Cassels

Use it or Lose it! Non-Compliance with USA Provides Risk of Repudiation of Share Transaction

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In *Leeder Automotive Inc. v. Warwick*, the Ontario Court of Appeal ruled on a failed share-purchase transaction.[1] This decision demonstrates that a share purchase agreement arising from the triggering of a non-mandatory buy-sell clause in a unanimous shareholders agreement (USA) can be a standalone contract, and therefore that contract has the risk of being repudiated.

The Facts and Application Decision

Appellant John Leeder, as founder/majority shareholder of Leeder Automotive Inc. (collectively, Leeder), brought an application seeking to compel Douglas Warwick, the respondent minority shareholder (Warwick), to complete a share purchase transaction pursuant to the buy-sell provisions of Leeder's USA. Any shareholder seeking to sell their shares triggered the buy-sell provision to which Leeder held the first-right of refusal, followed by the fellow shareholders, and then third parties.[2]

When Warwick provided notice of his intention to sell all his shares, Leeder provided written notice of their desire to purchase, and a dispute over the applicable valuation method arose. The provisions of the USA required Leeder's auditors or accountants to prepare financial statements using generally accepted accounting principles (GAAP), that Leeder's real estate to be valued by an independent expert agreed upon by the shareholders, and that Leeder's goodwill be determined pursuant to a formula set out in the USA.[3]

Warwick refused to sell his shares when Leeder attempted to rely on outdated property appraisals from a non-arms' length third party and financial statements prepared on a Notice to Reader basis (which explicitly stated that they were "not GAAP"). Furthermore, due to the lack of compliance with the USA provisions, Warwick took the position that Leeder had repudiated the contract and refused to sell.[4] Repudiation occurs when the entire foundation of a contract has been undermined; where the very thing bargained for has not been provided.[5]

The application judge found that the buy-sell agreement did not constitute a standalone contract, but that the non-compliance of Leeder with the provisions of the USA amounted to repudiation since 1) the real estate appraisers were not truly independent or agreed upon by the shareholders, which was deemed a serious breach, and 2) the financial valuation report was not prepared according to GAAP.[6]

The Appeal Decision

On appeal, the Court held that the application judge made a palpable and overriding error in concluding that the buy-sell mechanism did not give rise to a standalone contract, since there is no such thing as partial repudiation. Specifically, the application judge could not rule that the share purchase agreement was merely an "implementation of the USA," but simultaneously make a finding that the transaction agreement alone had been repudiated.[7]

The Court held that the triggering of the non-mandatory buy-sell clause gave rise to a new contractual arrangement based upon the offer to sell and acceptance of the offer by the company, the other shareholders, or third parties. More simply, since the buy-sell mechanism required both an offer and acceptance, it contains the elements of a standalone contract.[8]

Lastly, the Court agreed with the application judge that since that Leeder had disregarded contractual provisions designated to generate a fair price for the sale of the shares, which were essential terms of the contract, the contract had therefore been repudiated.

Key Takeaways

Companies should maintain an awareness and remain compliant to valuation provisions in a USA when a buy-sell provision is engaged, as this case demonstrates that the failure to do so could result in a failed share-purchase transaction.

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[1] *Leeder Automotive Inc. v. Warwick*, 2023 ONCA 726, (*Leeder*).

[2] *Leeder* at para 10.

[3] *Leeder* at para 11.

[4] *Leeder* at para 23.

[5] *Leeder* at para 43.

[6] *Leeder* at paras 31-33.

[7] *Leeder* at para 44.

[8] *Leeder* at para 54.

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