

Buyer's failure to conduct due diligence defeats claim for misrepresentation against seller of laundry business

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Buyers of a small business would do well to conduct as much due diligence as a purchase agreement allows concerning the alleged income of the business being purchased. Certainly, any representations made by a seller should not be taken at face value when there is an opportunity to have income figures independently verified.

In *10443204 Canada Inc v. 2701835 Ontario Inc.*, 2021 ONSC 5429 (CanLII), the seller of a coin laundry business sued the buyer for unpaid amounts owing under a vendor take-back (VTB) mortgage, promissory note, and personal guarantee. In response, the buyer claimed that the seller had either fraudulently or negligently misrepresented the income of the business.

The case involved a coin laundry business in Brampton owned by the plaintiff from 2017 to July 2019, when it was sold to the defendant. The business offered wash and fold and dry-cleaning services in addition to the coin laundry. It was operated as a family business, owned by a husband and wife with their son.

The owners decided to sell the business in February 2019 and listed it for sale on the Multiple Listing Services ("MLS") for \$349,000.

In May 2019, the buyer learned about the business through an MLS search and he contacted the listing agent. The seller and buyer were from the same region in India, which added an extra level of trust for the buyer during their negotiations.

The buyer claimed that he was told in a meeting with the seller and the listing agent that the business was profitable and generated \$12,000 per month in gross income. Based on these representations, he offered to purchase the business for \$290,000.

The parties then signed a conditional Agreement of Purchase and Sale (APS), which included a written covenant from the seller stating that "the Business has been carried on in the ordinary course and all financial statements and other information provided to Buyer are true, accurate and correct in all material respects and have been prepared in accordance with generally accepted accounting principles ...".

However, the only financial statements that were actually reviewed by the buyer consisted of a brief one-page statement prepared by the listing agent based upon information provided by the seller. The statement indicated gross monthly income of \$12,000/month plus various expenses. At the bottom of the page, it stated "Buyer/Buyer agent must verify." The buyer did not request any additional financial statements. The buyer did not retain his own agent.

The buyer also had the opportunity to conduct an inspection of the revenues of the business over a 14-day period and was entitled to attend at the business during that time. He mostly went on evenings and weekends. The cash count provided by the owner's son during the time period was approximately \$374 per day, which was consistent with the \$12,000/month gross income amount in the one-page statement. While the APS provided the buyer with the right to have the money counted independently to verify the income, he did not do so.

The purchase transaction was completed in July 2019, with the buyer paying \$100,000 and agreeing to the VTB, promissory note, and personal guarantee for the balance owing of \$190,000.

Following closing, the buyer discovered that the monthly income was significantly less than \$12,000. From August 2019 to March 2021, the gross monthly income generated was approximately \$3,557 from the coin laundry machines, and the income from dry cleaning and wash and fold services was similarly less than anticipated. The buyer defaulted under the VTB payments in 2019 after only a few months of ownership. Litigation ensued.

In June 2021, the Ontario Superior Court of Justice heard a summary judgment motion brought by the seller. It was not disputed that the APS, VTB, promissory note, and personal guarantee were duly executed. The issue to be determined was therefore whether the buyers had raised a genuine issue regarding alleged fraudulent or negligent misrepresentations by the seller.

On this point, the court noted that to the extent there was a factual dispute between the parties over what the seller had told the buyer in their initial meeting, the APS that they subsequently negotiated contained an "entire agreement clause" stating that there were no representations, warranties, collateral agreements or conditions, affecting the agreement other than as expressed therein.

The seller further relied on the opportunities that the buyer had to conduct his own due diligence and cancel the APS during the conditional period. The buyer could have consulted a lawyer, his own real estate agent (rather than using the same listing agent), or an accountant, and he could have demanded greater financial disclosure before completing the transaction.

The court agreed with the seller's position. Contrary to the buyer's assertions, he had not relied completely on the seller's representations as a matter of law. The buyer had a negotiated right to independently verify the business' income. In the circumstances, the entire agreement clause was enforceable. In the court's view, the buyer was seeking a guaranteed minimum business income from the seller of the business after the completion of the transaction which had not been made part of the bargain. The APS was conditional and had provided the buyer with a reasonable opportunity to conduct whatever due diligence he saw fit. The time for doing so had passed.

As a result, the seller obtained summary judgment against the buyer for the amount owing from the purchase and an order repossessing the business. The court rejected the buyer's request for further financial records to be produced by the seller as such information had not been sought during the time provided by the APS to independently verify the income of the business.

The case reflects the difficult hurdles that a buyer of a business will face when attempting to show that a seller misrepresented—either fraudulently or negligently—its former revenue. A seller can be protected from claims for representations occurring before an agreement is signed by way of an entire agreement clause. If the buyer negotiates the right to conduct their own independent due diligence to verify financial information before closing, then the failure to take the opportunity to air out any dirty laundry will be at their own peril. A PDF version is available to download [here](#).

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