# KEEPING CURRENT

June 7, 2022

## No misrepresentations made by seller in asset purchase transaction

By James R.G. Cook



**James R.G. Cook**
Partner
416.865.6628
jcook@grllp.com

An asset purchase often involves an assessment of the value of the inventory and gross sales of the business being acquired. The terms of the asset purchase agreement should be carefully prepared to determine precisely what assets are being purchased, and for what amount, and a buyer should take reasonable steps to investigate any representations regarding the inventory and sales history of the company.

The decision of *Sexsmith v. Juby*, 2022 ONSC 2785 (CanLII), demonstrates what may occur when a buyer disputes the value of the business being purchased and attempts to withdraw from a transaction after entering into a binding asset purchase agreement.

The decision involved the sale of assets of Chimera Industrial Sales Inc., which sold and distributed industrial fasteners. In 2010, the owners of Chimera listed the business for sale through a brokerage.

An interested buyer, Eacott Group Inc., obtained a printout containing an income statement from Chimera's accounting system for the period January 1, 2010, to August 31, 2010, indicating gross sales for that period were $45,930.49. Eacott also obtained Chimera's financial statements for the year-end of December 31, 2009, which referred to an inventory of $93,720.00. Chimera's financial statements reflected a decline in sales from $181,961 in 2007 to $61,053 in 2010.

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On November 26, 2010, Eacott's principal (KJ) made a written proposal to purchase Chimera's assets for $150,000 plus 5% of sales for two years after closing. Through a real estate agent, KJ prepared a letter of intent which estimated Chimera's inventory to be $86,000. This letter was never signed.

Chimera's lawyer prepared an asset purchase agreement (APS) and a formal inventory count for Chimera occurred on December 21, 2010. KJ was invited to participate but declined to do so. The APS was signed by the owners of Chimera and Eacott in mid-January 2011. The completion date was scheduled for January 31, 2011.

The closing was extended on consent to February 4, 2011, while the lawyers exchanged draft closing documents. In anticipation of closing, the transition of the assets and business began and KJ commenced operation of the fastener distribution business through Eacott. Eacott received the proceeds from sales of inventory that were sold from January 1, 2011, to February 7, 2011.

The day before closing however, Eacott's lawyer wrote to advise that KJ was reluctant to close as the purchase price was premised on Chimera having $70,000 in gross yearly sales for 2010. KJ claimed that he had recently received information indicating substantially lower sales and he did not know exactly what he was purchasing as there had also not yet been an accurate listing of the inventory.

On the scheduled closing date, February 4, 2011, Eacott failed to tender payment of $75,000 or the required promissory note for a further $75,000 plus 5% of sales for the following two years.

Eacott's lawyer wrote to Chimera and advised that KJ considered the transaction to be at an end. He stated that the purchase was premised on information showing $70,000 in gross yearly sales and approximately $93,720 in inventory whereas recent information indicated the company projected gross sales of $60,800 and approximately $75,000 in inventory. Eacott took the position that since it never had been determined exactly what was being purchased, the transaction was at an end.

Litigation ensued. Eacott took the position that the APS was void since there had never been a determination of what was being purchased. Eacott further claimed that Chimera's owners had fraudulently misrepresented the 2010 sales and inventory. In response, Chimera asserted that it was Eacott and KB who refused to close and wanted to renegotiate to reduce the purchase price. Chimera sought damages for breach of contract.

In a decision following trial, the Ontario Superior Court of Justice found that there was a binding agreement to purchase the business and that there was no ambiguity

in the assets or inventory to be purchased notwithstanding some lack of precision in the APS.

In that regard, the APS set out the assets to be purchased as "all inventories, stock and trade, and all supplies used for the carrying on the business of the vendor, including software programming, except stationery and other printed material of the vendor which have a name printed thereon other than to be used by the purchaser, and excluding the computer." The APS did not have a schedule or any other list specifying the assets in more detail but the court was satisfied that KJ knew what the assets were. The court noted that KJ had access to Chimera's inventory and failed to participate in the final count or otherwise raise any issues or concerns until the transaction was scheduled to close.

As to the alleged misrepresentations, the court reviewed the income statement and sales figures that were provided to KB and found that they did not misrepresent any projected sales amounts. Rather, KB performed his own estimates based on the information he was provided.

The court also considered the circumstances and context of the transition period where Chimera (i) provided all customer lists, supplier contacts and various other materials to KJ; (ii) transferred the business software program to KJ;(iii) introduced KJ to customers; and (iv) gave KJ access to the business records and all inventories–consistent with the mutual expectations outlined in the APS.

There was no evidence to indicate that Chimera's sales figure for 2010 was in any way inaccurate or false and the financial records for the years 2007 to 2010 showed declining sales and revenues from year to year. The reduced sales were attributed by Chimera to the overall decline in the automotive and other manufacturing industries at that time. There was no misrepresentation of the inventory.

Absent a breach of a contractual provision or fraud, a party is required to take all reasonable and good faith steps to complete the transaction under a contract. Eacott's failure to complete the transaction without any legal basis to do so constituted a breach of the APS, entitling Chimera to damages to put it in the position that it would have been in as if the contract had been performed: *Young v. Euro Custom Homes Inc.* 2015 ONSC 5828 at paras 14-16.

The damages that Chimera actually suffered, though, were offset by the fact that it recovered control of the business and inventory shortly after Eacott failed to complete the purchase. As a result, the court declined to award the 5% fee on gross sales that were supposed to occur and reduced the amount of the recovered inventory and other capital assets (*e.g.* tractor trailers) from the agreed-upon contract price.

Chimera's damages for breach of contract were therefore assessed at $39,839, plus pre-judgment interest commencing as of the date of breach in 2011.

## Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact James Cook, at 416.865.6628 or jcook@grllp.com.

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