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Quarterly legal newsletter intended for accounting, management, and finance professionals

Contents

THE CONFIDENTIALITY AGREEMENT, CAN YOU LIVE WITHOUT IT?

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You are advising a client who is selling his business. The parties have already signed a letter of intent that provides for a due diligence review to be conducted in respect of your client's business.

Before such review begins and any information concerning your client is disclosed, should a confidentiality agreement be executed? Do the laws of Quebec protect your client despite the absence of such an agreement?

In Quebec, your client may obtain compensation for damages caused by someone else, including by the violation of a trade secret.

The *Civil Code of Québec* also provides that your client may be specifically compensated for the investments expenses made for the acquisition of a trade secret, its perfection and its use. However, in such a case your client must prove that the information indeed constitutes a trade secret in order to have the advantage of this specific compensation.

What constitutes a trade secret is not defined in the *Civil Code of Québec*. However, certain identification criteria have been developed by Canadian courts, including: (1) the degree of knowledge of the information outside the business; (2) the degree of knowledge of the information by the employees and other persons involved in the business; (3) the measures taken by the business to preserve the confidentiality of the information; (4) the value of the confidential information for the business and its competitors; (5) the amounts and the efforts invested by the business to develop the information; and (6) the ease with which others can legally acquire or copy the information.

Since the indemnification principles of the *Civil Code of Québec* respecting trade secrets apply whether or not there is an agreement, the absence of a confidentially agreement is not necessarily fatal, but it will result in the party seeking compensation being required to prove that the information was confidential in order to benefit from the specific protection under the *Civil Code of Québec*.

A confidentiality agreement can relieve your client from this burden if it provides, for example, that all the information provided thereunder is deemed to be confidential, except information that is known to the public or is obtained legally.

Do not hesitate to consult with your legal advisor who can provide you with solutions that are appropriate for your situation. ◂

A PERSONAL GUARANTEE ATTACHED TO THE PERFORMANCE OF SPECIAL DUTIES MAY TERMINATE UPON CESSATION OF THESE DUTIES

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The *Civil Code of Québec* ("C.C.Q.") includes a lesser-known feature respecting personal guarantees that may have major consequences on business transactions. Article 2363 of the C.C.Q. provides that: "A suretyship (i.e guarantee) attached to the performance of special duties is terminated upon cessation of the duties".

The Supreme Court of Canada ruled on the issue in 2004 in the *Épiciers Unis Métro-Richelieu Inc., division " Éconogros" v. Collin* case[1]:

> "The effects of art. 2363 C. C. Q. are produced in their entirety once the surety has proven that the suretyship was contracted in connection with the duties he or she performs. (...) the surety bears the burden of proof (...) a surety is required to prove neither that the creditor required the suretyship solely because of his or her capacity nor that the parties intended to make the termination of the suretyship conditional on the cessation of the performance of his or her duties (...) Since art. 2363 C.C.Q. already provides that the suretyship terminates upon cessation of the performance of the surety's duties, there is no need for the parties to provide for this in their contract. It is enough for the surety to show that the duties he or she performed constituted one of the reasons why the creditor requested the suretyship."

The Superior Court recently applied this principle in the case of *9074-9508 Québec Inc. v. Gagnon* (2008) QCCS 1259. In this case, a lease had been entered into between the owner of a building (the "Owner") and

another individual (the "Tenant"). The Tenant had subsequently subleased the building to a corporation (the "Subtenant") for the purpose of operating a Harvey's franchise. In order to obtain the Owner's consent to the subletting, the president (and sole shareholder) of the Subtenant (the "Guarantor") had signed a personal guarantee in favour of the Owner. A few years later, the Guarantor sold the shares he held in the Subtenant (along with the right to operate its restaurant) to third parties (the "Third Parties") and resigned his position as president of the Subtenant. Neither the Owner nor the Tenant was aware of the sale of these shares and the resignation of the Guarantor as president of the Subtenant.

The Third Parties operated the restaurant for many years, until they encountered financial difficulties which forced them to stop operating the restaurant and make an assignment in bankruptcy of the property of the Subtenant.

The Owner then sent a formal notice to the Guarantor, holding him solidarily liable for the obligations of the Subtenant toward the Owner.

At the hearing, the Guarantor maintained that Article 2363 C.C.Q. applied and challenged the very existence of the guarantee since he had ceased to hold the position of president of the Subtenant.

The Court concluded that the Guarantor had discharged his burden of proof, which consisted in proving that the guarantee granted was attached to his position as president of the Subtenant. Moreover, for Article 2363 to apply, the Guarantor was not required to notify the Owner or the Tenant that he had sold his shares in the share capital of the Subtenant and that he had resigned his position as president.

Therefore, certain precautions must be taken when requesting a personal guarantee from a director or officer: (i) the guarantee must expressly stipulate the obligation of the guarantor to notify you of any potential termination of his or her position or, even better, provide that the guarantee will not terminate even if the guarantor ceases to hold his or her position as a director or officer and (ii) provide for additional guarantees to avoid nasty surprises. Our experts in secured financing can help you protect your interests in this respect. ◄

1. [2004] 3 R.C.S. 257

WORDS VANISH: DOCUMENTS MUST BE MANAGED PROPERLY

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The complexity of the tax rules applicable to Canadian businesses has increased significantly over the past few years, inevitably resulting in a greater volume of documentation related to the tax affairs of businesses: books of account, memoranda from tax experts, correspondence, internal working documents, etc. Properly managing this documentation may bring considerable benefits to businesses and may facilitate the settlement of disputes with tax authorities or avoid these disputes altogether.

We should first note that the tax laws generally require that Canadian taxpayers carrying on a business keep accounting records that are adequate for determining the amounts payable under such laws. These accounting records must be kept for a minimum period of six (6) years following the end of the fiscal year to which they relate. Failing to do so may prevent a delinquent taxpayer from successfully challenging a notice of assessment and result in the application of certain penalties. The tax authorities and the courts have been more demanding in this respect over the past few years.

Despite these requirements, taxpayers are not required to retain all the documents that have any relevance whatsoever to their tax affairs. Generally, the relevance of retaining a specific document depends on its usefulness for determining the business's tax burden. To the extent that a document is not useful to determine the business's tax burden, it does not have to be retained. This being said, and even though the Act does not require that a document be retained, it is prudent to ask oneself to what extent the document in question may be favourable to the taxpayer's position.

In any event, the process of managing the tax documentation of a business should be well monitored and applied continuously. Destruction of the documentation in the context of a tax audit may result in criminal proceedings against the persons involved.

Beyond these questions of retaining or not retaining certain tax-related documents of a business, one should also ensure that documents that are essential or useful in connection with the tax affairs of a taxpayer are properly retained and managed. These documents may include documents, such as certain communications between an attorney and his client, which are protected under a privilege precluding the tax authorities from requiring their production in court in certain circumstances. It is important to manage these documents in such a way as to avoid losing their privileged status.

In future articles, we will revisit certain subjects related to the one discussed in this article, such as the client-attorney privilege, tax-related documentation management and the powers of the tax authorities in the context of a tax audit. However, Canadian taxpayers carrying on a business should, in any event, implement a stringent policy for managing tax-related documentation and systematic control measures to ensure that such policy is applied on an ongoing basis. ◂

THE FEDERAL LAW GOVERNING NOT-FOR-PROFIT ORGANIZATIONS UNDERGOES A FACE LIFT!

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Bill C-4, *An Act respecting not-for-profit corporations and certain other corporations* (the "Act") was assented to on June 23, 2009. It will come into force on a day to be fixed by order in council, which it is suggested could be during the second half of 2010. The Act replaces Part II of the current *Canada Corporations Act* (the "CCA"), which had hardly been amended since 1917. Not-for-profit organizations ("NFPOs") governed under Part II of the CCA will have three (3) years from the date of coming into force of the Act to request their continuance under the Act, failing which they may be dissolved by Industry Canada.

The incorporation of an NFPO under the Act is simplified compared to the current procedure of requesting letter patents and filing by-laws for approval. From now on, the incorporation of an NFPO will be made as of right by filing articles of incorporation. The procedure will be similar to that used for incorporating business corporations under the *Canada Business Corporations Act*.

The Act creates a distinction between NFPOs that solicit funds and those that do not. It subjects the former to more stringent requirements than the latter with respect to business management and financial responsibility, for instance, by requiring them to have a minimum of three (3) directors and to send copies of their financial statements to Industry Canada. Also, if an NFPO that solicits funds is wound up, any property remaining after the discharge of its liabilities must be distributed to "qualified donees" within the meaning of the *Income Tax Act*.

A soliciting corporation is a corporation which, during a three-year period, received cumulative income exceeding $10,000 in the form of (a) gifts or legacies requested from a person who is not a member, director, officer or employee of the NFPO at the time of the request, or the spouse of such a person, or a member of the family of such a person, (b) grants or similar financial assistance received from the federal government or a provincial or municipal government, or an agency of such a government; (c) gifts or legacies from a corporation or other entity that has received income in the manner described in (a) or (b).

The test for determining whether an NFPO is a soliciting corporation for any given year is applied as of the last day of the preceding fiscal year, taking into account the last three (3) completed fiscal years.

Under the Act, every NFPO must appoint a public accountant unless it has gross annual revenues that are less than the limit prescribed under the regulations ($50,000 for a soliciting corporation and $1,000,000 for a non-soliciting corporation). The public accountant conducts an audit engagement except in certain situations where the members may opt for a review engagement. The public accountant must in all cases be independent from the NFPO, its affiliates, or the directors or officers of the corporation or its affiliates.

The Act contains many other new features compared to the CCA, including allowing members to institute a derivative action (proceedings against the directors or officers of the NFPO in the name of the NFPO) and a remedy in case of abuse, to ensure that the members' rights are respected. ◄

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