RATIO

SPECIAL EDITION – *Business Corporations Act*

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Contents

Philippe Asselin
passelin@lavery.ca

Valérie Boucher
vboucher@lavery.ca

Marie-Hélène Giroux
mhgiroux@lavery.ca

André Paquette
apaquette@lavery.ca

INTRODUCTION

Last March, we informed you that the *Business Corporations Act* (Quebec) (the "**Bill**") had been adopted by Quebec's National Assembly and summarily described certain features of this new legislation, which will replace the *Companies Act* (Quebec) (the "**CAQ**"). In this special edition of Ratio, we provide an overview of certain aspects of the Bill that are of interest to professionals in the areas of accounting, management and finance.

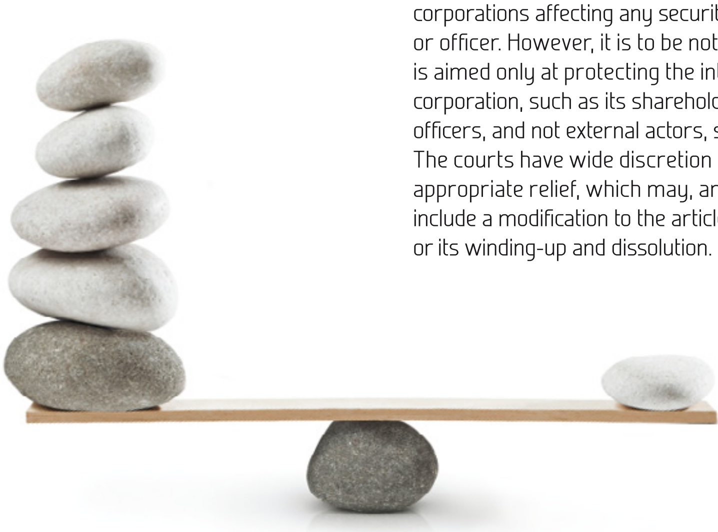
On November 3, 2010, the Minister of Finance and Minister of Revenue, Mr. Raymond Bachand, announced that the Bill will come into force on February 14, 2011. He stated that the time between the issuance of the order (November 3, 2010) and the coming into force of the Bill (February 14, 2011) will facilitate the transition to the new regime for businesses and business law professionals.

It is expected that an omnibus bill making certain amendments or corrections to the Bill will be put before the National Assembly this fall. As the content of this bill has not yet been made public, the text of this bulletin is based on the version of the Bill assented to in December 2009. ◂

REMEDIES FOR MINORITY SHAREHOLDERS

The Bill introduces a major innovation, new remedies to promote the protection of minority shareholders.

Inspired for the most part by the oppression remedy provided under the *Canada Business Corporations Act* (the "**CBCA**"), the Bill introduces, in particular, a remedy to counter abuses or inequities committed by corporations affecting any securities holder, director or officer. However, it is to be noted that this remedy is aimed only at protecting the internal actors of a corporation, such as its shareholders, directors and officers, and not external actors, such as its creditors. The courts have wide discretion in determining the appropriate relief, which may, among other things, include a modification to the articles of the corporation or its winding-up and dissolution.



In addition, although Quebec corporate law already grants shareholders the right to act on behalf of a company, the Bill clarifies the scope of this remedy, better known as a "derivative action". A shareholder may thus obtain authorization from the court to institute legal proceedings in the name and on behalf of a corporation, or one of its subsidiaries, or to intervene in legal proceedings to which the corporation or one of its subsidiaries is a party.

Lastly, the Bill introduces a right of shareholders to have their shares redeemed, which remedy is similar to the right to dissent provided under the CBCA, in the event that a shareholder wishes to oppose the adoption of certain resolutions, particularly with respect to a merger, alienation of property or continuance.

All these remedies are aimed at establishing a certain balance between the interests of controlling shareholders and the protection of minority shareholders. ◂

STREAMLINED REGIME FOR SOME SMEs

Most businesses incorporated under the CAQ are small or medium sized enterprises. However, the regime applicable to businesses incorporated under the CAQ, like that applicable to businesses incorporated under the CBCA, imposes the same formalities with respect to matters of legal organization and the holding of annual meetings, regardless of the size of the enterprise.

The Bill is innovative as it offers streamlined regime to corporations having only one shareholder. A sole shareholder who withdraws all powers from the board of directors may henceforth choose not to establish a board of directors and not to appoint an auditor. When a sole shareholder adopts this streamlined regime, his corporation is exempted from the requirements to pass general by-laws (which will henceforth be called simply "by-laws") and to hold meetings of the shareholders and of the board of directors. A corporation that adopts this streamlined regime may make its decisions by means of written resolutions of its sole shareholder and any action taken by the sole shareholder in the name of the corporation is deemed to have been authorized.

In the same manner, when a corporation having several shareholders withdraws all powers from the board of directors by means of a unanimous shareholder agreement, the shareholders may choose not to establish a board of directors, in which case the corporation must declare to the Quebec enterprise registrar (the "**QER**") the names and residential addresses of those who will exercise such powers.

This new streamlined regime will certainly be more in line with the reality of many SMEs and undoubtedly eliminate the necessity of drafting documents that many considered uselessly formalistic. ◂

CONTINUANCE

Legal and accounting practitioners in Quebec have complained for many years about the impossibility of continuing a company incorporated under the CAQ under the corporate laws of another jurisdiction and vice versa. Indeed, this impossibility has created complications in the context of reorganizations of corporate groups that included both companies incorporated under the CAQ and corporations incorporated under the CBCA. As the CAQ does not allow for continuing a Quebec company and then merging it with a federal corporation (or vice versa), the only available option is to wind up one entity into the other, which, from a business point of view, is generally more complicated than a merger and also may have different tax consequences.

The Bill allows both the continuance of a foreign corporation under the Bill (importation) and the continuance of a Quebec corporation under the law of another jurisdiction (exportation), in both cases to the extent that the other law also authorizes it. It is to be noted that the CBCA and the corporate legislation of the other Canadian provinces already allow the import of foreign corporations and the export of their own corporations.

To export a corporation incorporated under the Bill, it is necessary to obtain authorizations from the shareholders and the QER. It will grant its authorization to the extent that the following conditions are met: (i) the corporation will remain a legal person, retain its rights and obligations as such and remain a party to any judicial or administrative proceedings to which it is a party; and (ii) the corporation has complied with its obligations under the *Act respecting the legal publicity of sole proprietorships, partnerships and legal persons*. A declaration attesting that the shareholders of the corporation will not suffer harm as a result of the continuance must also be filed with the QER. ◂

HIGH-LOW SHARES

Shares having a high redemption price and a low issued and paid-up share capital ("**High-low Shares**") are sometimes used by practitioners for carrying out certain transactions.

For example, certain practitioners use this type of share to "freeze" the value of the participating shares of a company held by a given person and allow the issuance of new participating shares to another person for a nominal amount. The way to proceed in this context may be as follows: a High-low Shares stock dividend is paid to the holder of the participating shares (the "**Initial participating shares**"). The redemption price of the High-low Shares is then equal to the value of the Initial participating shares and their issued and paid-up share capital is equal to that of the Initial participating shares. Therefore, the value of the latter decreases by an amount equal to the value of the High-low Shares. The Initial participating shares are then exchanged for a preferred share. New participating shares may then be issued to a person other than the holder of the Initial participating shares, for example, a family trust, for a nominal amount.

This way of proceeding is generally used to limit certain adverse tax consequences that may occur when the freezing of the Initial participating shares is performed by an exchange of such shares for shares of another class.

Using High-low Shares is currently possible under the CAQ, but only when one uses shares with par value. The Bill specifically allows the issuance of High-low Shares without being required to use shares having a par value. ◄

ALIENATIONS AFFECTING SIGNIFICANT BUSINESS ACTIVITY

Under the CAQ, and contrary to what is provided under the CBCA, the board of directors may dispose of all the property of a company without having to submit the transaction to the shareholders. With the Bill, this rather surprising situation is corrected, as an entire chapter deals with alienations affecting significant business activities.

Under these new provisions, any alienation that affects the pursuit of significant business activities of a corporation, whether effected through a sale, exchange or lease of its property, must be approved by a special resolution (2/3 of the votes cast) of the shareholders.

The Bill further specifies that a corporation is deemed to retain a significant part of its business activity if, after the alienation, the business activity retained:

- Requires the use of at least 25% of the value of the corporation's assets as at the date of the end of the most recently completed fiscal year; and
- Generates at least 25% of either the corporation's revenues or its income before taxes during the most recently completed fiscal year.

However, the Bill contains an exception pertaining to an alienation of property in favour of a wholly-owned subsidiary of the corporation.

The Bill also restricts the alienation of the property of a subsidiary of the corporation; in such a case, the assets, revenues and income used for the above-mentioned test must be calculated based on the consolidated financial information of the subsidiary and of the parent corporation.

For the purposes of the application of this new chapter of the Bill, a corporation's loss of control over a subsidiary is also deemed to constitute an alienation of all the property of such subsidiary.

Lastly, it is to be noted that the passing of a resolution of the shareholders that authorizes the alienation of property affecting significant business activities confers on a shareholder who votes against the resolution the right to demand that the corporation repurchase all of his shares in accordance with the procedure set out in Chapter XIV of the Bill, a right that is not provided for under the CAQ. ◄

NEW RULES DEALING WITH CORPORATE INCEST

Some corporate law rules are likely to complicate the completion of transactions. For example, the CAQ provides that shares of the share capital of a company may not be acquired by its subsidiary ("**corporate incest**"). However, the CAQ tolerates corporate incest where the acquisition of the shares of a company by its subsidiary results from an unexpected situation, that is to say, unintentionally (unintentional incest). A subsidiary that has unintentionally acquired shares of the share capital of its parent corporation is, however, required to dispose of such shares within the five years following their acquisition.

In order to avoid a so-called "intentional" situation of corporate incest in the context of reorganization, certain additional preliminary transactions must sometimes be completed. Unfortunately, there are times when some practitioners forget about the existence of this prohibition and create short-lived "intentional" situations of corporate incest, which may jeopardize the completed reorganization.

For its part, the Bill allows corporate incest for a 30-day period, irrespective of the circumstances having led to the acquisition of the shares of a corporation by its subsidiary. The Bill thus simplifies the completion of transactions that lead to a short-lived situation of corporate incest.

This innovation will be very much appreciated by practitioners and may encourage them to favour the Bill over the CBCA, the provisions of which are similar to those of the CAQ in this respect, when incorporating a corporation. ◄

DISAPPEARANCE OF THE ACCOUNTING TEST

Practitioners will be pleased about the new rules that the Bill introduces with respect to maintenance of the share capital of a corporation.

Under the CAQ rules, a company must meet two tests when carrying out transactions affecting its share capital (particularly when redeeming its shares, reducing its share capital or paying dividends), namely: the accounting test (the total assets must not be less than the sum of its liabilities and its issued and paid-up share capital) and the solvency test (the company must be able to discharge its liabilities as they become due).

The Bill no longer makes it mandatory for a corporation to meet the accounting test, whatever the circumstances. However, it is to be noted that the solvency test that must be met in the above-mentioned situations remains, except with regards to financial assistance to shareholders, which is no longer subject to compliance with an objective test. The Quebec legislator has thus followed in the footsteps of other Canadian legislators, who already have abolished this kind of restriction with respect to financial assistance to shareholders.

According to the comments of the Minister of Finance on the Bill, it would seem that, despite the disappearance of the accounting test, maintaining the solvency test for transactions affecting the share capital of a corporation sufficiently ensures the protection of creditors, while the protection of shareholders will be ensured by providing them with new remedies for enforcing their rights. ◄

CONCLUSION

In this special edition of Ratio, we have briefly and non-exhaustively discussed certain changes brought about by the Bill. The Bill contains many other particularities that modify the corporate law rules applicable to corporations incorporated in Quebec. Feel free to contact us for more information on the new *Business Corporations Act* (Quebec). ◄

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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
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