Sean Lewis
416-865-2973
slewis@litigate.com

February 10, 2023

â€œNext Exit, Pleaseâ€•: Escaping a Contractual Buy/Sell Process

Shareholder agreements commonly contain buy/sell provisions establishing a process by which a shareholder can initiate a sale of their interest or can acquire the interest of another shareholder. The particulars of this process vary. Based on the parties' bargain at the time the agreement is made, there are frequently unique and particular requirements to these provisions. The Ontario Superior Court of Justice emphasizes the importance of abiding by those requirements, as seen in a recent decision invalidating a purported closing of a share purchase transaction for the purchasers' failure to comply with the specific process set out in the Shareholders' Agreement. Justice Vella's reasons in *Leeder Automotive Inc v Warwick* therefore offer an excellent reminder to shareholders that they disregard the requirements of a buy/sell provision at their peril.

Facts

In early 2020, the Respondent, Douglas Warwick, and other minority shareholders of the Applicant, Leeder Automotive Inc. ("**Leeder**"), indicated that they may be interested in selling their shares. Leeder operates car dealerships and owns commercial properties in the Toronto area. It retained its usual appraisers, Cushman & Wakefield ("**Cushman**"), to undertake an appraisal of the company's real estate holdings to assist in determining the approximate value of the company's shares.

The Shareholders' Agreement contained a buy/sell provision governing share sales, and later that year, Mr. Warwick and the other minority shareholders provided notices under the Shareholders' Agreement to sell their shares.

In response, the company took steps to implement the transaction, including instructing its accountants to prepare financial statements, asking Cushman to confirm its appraisal was current, and delivering year-end statements.

But on review of the financial documents, Mr. Warwick expressed some concern. While negotiations were unsuccessful in resolving the issues raised, the company nonetheless delivered closing documents to Mr. Warwick, purportedly to close the share sale transaction. Mr. Warwick refused to close.

The Decision

Leeder brought an Application to enforce the share sale transaction. Mr. Warwick argued that the company had repudiated the offer and acceptance to buy his shares by failing to comply with its obligations under the Shareholders' Agreement in completing the transaction.

The Application Judge accepted that there had been a *prima facie* share purchase transaction established, which meant that the critical question was whether Leeder complied with the implementation process under the Shareholders' Agreement, and if not, whether this non-compliance was sufficiently fundamental to give rise to a repudiation of the transaction.

The Application Judge found that Leeder had not complied with the requirements for determining "fair market value" for Warwick's shares, and that this non-compliance amounted to a repudiation, in two ways.

First, the company used Cushman without consulting Mr. Warwick, and relied on the appraisal it obtained before the notice to sell was received. Given that the Shareholders' Agreement required an "independent business valuator," and considering the importance of the real estate holdings to the company's value, this breach of the implementation provisions amounted to repudiation. As the Application Judge explained:

> … the appraised value of the four properties was a significant component of the valuation of the shares and therefore the ultimate purchase price or "fair market value" of Mr. Warwick's shares. It cannot be said to be a minor or trivial aspect of this transaction. …
>
> The breach is serious – Mr. Warwick was not even consulted in the appointment of Cushman & Wakefield, contrary to the express terms of Article 12.2 which calls for a mutually agreeable appointment. [paras 70-72]

Second, the company instructed its accountants to provide financial statements on an unaudited basis, in violation of its obligation under the agreement to provide audited financial statements for the purposes of determining fair market value for Mr. Warwick's shares. The Application Judge found that this breach was fundamental, and therefore a repudiation, for the same reasons as the appraisal breach (i.e., the importance of the financial information).

Ultimately, the Court found that while each breach individually would have given rise to a repudiation, collectively "there was no doubt" that the threshold had been met:

> The basis by which Leeder agreed to have Mr. Warwick's

> shares valued was totally undermined by its conduct and essentially deprived Mr. Warwick of the very thing bargained for under the Shareholders' Agreement. [para 93]

In the result, the Application was dismissed, and Mr. Warwick retained his shares.

Takeaways

Although buy/sell provisions have been held to require "strict, but not perfect" compliance, this case serves as an important reminder that the requirements of buy/sell provisions cannot be disregarded lightly.

Ordinary business practices for estimating value and for financial reporting may not be sufficient to comply with the requirements of the buy/sell provision. Absent a waiver, potential purchasers must exercise caution when implementing share purchase provisions to closely follow the prescribed requirements for determining value, even if the requirements are considered repetitive or unnecessary.

For vendor shareholders, the case serves as a reminder that delivering a notice to sell is simply one of many steps in the prescribed process. Details regarding subsequent compliance matter, and remedies may be available where these requirements are not followed.

Not all breaches of implementation provisions will, of course, give rise to repudiation. Mere technical complaints or a change of heart will not suffice. This decision does not change the reality that in any buy/sell, once the process starts, it can be very challenging to stop.