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Buying a Business in Quebec: The Basics of Buy-Side Legal Due Diligence

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Acquiring the shares or assets of a privately held business will raise certain complexities, particularly for a first-time or, in the case of a Quebec or Canadian-based business, an out-of-province or foreign investor who may be unfamiliar with the process followed leading up to the closing of such a transaction. Effective buy-side legal due diligence is critical to navigating such complexities. To a significant extent, each transaction will require customization in the approach taken for legal due diligence, and what may be a relevant or integral component of the legal due diligence recommended for one transaction may be irrelevant for another. The legal advisors of the prospective purchaser can establish and implement a customized buy-side legal due diligence strategy which is proportionate to the scale and nature of the transaction and tied to gathering pertinent information regarding the key commercial issues at stake.

It should be noted at the outset of this article that although a significant portion of the legal due diligence steps which may be useful or necessary for the purchase of assets or shares of a Quebec business may be similar or equivalent to the process typically followed in other jurisdictions, the focus of this article is the Quebec-specific best practices and protocols to be considered in the course of buy-side legal due diligence. This article aims to provide a basic roadmap regarding those legal due diligence steps which may be recommended by the attorneys for a prospective purchaser of the assets or shares of a privately held Quebec business, with a view to enabling the prospective purchaser to make an informed decision regarding the viability of the transaction in question, the scope and nature of the representations and warranties to be granted by the vendors in the asset or share purchase agreement to be entered into between the parties, and the necessary action items to be undertaken prior to the closing of the transaction (such as obtaining any required third party consents).

THE BUY-SIDE LEGAL DUE DILIGENCE PROCESS

By way of general background, the Court of Quebec¹ has described due diligence as a "basic precautionary step" to be undertaken when purchasing a business. It is critical to conduct a comprehensive investigation of the target business to confirm the desirability and feasibility of the investment, both in terms of commercial due diligence more broadly (which is typically handled by the

¹ *Riccio v. Di Raddo*, 2010 QCCQ 6889, par. 44.

prospective purchaser internally and/or by its financial or tax advisors), as well as legal due diligence. The fundamental objective of the legal due diligence process is to provide the prospective purchaser with sufficient information to evaluate the potential risks, obstacles or barriers to the contemplated investment. Accordingly, the buy-side legal due diligence process frequently involves conducting searches of relevant public registries, obtaining information from governmental authorities regarding the target business and reviewing contracts and other documents with legal implications, all with a view to flagging potential risks from a legal perspective to the attention of the prospective purchaser. As mentioned at the outset of this article, the focus and scope of the buy-side legal due diligence will depend on a variety of factors, including the size of the transaction, the structure and complexity of the transaction (including whether the purchase of assets or shares is being contemplated), the nature of the target business, the budget allocated by the purchaser for due diligence review and the time delay for the completion of due diligence. On this last point, it should be emphasized that both commercial and legal due diligence frequently take more time to complete than the parties may expect at the start of the process, especially in more complex transactions; legal counsel for the purchaser can help address this issue proactively by establishing reasonable and realistic time delays and managing expectations.

SEARCHES OF PUBLIC REGISTRIES

Buy-side legal due diligence in asset and share purchase transactions in Quebec will normally involve conducting searches of public registries that contain useful information regarding the target business, such as:

- **Quebec Registry of Enterprises:** The Quebec Registry of Enterprises is a public register constituted under the *Act respecting the legal publicity of enterprises*². Since January 1, 1994, all enterprises operating in Quebec, regardless of their legal form, have been required to register and declare information regarding their activities (including the applicable industry sector and the number of employees employed by the enterprise in the Province of Quebec), the names and personal addresses of their shareholders, directors, partners and key officers who are not members of the board of directors, the addresses of the registered office and establishments of such enterprises and the trade names under which they carry on business activities. For the most part, this information is made available on an “as self-reported” basis. In the context of a share purchase transaction, this will facilitate the review by the purchaser’s legal advisors of applicable minute books and corporate registers. The information on record with the Quebec Registry of Enterprises will also indicate whether the enterprise is in good standing and up to date with required filings in the province.
- **Plumitif:** The Plumitif is a computerized public register which is directly linked to the database of the Ministry of Justice of Quebec and contains records of judicial proceedings in civil, criminal/penal, municipal and other statutory matters in the Province of Quebec. Litigation searches of the target business and/or the vendors are frequently conducted in order to determine whether there is any ongoing action, suit or proceeding which may affect the assets or shares being sold.
- **Register of Personal and Movable Real Rights (RPMRR):** The RPMRR is a public register which contains records of certain rights registered against movable (personal) property (for example, security interests, known in Quebec as, *inter alia*, “*hypothecs*”, on inventory, motor vehicles or financial products) or persons in Quebec (for example, marriage contracts). In both asset and share transactions, buy-side legal advisors will typically conduct searches to verify whether the prospective purchaser would be acquiring good title to the purchased assets or shares, as the case may be, free and clear of encumbrances published at the RPMRR. Rights published at the RPMRR

² *Act respecting the legal publicity of enterprises*, CQLR c P-44.1.

are opposable to and may be set up against third parties. In addition to searches on the RPMRR, buy-side legal advisors will frequently conduct searches under (i) Section 427 of the *Bank Act*³ with respect to notices of the intention to give security, (ii) the *Bankruptcy and Insolvency Act*⁴ and (iii) federal litigation searches of the Federal Court and the Federal Court of Appeal.

- **Quebec Land Register:** The Quebec Land Register is a public land register which contains records of real estate transactions carried out in Quebec since its creation in 1830. To the extent that the asset or share transaction in question involves the acquisition of immovable (real) property, buy-side legal advisors will typically conduct searches to verify whether the prospective purchaser would be acquiring good title to such property, free and clear of encumbrances. It should be noted that Quebec does not have a system similar to the Torrens system (in which the contents of the registry are guaranteed by the state) and instead relies on a chain of title system in which the registry is a repository of deeds and other documents forming a chain of title that must be examined and analyzed by a lawyer or notary as part of due diligence. The purpose of this process is to determine whether the target has good title to real estate. Unlike many other jurisdictions, Quebec does not have leasehold interests in land; a lease of real estate gives rise to personal rights between the parties which may nonetheless be published in the Land Register.

While the focus of this article is Quebec-specific legal due diligence, it would be remiss not to mention that the attorneys for the prospective purchaser will generally carry out standard due diligence actions such as corporate minute book audits (in the context of a share purchase transaction), document review (to the extent that the contracts and other documents made available to the prospective purchaser raise legal issues) as well as more specialized legal inquiries depending on the nature of the business and its assets (for example, it may be useful to conduct legal due diligence in connection with intellectual property matters, depending on whether the business holds any such intellectual property). Ideally, the scope of the buy-side legal due diligence should be well defined in advance, and the attorneys for the prospective purchaser will confirm which activities fall outside the scope of their review and under the responsibility of the clients and their advisors. Normally, matters excluded from the scope of legal due diligence review will include technical, physical or structural, operational, financial, accounting or actuarial issues.

REQUEST FOR ACCESS TO INFORMATION FROM PUBLIC BODIES

In Quebec, it is possible to submit a request for information and documents to public bodies (including the provincial government, its departments and agencies, municipalities and school boards, and health services and social services institutions) in order to obtain information on record with respect to a target business, pursuant to the *Act respecting Access to documents held by public bodies and the Protection of personal information*⁵. This is a common step followed in connection with buy-side legal due diligence, and the process normally involves obtaining a written authorization from a representative of the target business to conduct requests for information and making specific requests to relevant public bodies. The public body will normally have twenty days to respond to the request, but this time limit is frequently extended. It should be noted that access to information requests can be made to federally regulated public bodies pursuant to the federal *Access to Information Act*⁶.

The following are non-exhaustive examples of access to information requests in buy-side due diligence:

³ *Bank Act*, SC 1991, c 46.

⁴ *Bankruptcy and Insolvency Act*, RSC 1985, c B-3.

⁵ *Act respecting Access to documents held by public bodies and the Protection of personal information*, CQLR c A-2.1.

⁶ *Access to Information Act*, RSC 1985, c A-1.

- In a share purchase transaction, requests for access to information are frequently made under the foregoing laws to Revenu Québec and the Canada Revenue Agency with a view to identifying red flags from a taxation due diligence perspective.
- To the extent that the transaction in question involves employees, it may be desirable for the prospective purchaser's advisors to request information and documents on record with the *Commission des normes de l'équité de la santé et de la sécurité du travail* (the "CNESST"). The CNESST is a public body which administers and enforces employment regulations in the province of Quebec. Access to information requests to CNESST can reveal, with respect to the target business, its occupational health and safety history, and its past compliance with labour standards and pay equity legislation.
- Access to information requests to public bodies in more specialized areas may be relevant depending on the nature of the business. For instance, if a transaction involves environmental due diligence (such as in many real estate transactions or in connection with the purchase of a manufacturing business), an access to information request to the *Ministère de l'Environnement et de la Lutte contre les changements climatiques* may be relevant in order to obtain documents and information regarding the compliance history of the target business and/or its properties.

CONCLUSION

Although buy-side legal due diligence can be relatively complex and technical in Quebec, the end goal is to produce a relatively straightforward and accessible work product, frequently in the form of a legal due diligence memorandum that distills key red flags for the benefit of the prospective purchaser. For the prospective purchaser, effective buy-side legal due diligence leads to a better understanding of the target business and the potential risks involved with the investment. Moreover, to the extent that the prospective purchaser wishes to proceed with the transaction following the completion of the due diligence phase, the prospective purchaser's legal advisors will be better positioned to negotiate and prepare an asset or share purchase agreement with customized representations and warranties or indemnification provisions addressing risks identified by due diligence. Last, it bears repeating that the specific circumstances of each transaction should dictate the scope, breadth and nature of the steps taken in the course of buy-side legal due diligence.

The information and commentary set forth herein are for the general information of the reader and are not intended as legal advice or as an opinion to be relied upon in relation to any particular circumstances.

If you have any questions with respect to the subject matter hereof, please contact one of our specialized attorneys, who will be pleased to advise you.

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