

MINDING YOUR BUSINESS

Take The Assets – Leave The Liabilities

By William S. O'Hara

There are many ways to acquire a professional land surveyor's practice and all of the good things that go along with the practice. The most common ways are to purchase the shares of a company operating the practice, or to purchase the assets of the company. Other arrangements are limited only by the imagination. The specific method used on the purchase of a professional practice is often dictated by the tax implications to the parties involved. No matter which method is used, the main aim of the purchaser is usually to gain

the maximum benefit of the goodwill, the equipment and the personnel of the acquired land surveyor's practice, as well as the existing work product.

Often there are decades of records in the vaults of a professional land surveyor's professional practice. Most of the inventory of surveys and field notes acquired will be of the highest quality, reflecting the reputation of the surveyor or surveyors who produced the work. But lurking in the dark recesses of even the best surveyors' practices are problem surveys – surveys or notes that were not quite accurate when they were



done, with problems that have not yet come to light.

If you are acquiring a professional land surveyor's practice, how do you acquire the assets without assuming the liabilities? How do you avoid becoming the guarantor of the work of another professional? How do you avoid blame for mistakes you did not make?

Over the next few years a large number of land surveyors will reach retirement age and will want to sell their practices. This will coincide with a general trend in professional practices to increase in size and decrease in numbers. Ten years from now there will be fewer land surveying practices in Ontario, with each one enjoying the efficiencies inherent in a larger scale. The issue of avoiding hidden liabilities will arise whenever a professional land surveying practice changes hands. This brief article may provide some practical suggestions to assist purchasers of land surveying practices to avoid unwanted liabilities. At the same time it is hoped that sellers of practices can gain some insight into ways of making their practices more attractive to potential buyers.

Due diligence

The first step in acquiring a professional practice, of course, is to carefully scrutinize the books and records of the practice to see what you are proposing to purchase. This may involve an audit of both the books and the inventory. It will be useful to find out the claims record of the selling surveyor. How many claims have been made against the selling surveyor in the past? How many of those claims

were paid? What was the value of the claims paid? Are there signs of instability in the selling surveyor's practice that might indicate frailties in the work product? For example, has there been frequent staff turnover, or frequent changes in the location of the practice? Have there been any complaints to the AOLS or disciplinary problems with the selling surveyor?

The overall quality of the selling surveyor's work product will usually be known in the local surveying community, but it is still imperative to conduct a diligent examination of the state of the inventory. Is the work product well organized and accessible? Are there gaps or inconsistencies in the work product from year to year that might indicate problems to come? Are the selling surveyor's financial records up to date and thorough? Is there any discrepancy between the quality of the work product disclosed to the public and the financial records that are not disclosed to the public? Although mistakes in financial records do not usually result in claims, they are often a good barometer of the care and professionalism of the selling surveyor.

Transfer of liability

Does the purchase of a land surveying practice automatically transfer the liabilities of the practice to the purchaser? The answer depends on how the sale was structured. In a share purchase the legal entity continues to exist with new owners carrying on the business. This is often done where employees or associates of a retiring land surveyor take over the existing practice. The location of the practice and even the name of the practice may stay the same. In that case the legal entity continues and it remains responsible for the past negligence of the legal entity and any past breaches of contract. Similar consequences flow where a professional association or a partnership is involved.

Where the assets of an existing practice are purchased and the existing legal entity ceases to exist there is no automatic transfer of liabilities. The legal

entity that made the error or breached the contract no longer exists. If a claim arises after the selling corporation (or partnership or professional association) has ceased to exist there may still be claims against the individuals involved in the former entity. The professional liability insurer of the individuals involved in the former legal entity will likely respond to the claim even after the entity has been wound up. But there will be no claim against the purchaser of the assets or the records of the former legal entity. The new purchaser is insulated by the purchase.

Independent liability of the purchaser

Even though the purchaser is insulated by the asset purchase from the errors, omissions and breaches of contract committed by the former legal entity, that does not preclude the purchaser from becoming independently liable for the mistakes made by the former entity or the individuals involved in the former entity. For example, if the purchaser purchases the assets of a survey practice that includes a defective plan of survey, and the purchaser agrees to sell the defective plan of survey to a client after the sale, the purchaser will be independently liable for selling the defective plan of survey. A surveyor who relies on information supplied by others without confirming the information must take the consequences: *Money Penny v. Hartland* (1824), 171 E.R. 1227. The purchaser of the land surveying practice, depending on the terms of agreement of purchase and sale, may have a claim against the seller for preparing the defective plan of survey in the first place, as set out below, but that does not eliminate his or her own liability for selling it to another.

The purchaser can reduce his or her independent exposure to liability in respect of the sale of plans of survey acquired from the seller by using limitation of liability clauses, as described in *Avoiding Professional Liability*, William S. O'Hara, *The Ontario Land Surveyor*, Volume 47, No. 1, page 25.

Representations and warranties

Purchasers of businesses, including professional practices, usually extract a list of representations and warranties from the seller of the business confirming assumptions relating to the business on which the purchaser relied. The representations and warranties are included in the agreement of purchase and sale of the business. They can be used prior to the actual sale to elicit information as part of the due diligence process. They should set out the status of any outstanding claims or litigation. Representations can set out the level of quality of the seller's work product as a means of holding the seller accountable for claims about quality used to interest the purchaser in the business. If the representations turn out to be incorrect, the purchaser has a cause of action against the seller.

Warranties are the guarantees that accompany the representations. They set out the promises made by the seller of the business as to the state of affairs of the business as of the date of the sale.

Warranties can also include promises to do certain things in the future. For example, they can specify that the seller will be responsible to the purchaser for any liability that arises from errors or omissions in the work product purchased by the purchaser of the business or breaches of contract. Warranties can also provide that the seller will continue to carry professional liability insurance for a specified period of time.

Hold harmless agreements

Hold harmless agreements are a type of indemnity agreement contained in the agreement of purchase and sale. They provide that the seller of the business will protect the purchaser from any harm arising from the purchase of the business. This may include claims by third parties against the selling surveyor made after the sale arising out of professional services provided before the sale, or claims by third parties against the purchasing surveyor arising out of errors or omissions in the seller's work product purchased in the sale.

Hold harmless agreements provide the remedy in agreements of purchase and sale where there has been a misrepresentation or a breach of warranty. They are usually open-ended, so that the seller is obligated to pay the purchaser regardless of the amount involved. From the point of view of the purchaser of the business, this provides maximum protection from any hidden liabilities – at least to the extent of the seller’s assets. From the point of view of the seller, an unlimited indemnity or a hold harmless clause is like writing a blank cheque. It requires considerable confidence on the part of the seller of a professional practice to guarantee the quality of his or her work product and agree to bear all of the expenses associated with errors or omission in the work product or breaches of contract.

Professional liability insurance

Whether selling or purchasing a land

surveying practice, it is wise to consult with your broker or professional liability insurer as part of the process. Ideally, both parties should obtain letters from their respective insurers in advance of the closing setting out the terms of the proposed transaction, including any indemnities or hold harmless agreements, and the insurers’ position on coverage. Often a purchaser’s professional liability insurer will cooperate and simply add the newly acquired inventory (warts and all) to the existing risks insured by the purchaser. This is the best possible result for the purchaser. It may also benefit the seller of the practice, but the seller should confirm his position with any insurers who may be on risk. There could be many.

Insurance policies are usually either “occurrence” policies or “claims-made” policies. Occurrence policies will provide coverage for losses occurring in the year in which the policy is held, no matter when the error or omission was

made, or when the claim is made.

Claims-made policies are more common in current professional liability policies. They provide coverage for any claims made during the policy period, no matter when the error or omission occurred, or when it was discovered.

In addition to occurrence policies and claims-made policies, there are some policies that combine attributes of both. A land surveyor who has been practising for a number of years may have several insurers interested in the arrangements made by the land surveyor on the sale of his or her practice. The best practice for the selling land surveyor is to clear the sale arrangements with any insurer with an interest in the practice. The best practice for the purchasing land surveyor is to obtain warranties from the seller that this has been done.

Many retiring professionals maintain run off or tail insurance to provide professional liability coverage for any

claims made in the years after retirement. Insurance of this kind is often described as being cheaper and more effective than sleeping pills. Purchasers of a professional practice may also sleep more peacefully knowing that the seller has this type of insurance in place. An agreement of purchase and sale can specify that the seller will take all necessary steps to ensure compliance with the tail insurance to ensure that coverage is not lost by reason of late reporting or failure to pay premiums, for example.

Professional liability policies include two important types of coverage for the professional. The primary coverage is the agreement to indemnify the professional in respect of any judgment for damages against the professional, subject to the terms of the policy. The second is the agreement to pay defence costs of the professional who has been sued. It is important to have both in place, especially when purchasing a professional practice. The duty to

defend is triggered when a claim within coverage is made against the purchasing professional, no matter how spurious the claim. A claimant who has a claim against a retired surveyor whose professional practice has ceased to exist will take the shot gun approach in litigation and will sue any party with a connection to the retired surveyor. These claims are certain to be a nuisance and can usually be disposed of quickly by counsel for the purchasing surveyor. Apart from being a nuisance, these claims can be expensive to deal with. It is best to ensure in advance of the purchase that an insurer will bear the expense.

Conclusions

The critical thing from the point of view of both the seller and the purchaser is to ensure that there are no gaps in responsibility or coverage. Just as the responsibility for breaches of contract and errors and omissions in the purchased inventory of the profes-

sional practice should be set out in the purchase and sale agreement in advance of the sale, coverage for the various risks assumed should be ascertained before the sale. Obviously, coverage for the buyer and the seller should match the risks assumed by of each of the parties. Keeping these principles in mind should permit the purchaser to acquire the benefits of a land surveying practice without acquiring the unwanted liabilities, and at the same time protect the seller from any uninsured liabilities.

Will O'Hara, of Gardiner Roberts LLP in Toronto, has a dispute resolution practice focusing on professional liability litigation. He can be reached by phone at 416-865-6632 or by email at wohara@gardiner-roberts.com

This brief article is intended to raise issues relating to the purchase of a professional practice. It should not be relied upon as legal advice. Consult your lawyer for legal advice regarding any specific issue raised in this article.