



M&A pet shop talk

Chewy and Parker are the principals of Pit-bull Marketing Inc., an Ontario-based marketing company that specializes in marketing dog rainwear, a lucrative niche industry. Chewy and Parker have determined there is more profit to be made in selling dog rainwear and want to expand their company by acquiring Raining Cats and Dogs Ltd., an Ontario-based company that retails dog rainwear. You are the new in-house counsel for Pit-bull Marketing. The parties have signed a non-binding letter of intent to proceed with the purchase of 100 per cent of the shares of Raining Cats and Dogs in an all-cash deal.

- 1** Chewy and Parker need outside financing to complete the proposed purchase and have lined up a potential loan to Pit-bull Marketing for the purchase price. Pit-bull Marketing also has an existing operating loan from Big Bank. The new lender is aware of the existing loan and is willing to take a second-ranking general security interest in the assets of Pit-bull Marketing. Chewy wants to save every penny possible, and thinks there is no need to involve Big Bank or incur the additional costs of dealing with their lawyers. Is he right?

 - a) Yes
 - b) No
- 2** During the course of your due diligence, you discover that last year Raining Cats and Dogs did an e-mail marketing campaign which stated their dog booties would “make your dog run faster, jump higher and be more active, guaranteed.” A competitor of Raining Cats and Dogs complained to the Competition Bureau, which has opened a file and is investigating the matter. Chewy and Parker are worried about potential liability. What, if anything, should you tell them?

 - a) Consider buying the assets of Raining Cats and Dogs instead of the shares.
 - b) Request a holdback of the purchase price and indemnity from Raining Cats and Dogs to cover any potential liability.
 - c) Don’t worry about it — it will work out. The Competition Bureau probably won’t follow through with any investigations.
- 3** You learn that Raining Cats and Dogs is a franchise of Petwear Co., a national pet clothing franchisor. Raining Cats and Dogs’ counsel has informed you that Petwear Co. will not consent to the deal unless Pit-bull Marketing enters into a new franchise agreement. Petwear Co. also requires payment of an upfront fee of \$20,000 before it will provide a copy of the agreement. As a franchisor, is Petwear Co. entitled to require these conditions?

 - a) Yes
 - b) No
- 4** Chewy and Parker are comfortable with the indemnities and holdback that you and Raining Cats and Dogs’ counsel have negotiated and have decided to proceed with the share deal. You have arranged for outside counsel, Bulldog & Bulldog LLP, to assist with the transaction. On the closing date, a senior partner at the firm insists that you not wire funds or proceed with closing until you get a Section 116 clearance certificate for Gidget Rolo, a 25 per cent shareholder of Raining Cats and Dogs who lives in Florida. He says without the certificate Pit-bull Marketing would have to remit part of the purchase price to the Canada Revenue Agency on account of Rolo’s tax liability on the sale. Rolo is on a meditation retreat and cannot be reached. What do you tell your external counsel?

 - a) You must report.
 - b) You do not need to report to the Canada Revenue Agency.
- 5** Another last-minute issue has arisen. An articling student at Bulldog & Bulldog reviewed the minute books of Raining Cats and Dogs and can’t find Gidget Rolo’s share certificate. It appears the certificate is being held by Hunter Willy, to whom Rolo pledged the shares as collateral for a payday loan. Rolo claims that she repaid the loan, but Willy says she hasn’t paid a fee due on her late repayment and won’t give up the share certificate. Raining Cats and Dogs’ counsel asserts that Willy is charging too high of a fee and has no proper claim to the shares. He suggests having Rolo sign an affidavit of loss and reissuing the certificate to get the deal closed. Chewy and Parker say this sounds like a good idea. What do you tell them?

 - a) OK
 - b) No way



1 **PROBABLY NOT.**

Although the new arrangement will not interfere with Big Bank's priority under the Personal Property Security Act in Ontario, loan agreements typically contain negative covenants regarding additional debt or security. You should review the existing loan agreement and engage Big Bank as early as possible to get the necessary consents, and advise Pit-bull Marketing that Big Bank's consent may be required for closing.

2 **A) OR B)**

When it comes to deceptive marketing practices, the Competition Bureau focuses its enforcement efforts on the businesses that are responsible for content or have a degree of control over that content. This is set out in ss. 52(2) and 74.03(1) of the Competition Act, and the bureau's published enforcement guidelines. As Raining Cats and Dogs had the power to decide what content went in their campaign, there is potential for liability under the Competition Act. Under s. 74.1, for a first offence, a corporation may be liable in an amount up to \$10 million for deceptive marketing practices. You should consider whether a holdback of the purchase price and an indemnity from Raining Cats and Dogs will give your client sufficient comfort regarding these contingent liabilities, or whether they would prefer to proceed with an asset deal and exclude such liabilities from the purchase.

3 **B)**

No. Under Section 5(1) of Ontario's Arthur Wishart Act, Petwear Co. is required to deliver to Pit-bull Marketing a disclosure document that complies with the requirements of the act. As a prospective franchisee, Pit-bull Marketing is entitled to receive the disclosure document not less than 14 days before signing the franchise agreement or any other agreement relating to the franchise, and before paying any consideration to the franchisor. Under s. 6(2) of the act, where a franchisor has not delivered a disclosure document to the franchisee, the franchisee is entitled to rescind the franchise agreement within two years of entering into the franchise agreement. You should remind Petwear Co. of its obligations under this statute and require full compliance.

4 **IT MAY NOT BE NECESSARY.**

The federal Income Tax Act was amended in 2010 so that shares of a Canadian private corporation are no longer defined as "taxable Canadian property," unless they are

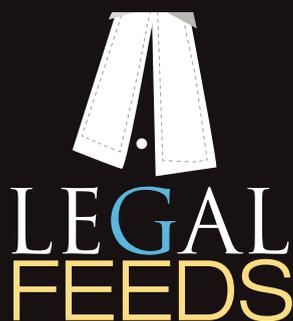
shares in a corporation of which more than 50 per cent of the value is derived directly or indirectly from Canadian real property (or other impugned property listed in the act) owned within the 60 months preceding closing. Provided Raining Cats and Dogs has not exceeded this 50 per cent threshold, Section 116 clearance certificates for non-Canadians who are selling their Raining Cats and Dogs shares are not required for the closing of the transaction.

5 **B)**

No way. Under the Ontario Securities Transfer Act, 2006, a purchaser of shares will only meet the definition of a "protected purchaser" if it (i) gave value, (ii) did not have notice of any adverse claim to the shares, and (iii) obtained control of the shares. For a certified security, a party obtains "control" under s. 23(2) of the act by taking possession of the certificate, together with (i) an appropriate endorsement, or (ii) arranging for the issuer to register the security in the name of the secured party. In this case, your client would not qualify as a protected purchaser both because it would not obtain possession of the existing certificate and because it has notice of Willy's adverse claim. Therefore, if Pit-bull Marketing proceeds as suggested it would buy the shares subject to Willy's lien if it proved valid. In addition, faking an affidavit of loss may constitute perjury, and acquiescing to it would breach rules of professional responsibility. You don't want Raining Cats and Dogs to inherit this problem and should require that the sellers deal with it prior to or on closing, perhaps by directing some of the purchase price to Willy to settle the dispute and get the certificate released.

YOUR RANKING?

- **One or less correct:** *might be time to brush up*
- **Two correct:** *not bad, but some further work needed*
- **Three correct:** *very well done, but not perfect*
- **Four correct:** *impressive*
- **Five correct:** *excellent*



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