Court of King's Bench of Alberta

Citation: Dentons Canada LLP v Rehill Holdings Ltd, 2024 ABKB 260

Date: 20240503
Docket: 2301 13237
Registry: Calgary

Between:

Dentons Canada LLP

Plaintiff

- and -

Rehill Holdings Ltd., Buta Singh Rehill, 2290808 Alberta Ltd., Poonamjeet Kaur Toor, Neosome Lenders Ltd., Trilochan Singh Sekhon, 2290789 Alberta Ltd., Jagroop Randhawa and 2329716 Alberta Ltd.

Defendants

Endorsement
of the
Honourable Justice M. J. Lema

I. Introduction

[1] Parties to a commercial transaction dispute the amounts releasable from escrow to clear the vendor's share of certain pre-closing or closing-related liabilities.

[2] As explained below, I accept the vendor's position on each of the liabilities.

[3] For ease of reference, I will refer collectively to the selling parties as the vendor and the acquiring parties as the purchaser.

II. Analysis

A. Carbon Tax

[4] The parties agree that $219,189.62 should be released from escrow to cover the vendor's share of the tax in question.

[5] The debate is whether the vendor is also responsible for associated interest and penalties (estimated at $22,753.68) and, if so, whether that amount should be paid out of the escrow monies or, alternatively, be parked there pending fixing of the amount via CRA assessment and (once fixed) paid out of escrow.

[6] The purchasers argue that the vendors declined until recently, and without good reason, to authorize the payment of the tax amount and, accordingly, are responsible to pay the resulting interest and penalties. In particular, the purchasers point to a further-assurances clause in the escrow agreement (" … Parties will … do all acts and things as the other party may reasonably require to effectively carry out … [the] Agreement") and a vendor-to-purchaser indemnity provision in the share-purchase agreement as anchoring the vendor's obligations here.

[7] I accept the vendor's position that the Carbon-Tax-related escrow arrangement did not extend to whatever interest and penalties may have accrued after the closing date, which date both sides appear to have accepted, at least for the purpose of this application, as being March 1, 2023.

[8] I recognize that, per the definition of "Tax" in the share purchase agreement (SPA), "Tax" includes both Carbon Tax and any associated interest and penalties.

[9] However, per para 5.1(e) SPA, the Carbon-Tax-related escrow obligation was limited to "any Carbon Tax owing during the period commencing January 1, 2023 and ending on the Closing Date" i.e. does not extend to any post-closing-date obligations (principal tax, interest or penalties) accruing after March 1, 203 i.e. does not reach the post-closing interest and penalties sought by the purchasers here.

[10] This is reinforced by para 4.01(1)(e) of the escrow holding agreement (EHA), which also zeroes in on "the amount of Carbon Tax owing up to and including the Closing Date."

[11] To the extent the purchaser has an interest-and-penalties-focused claim against the vendors for unduly delaying release of the principal-tax portion (which the vendor disputes), the EHA made no provision for its recovery out of the escrowed funds.

[12] Section 4.01 EHA reinforces that conclusion, providing that:

> … if any of the [identified] holdback amounts are not sufficient to satisfy the Vendors' payment obligations, the Escrow Agent may disburse from any other holdback amount, an amount that is sufficient to satisfy such obligations.

[13] In other words, a given holdback was to be applied to its identified purpose or to cover the shortfall in any other identified purposes, but not otherwise applied to any other vendor obligations.

[14] Accordingly, with the current focus limited to the appropriate distribution of those funds, I do not need to address whether the vendor unduly delayed here, whether the parties' mutual release of claims would bar an interest-and-penalties claim, or (if not) whether that claim would fall within the scope of the SPA's "arbitrate all disputes" provision.

[15] The result here is that, EHA-wise, the vendor's obligation is limited to $219,189.62.

B. Legal Fees

[16] The reasoning above on Carbon-Tax-related interest and penalties applies equally to the purchaser's claim for legal fees associated (per the purchaser) with enforcing the EHA: the escrow arrangement did not earmark any portion of the escrowed monies for such a claim or otherwise address legal costs.

C. Corporate Tax and GST

[17] The dispute here centres on the business's GST debt as of closing, half of which the vendor agreed to cover.

[18] Per the purchaser, the debt was $118,219.24 at that time. Factoring in a corporate tax credit of $5,989.10, the business's net GST and corporate debt was accordingly $112,230.14, with the vendors having to pay $56,115.07.

[19] Per the vendor, that overlooks the later transfer of approximately $43,000 in other corporate tax credits existing before closing, reducing the GST debt to $73,135.72 (per the vendor's calculation). Applying the corporate tax credit of $5,989.10, the net tax debt of the business at closing was effectively $67,146.62, making the vendor's half share $33,573.31

[20] Per para 4.2(c) SPA, the target obligation here was "all Taxes payable by the Corporation … up to the [Closing] Date after proper application of any losses, depreciation or amortization arising in any periods or years prior to the [Closing] Date."

[21] Per para 4.01(1)(b) EHA, the focus was "[assessed] corporate income taxes and GST owing up to and including the Closing Date …."

[22] The business had overpaid what was required to clear its corporate tax debt. The resulting credit was transferrable to the GST account and the credit was in fact applied (presumably at the business's direction), reducing the GST debt, as explained by the vendor.

[23] The purchaser did not dispute the existence or application of this larger credit. However, it argued at the recent hearing that "the application of a credit to an income tax debt does not reduce the amount of the debt", "applying a credit is not reducing the GST payable", and "[the transfer] of $45,000 from [the] income tax [account] to the GST account … is not a reduction in the GST."

[24] The purchaser effectively conceded that the focus here was the GST payable as of closing. Its argument is that applying an acknowledged credit to the GST debt did not reduce the GST payable.

[25] I do not follow that argument.

[26] Applying a credit, whether from the GST account itself or from a corporate tax account, is functionally the same as a payment by the taxpayer.

[27] In my view, it was implicit in both the SPA and EHA provisions that any tax liabilities existing at closing would be net of any available credits. Otherwise, the purchasers would receive a windfall, with the vendor paying one-half of a gross tax obligation (i.e. without benefit of the credit) and the purchaser inheriting the full credit on its own.

[28] The whole idea was shared responsibility for the as-of-closing tax burden. That burden could not and cannot, be fairly gauged without factoring in available credits.

[29] And nothing in the agreements compels or even suggests otherwise.

[30] Accordingly, EHA-wise, the vendor's obligation is limited to $33,573.31.

D. West Country Holdback

[31] The parties agreed to share equally the cost of clearing, whether by litigation or settlement, this claim against the business.

[32] The claim was settled for $30,000. Per the purchaser, associated legal costs were $3,371, meaning the vendor has to contribute $16,685.50 (half the settlement-and-fees amount) out of escrow.

[33] The purchaser invokes s. 8.2 SPA:

> The Vendors hereby covenant to pay 50% of any amount owing by the Corporation arising from the West Country Claim … following the issuance of a court order, arbitration or negotiated settlement that is not appealed within any relevant limitation period.

[34] As well as para 5.1(c) SPA, which essentially tracks s. 8.2.

[35] Per the purchaser, "any amount owing … arising from [that] claim" includes the legal fees associated with negotiating the settlement.

[36] That may be so, but the question is whether the escrow arrangement embraced legal fees as well.

[37] The vendor acknowledges responsibility for $15,000 but disavows responsibility for any share of the legal costs.

[38] It points to para 4.01(c) EHA:

> West Country Holdback – within 5 Business Days following the final resolution of the West Country Claim …, the Escrow Agent shall disburse 50% of the **amount owing by the Corporation … to West Country** … and release the remaining amount equally to the Vendors. [emphasis added]

[39] I agree with the vendor: the escrow obligation was limited to the settlement amount payable to West Country i.e. does not extend to amounts payable by the business to others e.g. its legal counsel.

[40] As with the Carbon Tax interest and penalties, the purchaser's (possible) claim for contribution to legal expenses was not escrowed, meaning it may fall within the scope of released claims or, alternatively, fall to be arbitrated, neither of which aspects I am deciding here.

E. Change-of-Control Financial Statements Holdback

[41] The last dispute is over responsibility for the cost of certain financial reporting for the business.

[42] The vendor acknowledges responsibility to pay out of escrow $21,585, which is half the cost of certain standard financial reports (e.g. balance sheet, income statement, etc.) through to

closing. However, it resists having to pay a further $2,250, half the cost of certain additional financial reports prepared (as it sees it) for the exclusive benefit of the purchaser and addressing post-closing matters, all at the direction of the business's bankers.

[43] The purchaser argues that the vendor has to pay half of "all required financial statements" and that the latter set also qualifies.

[44] I agree with the vendor.

[45] The key provision is para 4.2(a) SPA

> The Purchasers shall, at the shared cost of the Vendors and Purchasers, cause the Corporation ... ... to:
>
> a. prepare **the financial statements** of the Corporation … as of the [Closing] Date (the "Change of Control Financial Statements"), including a balance sheet, statement of retained earnings, statement of income and accruals of all outstanding obligations of every nature and kind whatsoever from the period or periods beginning on the date of the acquisition … and ending on the [Closing] Date, and warrant in writing to the Purchasers that the said financial statements were **prepared on a "notice to reader" basis, applied on a basis consistent with that of prior financial years** …. [emphasis added]

[46] I find as follows:

1. the reference to "*the* financial statements" signals a focus on standard financial statements;
2. that is confirmed by the examples of such standard statements provided (balance sheet, etc); and
3. more confirmation comes from the requirement to prepare the statements the same way as in "prior financial years" i.e. the focus here is on the standard, annually required financial statements.

[47] Accordingly, the vendors are not required to contribute to the cost of "non-standard" financial reports, such as the compilation-engagement statements here, as further detailed in the vendor's counsel's February 27, 2024 letter (paras 22-24).

[48] As a result, the vendor's escrow-anchored obligation is limited to the noted $21,585.00.

III. Conclusion

[49] For the reasons outlined, the vendor's obligations anchored by the escrow arrangement are as follows:

1. Carbon Tax holdback -- $219,189.62;
2. Tax return holdback -- $33,573.31
3. West Country holdback -- $15,000.00; and

4. Change-of-control financial statements holdback -- $21,585.00.

Total payment: $289,374.93

[50] As I understand it, with the interest, the initial fund held by the escrow agent ($307,500) had grown to $315,000.27 when paid into Court on or around November 10, 2023.

[51] I do not know what amount of interest, if any, has accrued since then.

[52] Given that the escrow amount represented consideration due to the vendor on the share purchase transaction that was parked to meet the noted vendor obligations, and with those escrow obligations now determined, I find that the balance of the escrow monies, plus any additional interest that has accrued since the payment into court, shall be paid to the vendors.

IV. Costs

[53] The purchaser asked for solicitor-and-client-level costs, claiming entitlement under both the agreements and the common law. On both bases, it stressed perceived intransigence and delay by the vendor in agreeing to the unconditional release of any of the escrowed funds.

[54] The vendor argued that the root cause of the delays was the purchaser's failure to provide timely responses to legitimate inquiries about the status of the tax accounts and the costs of the financial statements.

[55] As explained above, I did not have to explore these allegations and cross-allegations.

[56] Instead, the focus here was exclusively on interpreting the SPA and the EHA and deciding whether a given liability pointed to by the purchaser fell within the scope of the associated escrow holdback and, if so, its proper quantum.

[57] On each of those debates, the vendor was successful.

[58] Given essential agreement on the vendor's escrow-anchored liabilities for the principal Carbon Tax, the core West Country settlement amount, the cost of standard financial statements, and the net GST debt, the amount actually at stake here was in the neighbourhood of $50,000, consisting (collectively) of the difference between the parties positions on the net-of-credit GST debt, the asserted liability for interest and penalties on the Carbon Tax, the West Country legal fees, and the cost of the "non-standard" financial statements.

[59] In these circumstances, the vendor is entitled to costs under Column 1, with a multiplier of 3.

Heard in Edmonton, Alberta via Webex on April 25, 2024.
Dated at Peace River, Alberta this 3rd day of May, 2024.

M. J. Lema
J.C.K.B.A.

Appearances:

Christian J. Popowich
Katherine Reiffenstein
Code Hunter LLP
For the applicant purchasers

Robert J. Stack
Aimee Louie
Wilson Laycraft
Barristers & Solicitors
For the respondent vendors