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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

"Is it possible to buy a business and end up having to pay for it twice because you neglected to follow the letter of the law the first time around? In Ontario...the answer can be yes."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Business Law Department, Steven Jeffery at 416.593.3939 or sjeffery@blaney.com.

BUYER BEWARE? IN 'BULK SALES' IT'S PARTICULARLY IMPORTANT

Steven P. Jeffery

Is it possible to buy a business and end up having to pay for it twice because you neglected to follow the letter of the law the first time around? In Ontario, a Court of Appeal decision indicates that the answer can be yes.

Bulk sales legislation, which originated in the United States at the turn of the 20th century, was introduced throughout Canada to ensure that the creditors of a business would be paid what they were owed if the owners of the business sold the assets of the business "in bulk".

Recently, however, several provinces have repealed it on the basis that compliance creates significant commercial inconvenience, disruption and expense and that, for the most part, creditors can obtain sufficient protection from laws dealing with fraudulent conveyances.

Ontario has retained its bulk sales legislation, however, and the need for strict compliance has recently been underscored by the Court of Appeal.

A sale in bulk is a sale of goods, wares, fixtures or other chattels that is made out of the usual course of the seller's business. (If a shoe manufacturer sells shoes, that is considered 'inside' the normal course of business. If the manufacturer sells its shoe-making machinery, or all of its shoe inventory at one time, that may be considered 'outside' the normal course of business and therefore a sale in bulk.) Many sales in bulk are sales of the entire business.

The Ontario Bulk Sales Act is designed to prevent a seller from making a sale in bulk without either the consent of its creditors, or the payment of their claims, or a court order. Even though the Act targets the seller, it puts the onus on the buyer to demonstrate that the seller has complied with its requirements. The buyer must demand and receive from the seller a statement showing all of the seller's trade creditors. The buyer must then ensure that all of such creditors are paid, or must pay the purchase price to a trustee if a certain percentage of the seller's creditors agree. After the sale is completed, the buyer must file an affidavit with the court evidencing compliance with the Act.

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"Even though the (Ontario Bulk Sales) Act targets the seller, it puts the onus on the buyer to demonstrate that the seller has complied with its requirements."

Steven P. Jeffery is a partner in Blaneys' business law department. His practice focuses on financing, particularly real estate financing, and real estate and business acquisitions and divestitures. He serves as Editor-in-Chief of Blaneys on Business.

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Failure to comply may result in the buyer having to account to the seller's creditors for the value of the assets purchased.

The severity of this remedy was demonstrated in *National Trust Co. v. H&R Block Canada, Inc.* In this case, H&R Block purchased the assets of Tax Time Services for $800,000. Instead of insisting that Tax Time comply with the Act, H&R Block obtained an agreement from Tax Time and its president to indemnify H&R Block from any liability that might be incurred as a result of failing to comply with the Act. This is not an uncommon practice. As it turned out, however, the indemnity didn't provide much comfort because both the seller and its president went into bankruptcy.

The seller's assets were heavily secured. Each of the secured creditors released their security so that the seller could sell the assets and then turn the cash over to the secured creditors. The seller did this, and all of the net proceeds were used to pay out the secured creditors.

The Court of Appeal noted that, although H&R Block did not comply with the Act, H&R Block did appear to distribute the proceeds of the sale as prescribed by the Act.

Although H&R Block was aware of the unsecured creditors, it felt confident that there would be no liability arising from noncompliance with the Act because all of the proceeds of the sale were disbursed to the secured creditors, whose priority ranked ahead of the unsecured creditors.

However, when National Trust, an unsecured creditor, brought an action to declare that the sale was void against it, the Court of Appeal listened and agreed. The court held that H&R Block's calculated decision not to comply with the Act meant that all of the creditors, including National Trust, were deprived of their statutory right to contest the sale. The court held, further, that it was too late to speculate on whether a court would have approved of the sale in the manner in which it actually proceeded, had the Act been complied with and that a unilateral decision of how to distribute the proceeds was not a substitute for compliance.

Accordingly, H&R Block was held liable to National Trust for the debt, plus interest, owed by Tax Time. The debt was not equal to the value of Tax Time's assets, but it was not inconsiderable, either. It amounted to $205,000, roughly one-quarter of the price H&R Block paid for Tax Time, plus interest.

The lesson from this case is clear; compliance with Ontario's Bulk Sales Act is not a trivial matter. While a buyer may decide to waive compliance in return for an indemnity from the seller, a waiver should only be considered after fully assessing the potential risks involved, including, of course, an assessment of the seller's creditworthiness. ■

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"The client must feel comfortable enough that he can share his innermost thoughts with the lawyer and the lawyer must be confident enough that he will be very open with the client."

Rodney L.K. Smith, Q.C. leads Blaneys' commercial and general litigation group. He has a wide-ranging practice in corporate, commercial, insurance and municipal litigation and is an authority on construction, municipal, planning, environmental and expropriation law. He has counselled and represented the public and private sectors in a wide variety of cases and is a director of the City of Toronto Economic Development Corporation (TEDCO).

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GETTING ALONG WITH YOUR LITIGATION LAWYER

Rodney L.K. Smith, Q.C.

This is the second of three articles by Rodney L.K. Smith, Q.C. group leader of Blaneys' commercial and general litigation practice, about measures that business people and their litigation lawyers can take to establish and maintain the clear, constructive relationships that produce the most efficient and effective outcome.

Our first article about forthright, productive relationships between litigation lawyers and their business clients advocated a thorough discussion, "up front," about what the costs of the litigation process might be and described a number of techniques for keeping the cost question in clear view throughout the course of the case. If the businessman or woman and the lawyer have had that discussion, both will be well on the way to establishing the kind of relationship that will help achieve a successful outcome in the case.

The spirit of this relationship must be one of shared responsibility and utter frankness. The client must feel comfortable enough that he can share his innermost thoughts with the lawyer and the lawyer must be confident enough that he will be very open with the client.

Litigation is not an easy journey. There will be times of difficulty and stress. It is important that the client and the lawyer are able to travel comfortably together.

In addition to a sense of partnership and teamwork, another very important thing to establish at the beginning of a lawsuit is realistic expectations. The client will always want to know whether he or she has a good case or a good defence. In this connection, I believe it is very important in every case for the client to obtain a preliminary assessment from the lawyer about the case.

Such an assessment consists of a clear, insightful analysis of the strengths and weaknesses of the case and an explanation, in plain language, of the theory of the case and the chances of success. This assessment is best put in writing so that the client can study it carefully and review it systematically with the lawyer, exploring the questions that will arise inevitably and examining the assumptions on which the opinion is based.

The assessment should also contain a roadmap for the future of the case. It should, for example, contain recommendations on the hiring of forensic accountants to provide a calculation of the damages, other expert witnesses and any other investigations that should be carried out. Depending on the experience of the client, the roadmap should also contain a description of the litigation process. This would include the requirement for the production of documents; examinations for discovery; the fact that various motions will be brought; and, generally, the time and effort to bring the case to trial.

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"...a preliminary assessment is a very useful step towards ensuring that the expectations of both the businessperson and the lawyer are in tune."

In many cases, a commercial litigation lawyer will provide a preliminary assessment without being asked. Sometimes, however, a client will instruct the lawyer to prepare a statement of claim immediately or prepare a defence without providing an assessment of the case.

While there may be some exceptions, I would say that a preliminary assessment is a very useful step towards ensuring that the expectations of both the businessperson and the lawyer are in tune. At some point, sooner rather than later, once witnesses have been interviewed, further investigation carried out and necessary legal research done, the lawyer should be able to give a more definitive view of the case. This should be in writing as well.

Once the litigation is under way the client should require regular reports from the lawyer. This is a good discipline for both the lawyer and the client. There may be times when the relationship between the lawyer and the client allows for regular reports to be given orally. Nevertheless, it is good practice for both the lawyer and the client to have a report in writing periodically. The report should contain a continuing assessment of the case as well as a status report. It can include an overall description of the work completed since the last report and a description of where the case is going. This may be a suitable time for the client to obtain a continuing fee estimate for future work from the lawyer.

To conclude, good communication is key to a successful outcome. If the lawyer and the client communicate fully, frankly and regularly about the strengths, weaknesses and progress of the case, the prospects for a successful outcome will be enhanced. ■

WE ARE PLEASED TO ANNOUNCE

Christopher Kropka, LL.B. has joined the firm's real estate group where he will continue his practice in commercial real estate and commercial leasing including joint ventures, partnership syndications, secured lending transactions and asset and corporate acquisitions/divestitures, commercial lease enforcement and real estate development.

Christopher was called to the Bar in 1982 and acts, generally, as legal counsel to resident and foreign owners and managers of real estate.

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EXPECT THE BEST

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