

Quarterly legal newsletter intended for accounting, management and finance professionals

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## Contents

**Are You Ready? The Harmonization of the QST and the GST May Considerably Impact your Business or Clients**

**Sale of Litigious Rights: Beware of the Redemption Right**

**Determining the Purchase Price of Shares in a Shareholder Agreement: When "Quiconque" ("Any Person") Excludes the Person Who Signs**

**Advance Notice Policies: A Tool to Consider With Regard to Shareholder Nominations for Electing Directors**

## ARE YOU READY? THE HARMONIZATION OF THE QST AND THE GST MAY CONSIDERABLY IMPACT YOUR BUSINESS OR CLIENTS

Luc Pariseau  
lpariseau@lavery.ca

Audrey Gibeault  
agibeault@lavery.ca

On March 28, 2012, the federal government and the Quebec government entered into a tax coordination agreement<sup>1</sup> under which significant changes will be made to the Quebec Sales Tax (QST). This agreement modifies in many respects the application of the QST in Quebec by providing for, among other things, material changes applicable to financial services rendered in Quebec. However, Quebec will generally retain the administration of the Goods and Services Tax/Harmonized Sales Tax (GST/HST) and QST in its territory.

Firstly, from January 1, 2013 onward, QST will be calculated on the sale price excluding GST. In order to neutralize the withdrawal of the GST in calculating the QST, the QST rate will be increased by 0.475% to 9.975%. Under the agreement entered into between the two levels of government, Quebec will ensure that its tax base is virtually identical at all levels with the one applicable for GST/HST purposes in the other provinces and, to do so, will include the parameters provided under the agreements entered into with the other provinces. Thus, the differences which currently exist between the GST and QST regimes should be practically eliminated.

In addition, from April 1, 2013 onward, goods and services providers will be required to charge the QST and GST/HST to all federal and provincial departments and agencies. As a result, the exemption certificates will no longer be valid<sup>2</sup>.

Major changes are also planned with respect to financial services provided in the province of Quebec. As these services are currently zero taxed, they will become exempt from January 1, 2013 onward with the result that financial services providers will no longer be able to claim input tax refunds (ITR). This loss of ITR will have significant impact on financial services suppliers. Planning may be possible in certain cases in order to avoid or limit the net cost resulting from the ITR loss. It is



further planned that the compensation tax applicable to designated financial institutions will be gradually eliminated by March 31, 2014.

Revenue Canada will henceforth be responsible for the administration of the GST/HST and QST for some financial institutions, including "selected listed financial institutions". Thus, the reporting period used for the QST will need to be aligned to the one used for the GST. In the event the reporting period of a selected listed financial institution registered in the QST register includes January 1, 2013, this reporting period will end on December 31, 2012. Therefore, a new reporting period will begin on January 1, 2013 and will be combined with the one used for the GST/HST. Currently registered financial institutions may retain their registration to the extent they qualify as a "designated financial institution" or if they hold the majority of shares of an operating corporation. The concept of optional registration will be eliminated. As a result, many financial institutions will have to cancel their registration as of January 1, 2013.

Thus, although these changes do not materially affect consumers, it nonetheless remains that they will significantly affect certain types of businesses. It would therefore be advisable to take the changes into consideration and possibly consult a tax advisor.

1. *Memorandum of Agreement Concerning a Canada-Quebec Comprehensive Integrated Tax Coordination Agreement.*

2. Special rules are provided for contracts which will be in force as of April 1, 2013.

## SALE OF LITIGIOUS RIGHTS: BEWARE OF THE REDEMPTION RIGHT

**Bruno Verdon**  
bverdon@lavery.ca

A recent decision of the Superior Court<sup>1</sup> reminds us that one must be prudent when the rules applicable to litigious rights may apply.

The Civil Code<sup>2</sup> provides that when litigious rights are sold, the person from whom they are claimed is discharged by paying to the buyer the sale price, the costs and interest on the price computed from the day on which the payment was made.

Although this rule is not new, it still causes difficulties when, for example, a transfer of enterprise occurs as a result of the sale of assets which includes the rights of the seller in judicial proceedings which have already been undertaken. This right, conferred on the person against whom a claim exists, is called the redemption right.

When the rights of the seller in an action are sold, the defendant may be entirely discharged of the recourse against him by repaying the purchaser the price the purchaser paid to acquire these litigious rights.

The Civil Code provides for several exceptions to this rule. The right of redemption may not be exercised:

1. where the sale is made to a creditor in payment of what is due to him, to a coheir or co-owner of the rights sold or to the possessor of the property subject to the right;
2. where a court has rendered a judgment affirming the rights sold; or
3. where the rights have been established and the case is ready for judgment.<sup>3</sup>

Attempts have been made to circumvent the application of the right of redemption by adding to the sale price a percentage of the amount to be collected at the end of the judicial proceedings. However, under case law, the price of the redemption right must



be equal to the price actually paid by the purchaser at the time of the sale, which excludes, according to Madam Justice Pierrette Rayle, of the Superior Court in the *Mendel*<sup>4</sup> case and confirmed by the Court of Appeal<sup>5</sup>, the commitment to pay a percentage of the amount obtained as a result of the claim:

*"With respect to the 5% to be paid on the eventual recovery of the Mendel claims, since it was never disbursed by Kuczer, it does not have to be included in the amounts to be «reimbursed» in virtue of Art. 1784 C.C.Q. (1) Furthermore, an undertaking to pay a percentage of the claim recovered may very well be illegal and unenforceable."*

The redemption right does not apply in case of an assignment or transfer free of charge (gift) and, as it is incumbent on the person who redeems to prove the actual amount of the sale price, the right cannot be exercised if several items of property have been transferred with the litigious claim for an all inclusive or single price.<sup>6</sup>

If there are ways to avoid the possible application of the redemption right, the purchasers of litigious rights will be well advised to acquaint themselves with the rules applicable to the redemption right before going ahead with the sale rather than after the fact.

1. *Girard c. Pearl*, 2012 QCCS 5259 (CanLII), October 23, 2012.

2. Article 1784 paragraph 1.

3. Article 1784 paragraph 2.

4. *Mendel v. Entreprise Pemik inc.*, J.E. 97-531 (C.S.).

5. *Kuczer v. Mendel*, J.E. 2001-761 (C.A.).

6. *Rénovations Langis inc. v. Cabessa*, REJB 1996-30611 (S.C.).

## DETERMINING THE PURCHASE PRICE OF SHARES IN A SHAREHOLDER AGREEMENT: WHEN "QUICONQUE" ("ANY PERSON") EXCLUDES THE PERSON WHO SIGNS<sup>1</sup>

Catherine Méthot  
cmethot@lavery.ca

Valérie Boucher  
vboucher@lavery.ca

The Superior Court issued a surprising decision this summer concerning the determination of the value of shares in the context of a purchase under a shareholder agreement. In this case, following the second loan of Société Innovatech du Sud du Québec ("**Innovatech**") to Signaflex Inc. ("**Signaflex**"), its first loan had been converted into shares and a shareholder agreement had been entered into, which granted to Innovatech the right to request that its shares be purchased (the "**Option**") at a price per share equal to the higher of (1) the highest price paid for any share by "quiconque" ("any person") during the three preceding fiscal years (the "**Reference Period**") (sec. 9.1.1.1) and (2) the fair market value of the shares at the time the option was exercised (sec. 9.1.1.2), as established by an independent expert (the "**Agreement**").

When Innovatech exercised the Option, since Signaflex had issued no other shares during the Reference Period, it put Signaflex on notice to pay to it an amount of \$11,455,287, calculated according to section 9.1.1.1 of the Agreement, such amount being equal to the amount of its 2011 investment.

The main issue raised was the determination of the price at which Signaflex was required to purchase Innovatech's shares. Signaflex maintained that the expression "quiconque" referred to a party not yet identified as of the time at which the Agreement was executed and excluded Innovatech. For its part, Innovatech argued that it was included in the term "quiconque" and that its second loan had to be taken into account in determining the price of the shares.

Although the common meaning of the word "quiconque" is "any person", by analyzing the intent of the parties at the time the

Agreement was executed and reviewing the nature and context in which the term was used, the judge concluded that the second loan of Innovatech had been made in a context where it had been anticipated that other investors would inject funds into Signaflex and that therefore, the term "quiconque" was referring to one or several other possible investors and not to either of the parties to the Agreement. Since no investment had been made during the Reference Period, other than that of Innovatech, the Court decided that the purchase price could not be determined under section 9.1.1.1 of the Agreement. This interpretation undoubtedly surprised Innovatech, but not nearly as much as what followed...

Considering that Innovatech had, according to the Court, voluntarily ignored the only accounting report made, which stated that the fair market value of its shares was between 2.2 and 2.9 million dollars, that it had not requested a supplemental report or even a new report and that Innovatech had always maintained that the value of its shares had to be determined under section 9.1.1.1, the Court

decided that section 9.1.1.2 could not apply in the circumstances. In the opinion of the Court, Innovatech had knowingly chosen not to rely on the mechanism provided under section 9.1.1.2 and there was no reason to reopen the hearing or request that a new report be prepared. The Court added that Innovatech had the burden to demonstrate the value of its shares, which it failed to do. The Court therefore dismissed the claim of in excess of \$11 million and fixed the purchase price of the shares at \$0! The decision has not been appealed.

Upon reading this decision, we realize once more that the words used in a contract must be chosen with care and that it is crucial to carefully define the terms used when they may be interpreted in several ways. The judgment also teaches us that a party exercising a contractual right must be prudent in devising its strategy since in law, things are not always as obvious as they seem to be.

1. *Société Innovatech du Sud du Québec c. Signaflex inc.*, 2012 QCCS 3275.



## ADVANCE NOTICE POLICIES: A TOOL TO CONSIDER WITH REGARD TO SHAREHOLDER NOMINATIONS FOR ELECTING DIRECTORS

**Maxime Bergeron**  
mbergeron@lavery.ca

On July 20, 2012, the Supreme Court of British Columbia rendered a judgment that sheds new light on the shareholder nomination process for electing the directors of a business corporation.<sup>1</sup> In fact, the Court confirmed that a corporation's policy, which aimed to impose an advance nomination process at a shareholders' meeting, was reasonable and did not infringe shareholder rights with respect to electing the directors of a corporation.

The advance notice policy approved by the board of directors of Mundoro Capital Inc., a corporation governed by the corporate legislation of British Columbia included a deadline by which time shareholders were required to submit, in writing, nominations for directors to be elected during the corporation's annual general meeting of shareholders. In particular, any nomination had to be received at least 30 days before and no more than 65 days prior to the meeting. Only such nominated persons would be eligible for election as directors.

One of Mundoro's shareholders brought an action against Mundoro in order to contest the validity of this policy. This concerned shareholder alleged namely that there was

no legal basis for such a policy and further argued that its implementation constituted an attempt to limit the fundamental right of shareholders to elect directors.

By ruling that the advance notice policy did not breach shareholder rights, the Court recognized that such a policy favored the implementation of an orderly nomination process, which would enable shareholders to make an informed decision.

Although such policies and their integration into a corporation's by-laws are currently not standard practice for reporting issuers in Canada, the *Mundoro* case could prompt issuers to amend their by-laws. In all likelihood, this policy would strengthen the directors nomination process by requiring a shareholder to send the issuer an advance notice, affording him sufficient time to analyze and respond in an informed manner to the proposed nominations. This tool could prevent nominations which are sometimes enforced by ambush or by proxy contest during annual shareholders meetings.

The Court's decision suggests that advance notice policies or the addition of a provision to that effect in a corporation's by-laws should be carefully drafted and established to strike a reasonable balance between the rights of shareholders to elect directors, and the

responsibilities of the board to make sure that the nomination process for electing directors is respected.

An advance notice policy regarding the nomination process for electing directors can represent an important tool for a reporting issuer to ensure that all shareholders are treated fairly and that they are provided in a timely manner with relevant information pertaining to the nomination of directors.

1. *Mundoro Capital Inc.*, 2012 BCSC 1090 [Mundoro Capital].



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### CONTACTS

MONTREAL – 1 Place Ville Marie  
514 871-1522

QUEBEC CITY – 925 Grande Allée Ouest  
418 688-5000

OTTAWA – 360 Albert Street  
613 594-4936

▶ [lavery.ca](http://lavery.ca)

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