SCC on Suing Tax Advisers

The SCC's recent decision in *Brunette* (2018 SCC 55) inspired both relief and head-scratching from tax professionals. In an 8-1 judgment, the SCC upheld lower court rulings dismissing a lawsuit filed against a group of tax advisers (lawyers and accountants) whose supposed negligence was alleged to have led to the 2010 failure of Quebec's Groupe Melior, which was in the business of building and operating retirement homes.

The SCC held that the plaintiff (Fiducie Maynard 2004, hereinafter "Fiducie") lacked standing to pursue its claims. At first glance, this result seems incongruous because Fiducie apparently had contractual adviser-client relationships with the various defendants. Legally, standing refers to whether a plaintiff has sufficient interest in a dispute to institute a claim. It is usually considered a very low bar to satisfy, and one would normally think it self-evident that a client has standing to sue its advisers for alleged breaches of their professional duties that cause injury.

The SCC decision provides very little background on the underlying tax issues that led to the collapse of Groupe Melior and how the defendants allegedly contributed to them; a review of lower court decisions in the Superior Court (2015 QCCS 3482) and Court of Appeal (2017 QCCA 391) is necessary to appreciate the reasoning behind and scope of the SCC decision. The Superior Court motions judge noted that Groupe Melior had a complex corporate structure comprising more than 60 different entities under the holding company 9143-1304 Quebec Inc. ("9143"). Generally, for each retirement home project, one entity owned the land, another entity built or renovated the retirement home, and yet another would operate it once completed. Under the self-supply rules of the federal Excise Tax Act (ETA) and the provincial Act Respecting the Québec Sales Tax (LTVQ), the entity that built or renovated the retirement home must self-assess and remit sales taxes based on the home's FMV on the date of substantial completion (but those provisions do not define how the FMV is to be calculated). Groupe Melior obtained valuations and remitted sales tax accordingly.

Revenu Québec audited Groupe Melior in 2009 and challenged its methodology for determining the properties' FMV. Essentially, Groupe Melior used a method that relied primarily on anticipated revenues, and Revenu Québec took the position that the taxpayer should have used a method based on the cost of construction. (At the same time but in a different case, Revenu Québec was challenging another taxpayer's valuations of retirement homes on the opposite basis, claiming that the taxpayer used a cost-basis methodology and not an income-based methodology: *Beaudet*, 2014 TCC 52.) Neither the ETA nor the LTVQ specifies how FMV is to be calculated; this lack of clarity has been a longstanding source of difficulty. In the 2006 case of *Lions Village of Greater Edmonton Society* (2006 TCC 670), Campbell Miller J expressed "frustration" over this issue and called for parliamentary intervention that has not materialized.

Revenu Québec issued a series of reassessments to 17 Groupe Melior entities; collections action ensued (sales tax reassessments, unlike income tax, are 100 percent collectible, even if disputed). Soon afterwards, all of the Groupe Melior entities, and Jean M. Maynard personally, filed for bankruptcy.

Fiducie owned all the shares of 9143 and estimated its total losses after the collapse of Groupe Melior to be $55 million. It sued its law firm (Legault Joly Thiffault), its accountants (Lehoux Boivin), and sales tax specialist Marcel Chaput, alleging that they had negligently participated in developing a corporate structure that did not comply with fiscal legislation and used an inappropriate valuation methodology to calculate sales tax remittances.

The defendants moved to dismiss the action on the basis that any injuries resulting from their alleged negligence were suffered by the various entities of Groupe Melior, and Fiducie suffered injury only in its capacity as shareholder of 9143. Thus, any professional negligence claim must be brought by the Groupe Melior entities—or potentially their creditors—as derivative actions in the context of the bankruptcy proceeding. The motions judge found that Fiducie lacked standing to bring its suit, and the Court of Appeal agreed.

The defendants relied on the principle set out in the classic 1843 common-law case of *Foss v. Harbottle* (67 ER 189), which held that a shareholder cannot pursue the claims of a corporation. Quebec is not a common-law jurisdiction, and although it has followed *Foss v. Harbottle*, the province's case law also recognizes that a shareholder can sue a party whose wrongful conduct results in a loss of its share value, provided that fault and direct causality are adequately demonstrated. The leading

case on this matter is the SCC's 1990 *Houle* decision ([1990] 3 SCR 122), in which a bank was found liable to shareholders of a family-run corporation when the bank called in a loan to the corporation without reasonable notice, precipitously seized the corporation's assets, and sold those assets at a fire-sale price. The SCC found that under the circumstances and taking into account the relationship between the bank and the shareholders, the bank had a "distinct legal obligation to act reasonably towards [the shareholders] independently of its contractual obligation towards the company." The SCC found that the bank had breached this "distinct legal obligation" and civil liability to the shareholders arose.

Houle is a leading case on the abuse of rights in the civil law and has formed part of the standard Quebec law school curriculum for over a generation, although the decision may not be well known outside the province. Much of the SCC's analysis in *Brunette* is a reconciliation of *Houle* with the common-law principles in *Foss v. Harbottle*, and one might speculate that the SCC granted leave in this case precisely with that objective in mind.

After reviewing certain points of procedure for challenging a suit based on lack of standing (including the standard and onus of proof and the ability to adduce evidence), the SCC held that there is no inconsistency between *Foss v. Harbottle* and analogous principles in Quebec civil law, which in the end produce similar results. Under Quebec law, a corporation has a distinct legal personality and exercises its own civil rights. A cause of action that belongs to a corporation must be exercised by the corporation, not a shareholder, unless the legal requirements for a derivative action are met. As held in *Houle*, a shareholder may pursue an action against a defendant whose wrongful conduct caused damage to the corporation only if (1) the "defendant breached a distinct obligation owed to the shareholders" and (2) "the breach resulted in a direct injury suffered by the shareholders, independent from that suffered by the corporation." The SCC added that in most cases a fault committed against a corporation only indirectly affects the shareholders and thus they do not have a cause of action.

The SCC noted that although Fiducie alleged a contractual relationship with the defendants, this fact alone was not sufficient to grant standing to pursue the claims set out in its pleadings. The pleadings failed to allege with precision which duties, contractual or otherwise, to Fiducie were breached by the defendants.

The question of the sufficiency of Fiducie's pleadings (the statement of claim, then known in Quebec as the "motion to institute proceedings") was dealt with in greater detail in the lower courts. The motions judge remarked that:

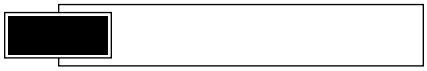
> The motion to institute proceedings does not respect section 76 of the *Code of Civil Procedure*. It spans 63 pages, over 316 paragraphs, without counting the sub-paragraphs. It is sometimes incomprehensible, redundant, and stuffed with outside facts not relevant to the litigation. . . . This immense and interminable procedure gives the appearance of a complex matter, but upon examination, one is forced to conclude that it conceals a claim destined to fail. [Paragraphs 37-38, translation by author.]

The motions judge's comments confirm that Fiducie's voluminous pleadings apparently gave little, if any, indication of what the defendants supposedly did wrong in designing and implementing the Groupe Melior corporate structure. The sales tax remittance obligations were, apparently, properly identified and would likely have existed (in some form) no matter what corporate structure was chosen. The ETA and LTVQ do not prescribe a valuation method for retirement homes for the purposes of calculating sales tax, and Revenu Québec itself apparently did not have a consistent position on the subject. It is far from clear how or why Fiducie's professional advisers should be held liable for Revenu Québec's aggressive and mercurial conduct in the course and aftermath of its audit.

In its submissions before the lower courts, Fiducie argued that the defendants had a duty to warn it, as their client, of the risks attending a Revenu Québec challenge of the valuation methodology used for the retirement homes. Fiducie argued that it would not have invested so much in the business if it had been aware of this risk. Both the motions judge and the Court of Appeal seemed to accept that a shareholder of a business would potentially have had standing to bring such a claim, but that the facts alleged in the motion to institute proceedings were insufficient to support one by Fiducie. One might speculate that the outcome of *Brunette*—before both the lower courts and the SCC—may have been different if Fiducie had framed its claims more coherently and with greater focus on the defendants' relationships with and obligations to Fiducie rather than the Groupe Melior entities in general.

However, as pointed out in Justice Côté's lone dissenting opinion in *Brunette*, issues involving sufficiency of pleadings or the prima facie merits of a claim are generally not dealt with as matters of standing. In her view, the fact that Fiducie had a contractual relationship with the defendants and that it alleged—rightly or wrongly—professional negligence in the performance of their contractual duties resulting in $55 million of damages was more than sufficient to meet the very low threshold for standing. She argued that the majority's holding—that a shareholder must allege some "particular" injury distinct from that suffered by a corporation in order to have standing to pursue a claim against its own professional advisers—added novel and unnecessary complexity to the law of standing.

Even in common-law provinces, if a shareholder initiates a lawsuit that states claims contrary to the principles set out in *Foss v. Harbottle*, the remedy is not generally to seek to dismiss the suit for lack of standing, but rather to strike the claim for failure to state a cause of action. A motion to strike for failure



to state a cause of action is also a recognized remedy if a plaintiff's pleadings are incoherent and contrary to the rules of procedure, which also occurred in this case. One might have thought that a motion to strike for failure to state a cause of action would have been procedurally a more appropriate course of action for the defendants in this case; as Justice Côté noted in her dissent, "it seems to me that these two exceptions to dismiss have to a large extent been confused with one another."

Brunette may be remembered primarily not for its treatment of the law of standing, but for narrowing *Houle* and bridging the longstanding gap between Quebec and the rest of Canada with regard to civil actions by shareholders. The unusual procedural aspects of this case—including the remarkable suggestion that a client lacks standing to sue its own advisers—may be attributed to incoherent pleadings rather than to the SCC's ushering in new and more restrictive principles of standing.

Michael H. Lubetsky
Davies Ward Phillips & Vineberg LLP, Toronto