific circumstance. With thorough preparation and the right support, sellers can embark on the journey of selling their company with a clear roadmap to success.

## About Michael Reid

Mike Reid is a corporate law generalist with a technology focus, often working with entrepreneurs, founders and other executives in startup and growth-stage companies.

Mike works with companies in a wide variety of sectors, from software to e-commerce, gaming to productivity tools, artificial intelligence to VR/AR, healthtech, fintech, consumer goods, food and beverage, life sciences and everything in between, at all stages of a company's life cycle from startup, through growth, to exit.

Mike is a trusted legal advisor, helping guide clients through their various corporate process and business issues. Specifically, he advises clients on corporate/commercial law including: company formations, such as structuring, shareholders agreements, and governance considerations; IP creation and commercialization; staffing concerns, such as employment and contractor matters; B2B and B2C contracting concerns; financing matters whether pre-seed, seed, series raises, private equity, venture capital or other strategic investments; and joint ventures, mergers and acquisitions.

Prior to practising law, Mike had a career in marketing and communications working for a wide range of clients. He brings to his legal practice a practical understanding of what it takes to grow successful business ventures in the modern economic landscape.

Mike has particular expertise advising startup companies and has written a number of articles providing tips, tools and programs for entrepreneurs and their startup ventures.

## About Patrick Webb

Patrick Webb practices corporate law with a focus on mergers and acquisitions, securities law transactions and general corporate matters.

Patrick advises public and private clients on a diverse range of corporate, commercial and securities law matters, including financings, public offerings, private placements, stock exchange listings and other transactions including underwritten offerings and private equity transactions. He also provides ongoing advice with respect to corporate governance, regulatory compliance, continuous disclosure obligations, stock exchange matters and general corporate law.

While completing his J.D. at the University of Victoria, Patrick was active in the community as a student clinician at the Faculty of Law's Business Law Clinic and Law Centre, by providing legal services to businesses and members of the broader community who have limited means. Prior to attending law school, Patrick obtained a Bachelor of Commerce from the University of Victoria.