
ACTUAL VS. CONTRACTUAL

ACTUAL OWNERSHIP VS CONTRACTUAL
RIGHT TO OWNERSHIP OF A PRODUCER'S
BOOK OF BUSINESS



The relationship between employee and employer is the single most misunderstood concept for most Producers. Let us take a few moments to outline what a Producer who has an ownership interest in their book of business, actually own, because it is not 50 percent of the clients, as many Producers believe.

In many cases, and previously a norm, Producers and the Brokerage at which they work at each have a percentage ownership interest in the book of business managed and developed by the Producer. The rights each party has in the book of business can vary and are usually detailed in an employment or contractor agreement entered into between the Producer and the Brokerage. These arrangements are often mutually beneficial, as it allows the Producer to retain an interest in

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the book of business that they have developed and incentivizes business growth which benefits the Brokerage. These interests could be vesting over time or with volume, or a 100 percent ownership by the Producer. In any event, the circumstances remain the same.

The following is an excerpt of a possible ownership term found in Producer Agreements that confers upon the Producer an ownership interest in their book of business and a right to purchase the Brokerage's interest at a predetermined rate:

“The Producer retains a fifty (50) percent equity stake in the book of business developed during his time of employment. Furthermore, the Producer acknowledges that The Brokerage retains a fifty (50) percent equity stake in the book of business developed by the Producer during the Producer's time of employment with the Brokerage. This includes any and all business developed by the Producer from the onset of employment in perpetuity. The Producer does have first right of refusal to purchase from the Brokerage, at a value of XXX times the annual gross commissions, the Brokerage's equity stake in the book of business upon termination of this agreement. Upon termination of this

agreement, the Producer will have sixty (60) days to exercise the right to purchase the book of business as outlined above and remit payment to the Brokerage. If the Producer does not exercise the right to purchase the Brokerage's equity stake, the book of business exclusively remains the property of the Brokerage, including the fifty (50) percent equity stake initially retained by the Producer during his time of employment with the Brokerage.”

However, this is where the uncertainty begins. In general, ownership rights in a Producer's book of business only becomes a live issue when a Producer is looking to leave their Brokerage, at which point it is important for the Producer and the Brokerage to understand their rights and obligations as it relates to both the terms of the employment or contractor agreement between the Producer and the Brokerage and the RIBO requirements related to servicing clients.

Ownership Rights and RIBO Requirements

As it relates to the RIBO requirements, the difference between a contractual right to an ownership interest and actual ownership is of significant importance. The terms of an agreement entered into between the Producer and the Brokerage may imply that the Producer has been granted an actual

ownership interest in a book of business, as the excerpted section above implies; however, an actual ownership interest cannot be granted to the Producer due to RIBO's rules and regulations. This is because a Producer is prohibited from servicing clients independent from a registered Brokerage. Therefore, the ownership interest granted to the Producer under an agreement with the Producer's former Brokerage must be transferred to the Producer's successor Brokerage and the successor Brokerage must also be the entity that exercises a right to purchase the remainder of the Producer's book of business, if such a right has been granted to the Producer. Thus, any ownership interest in a book of business granted to a Producer is not an actual ownership interest possessed by the Producer, but is rather a contractual right to an ownership interest, and a determining factor as to what interest needs to be purchased by the Producer or the Brokerage.

This is key as many producers we have encountered believe that they own 50% of the clients, can walk with those clients, even without paying for the remaining 50% and that they own it and can sell it, leverage it, use it as security, all of which is inaccurate and could lead to economic and litigious results.

Tax Considerations

Individual situations may vary, but the tax implications for a Producer whose book of business is being transferred from their previous Brokerage to a destination Brokerage are generally more favourable when the transaction is structured as a purchase of the book of business from the previous Brokerage by the successor Brokerage through rights afforded to the Producer, which are waved on the closing of the transaction. Therefore, as it relates to the tax consequences of such a transaction, a Producer does generally benefit from only being granted a contractual right to an ownership interest in their book of business, as the Producer is able to bring business with them to the destination Brokerage, but the right to purchase the book of business, or a portion thereof, must be exercised by the destination Brokerage.

Thus, a typical transaction could look like the following:

- Bob owns a 50% interest in his book with ABC Brokerage Inc.
- Bob is joining XYZ Brokerage Inc. and is buying the 50% interest he does not own, directly without the financial assistance of XYZ.
- Thus, the Asset Purchase Agreement to do so, would be between ABC, XYZ and Bob and would outline how ABC would

sell to XYZ. Bob would sign a waiver to waive his ownership interest in his 50% to allow this transaction to occur and 100% would be sold to XYZ for a multiple divided by 2.

- Bob would forward the funds to close to XYZ's lawyer for closing.
- Bob's agreement then with XYZ would denote Bob's 100% ownership in the former book from ABC, thus allowing him to take contractual control in the whole of the book.

As mentioned, the tax consequences of transactions vary and each party to a transaction should seek tax advice that would apply to their specific transaction.

Conclusion

It is important for Producers and Brokerages alike to understand the difference between a contractual right to ownership and actual ownership rights as it relates to Producers' books of business, and to be properly advised of such as part of initial negotiations between a Brokerage and Producer and during a Producer's transition from one Brokerage to another. Although the language used in agreements between a Producer and Brokerage may imply otherwise, an ownership right granted to a Producer in a book of business is a contractual right to ownership held by the Producer and any option to purchase a

further interest in a book of business must be exercised by the Producer's intended destination Brokerage. However, this lack of an actual ownership interest in the book of business does generally provide certain benefits to the Producer, as the Producer is able to bring business with them to their destination Brokerage and they do not attract tax consequences as part of the transaction because their destination Brokerage would be the entity exercising any right to purchase an interest in a book of business that may have been granted to the Producer.

RJS LAW has experience advising both Producers and Brokerages on all matters related to the purchase and sale of a book of business, a Producer's transition from one Brokerage to another, and a Brokerage's initial engagement with a Producer and would be happy to provide you with a business-focused legal perspective that will help you smoothly navigate any problems you may face.

For more information, check out www.rjslaw.ca or give us a call to set up a consultation.

