You Want to Sell — But are you Ready?

Should I Stay or Should I Go

By Steven Borlak

As the p&c industry is all too aware, insurers are aggressively vying to protect their territory and to attack the turf of their competitors. Many companies have established teams to streamline and implement acquisitions or to provide favourable loans to further such initiatives.

The net result is a wave of mergers and acquisitions and soaring multiples. It is clearly a strong vendors' market, and the pricing for acquisitions is as high as I can remember.

At the same time, the front edge of the generation of baby boomers is entering retirement mode. Experts suggest that 70 per cent of small and medium-sized enterprise owners plan to exit business within the next 10 years. My own surveys (admittedly limited and anecdotal) confirm this view - it appears that a large percentage of brokers intend to retire and sell within the next decade.

Paradoxically, my surveys also indicate that only a small percentage of brokers have developed formal succession plans. Despite their intentions, many brokers are simply not in 'sale condition' and therefore are not in a position to maximize the value that they might receive for their firms.

Certainly, all brokers should plan for succession. Perpetuation arrangements should be outlined in writing and should be submitted to consulting professionals (accountant, lawyer). Brokerages should also develop a 'disaster plan' that will set the agenda in the event that a principal or owner dies or becomes incapacitated before the succession plan can be implemented. As with the succession plan, the disaster plan should be lodged with the broker's consultants.

There are many operational issues that ought to be considered before you put your firm on the block — if you are to maximize value. I defer to other consultants to expound upon and assist you with such concerns.

Instead, I will make a few observations and recommendations, as a lawyer, to help brokers get 'sale-ready'. Please be cautioned (sorry, this is lawyer-talk) that this is not an exhaustive list. Also, some of these issues may take time to address or correct. Therefore, I urge you to start thinking about and dealing with them now!

STEP BY STEP

Assess ownership structure:
Most sales involving brokerages are structured as share sales rather than asset sales (sale of the book of business). The ability of vendors to utilize the small-business corporation capital gains exemption makes this alternative very attractive. You should, therefore, ask your tax advisor the following questions.

Are my shares qualifying for the purpose of the capital gains exemption? If not, can steps be taken to correct this?

Review minute book:
Is your minute book up-to-date? By this, I am not referring to missing or deficient annual minutes or resolutions (although these are technically mandated by statute). Delinquent annuals can generally be cleaned up with the signing of 'whitewash resolutions' prior to the closing of a sale. The more significant concern is where share ownership in a minute book is inconsistent with the identity of the vendor or vendors who wish to sell the shares.

For example, I can recall a transaction that was aborted at the last second due to minute book difficulties. When the minute book was finally presented, it identified split ownership among my client (the intended vendor), an estate (of which my client was not the sole executor), and a parent of my client who was no longer competent and therefore represented by committee (but my client was not the sole representative on the committee).

Premises lease:
What is the status of the premises lease? If the lease adds value, perhaps the broker should negotiate an extension. Possibly the lease has a renewal privilege that must be exercised in a timely manner. On the other hand, the lease may be undesirable. If this is the case, are subletting or assignment options? Will the landlord accept a termination of the agreement on terms?

Equipment leases:
Investigate the status of outstanding equipment leases. Are there any that are personal in nature and must be either bought out or transferred from the brokerage?

Encumbrances:
Are there any encumbrances affecting the brokerage that must be retired? Does the firm have outstanding credit facilities? Can these be retired without penalty? I recommend having a search conducted under the relevant provincial personal property security legislation to see if (a) the broker has forgotten about some encumbrances, (b) a secured party has forgotten to release some old security, or (c) registrations exist for security interests that the broker was truly unaware of.

Right of refusal:
Is the vendor bound by any rights of refusal? It is very common for insurance companies, as lenders, to include such rights as part of their security package. In some cases, rights of refusal are also granted to insurers in connection with other initiatives.

At the 'letter of intent' stage, a purchaser will usually demand a binding representation that the vendor is in control of the sale — in particular, that there are no rights of refusal that must be complied with in order for the vendor to sell. The rights of refusal are not all the same and brokers should tread very carefully.

If a vendor broker is bound by a severe right of refusal, this may have a chilling effect on prospective purchasers and could ultimately affect the marketability of the brokerage.

Documentation and records:
As part of the sale process, vendors are asked to provide complete disclosure of anything material that will affect the purchaser. This means that the vendor will be required to produce schedules with detailed information regarding employees and producers, licences, equipment leases, real property leases, insurance policies (E&O, office, fidelity), outstanding claims, and any other material agreements.

When it comes to disclosure through scheduling, there are varying levels of rigour demanded by different lawyers. Recently, I have seen this rigour expanded. Therefore, vendors should be forewarned that (a) this portion of a sale exercise can be very exhausting, and (b) the task of assembly of information may have to be delegated to a trusted member of staff.

Employment and producer agreements: The absence of employment and/or producer agreements or the unsuitability of such agreements can create problems for a vendor. Unfortunately, if agreements are missing or if they are deficient, this is an issue that might he difficult to correct.

For a binding contract to be struck, 'legal consideration' must pass at the time of signature. Therefore, correction of this problem by signing a new agreement after the commencement of the working relationship will generally result in the creation of an agreement that is vulnerable to legal attack.

To solve this, the broker should introduce the contract for signature at a time when he or she is also offering positive adjustments to the employee's terms. Then it may be supported by the fresh consideration in the form of the positive adjustments. It should be emphasized that a worker's agreement that is vulnerable because of the failure of consideration is, in my view, better than having no agreement at aII.

If it is unrealistic to create new agreements with staff prior to closing, can anything else be done in advance of a pending closing? This is a touchy area. I follow a technique that will be described in detail in a future article. On the other hand, if you wish to move forward with a new agreement for new workers or existing workers and the circumstances allow for it, there are many things to be considered. This will also be further explained in the future. In the meantime, here is an extremely abbreviated list.

- The agreements should clearly identify 'ownership' (particularly for producers) as between the worker and the broker. In situations involving exceptional producers, a broker may wish to confer ownership or quasi-ownership rights to the producer as an inducement. If this is the case, the rights should be clearly identified.
- Suitable restrictive covenants should be in place. Upon termination, the workers should be prevented from accepting business from the broker's customers. If the workers are only bound by conventional non-solicitation wording, this will not prohibit accepting business from customers who 'solicit the worker'. As was pointed out in the recent Staebler decision, the courts appear to be willing to enforce 'hybrid' clauses against former employees that prohibit them from conducting business with customers who were handled or serviced by the former worker (even in the absence of solicitation by the former worker).
- Be mindful of federal and provincial legislation and regulations that may affect the workers.

We plan to be regular bi-monthly contributors to this publication on matters of legal concern. Among other things, we are monitoring the appeal of the Staebler decision and we will provide an update on the results of this important case and other related cases in a future article. As indicated earlier, we will provide greater detail regarding employment and producer agreements in future articles. We have many other ideas in mind for articles and we welcome your feedback or suggestions.