

Beware of the Last Model Standing!



By Brian Madigan LL.B.

If you have located the ideal home and it is the builder's model, you could be in for a little surprise. If there weren't enough things to worry about in a real estate deal, you might also have to consider the *Bulk Sales Act*.

This is legislation in Ontario designed for the protection of both secured and unsecured creditors. It applies in situations where a vendor is selling assets out of the usual course of business.

So, in most cases, a builder will have an inventory of land and building sites. Some houses will be constructed on speculation, and most would be constructed as soon as they have been pre-sold. At least, that's the usual plan.

The only problem is that these are bad times for the building business and many small builders find themselves in financial difficulty. If a builder simply decides to close up shop and sell the 10 houses under various stages of construction, the building sites and the model home, to another but better financed builder, then, the *Bulk Sales Act* will apply. This is a sale of the entire undertaking. The usual sales would be "one by one sales" to individual consumers. This sale would not be "usual".

The Act is not restricted to business to business transactions. It doesn't say that at all. It characterizes the sale as being "usual" or "not usual".

The last house on the street could certainly be considered to be the last item of inventory. That would presume that perhaps other homes had been constructed and sold. However, what if this particular builder was simply a late entrant into a problematic economic period? The model home is constructed, but there are no sales. The builder decides not to take up his option to acquire 10 lots from the developer. This means, he has no inventory.

What does he have? He has a model home that was erected utilizing funds from various building trades. It's furnished with products and features supplied by others. The furniture is provided by a home staging company.

As you will no doubt appreciate, the time limit for registration of a construction lien will have long since expired. The lien needed to have been filed within 45 days of the date the last work was done. The model home probably took 4 to 6 months to construct, and probably sat and functioned as a model home and sales office for another 6 months before reality set in, and everyone realized that there were not going to be any sales.

So, the question ultimately is whether the model home in these circumstances might be subject to the provisions of the *Bulk Sales Act*.

Clearly, it is not a business to business sale, but unfortunately that is not a requirement under the Act.

Let's have a look at some of the **definitions** in the Act:

- **seller** means a person who sells stock in bulk
- **buyer** means a person who acquires stock in bulk
- **sale in bulk** means a sale of stock in bulk out of the usual course of business or trade of the seller
- **stock in bulk** means stock or part thereof that is the subject of a sale in bulk and all other property, real or personal, that together with stock is the subject of a sale in bulk
- **stock** means,
 - o goods, wares, merchandise or chattels ordinarily the subject of trade and commerce,
 - o the goods, wares, merchandise or chattels in which a person trades or that the person produces or that are the output of a business, or
 - o the fixtures, goods and chattels with which a person carries on a trade or business.
- **sale** includes a transfer, conveyance, barter or exchange, but does not include a pledge, charge or mortgage
- **proceeds of the sale** includes the purchase price and any security therefore or for any part thereof, and any other consideration payable to the seller or passing from the buyer to the seller on a sale in bulk, and the money realized by a trustee under a security or by the sale or other disposition of any property coming into the trustee's hands as the consideration or part of the consideration for the sale, less the proper and reasonable costs of the seller's solicitor for completing the sale

• **creditor** means any creditor, including an unsecured trade creditor and a secured trade creditor

As you will note the Act deals with transactions between sellers and buyers. It is not restricted in any way to commercial or business properties. It covers as stock in bulk just about everything that might go with a business as well as the real estate.

While the seller would have to have been in some sort of business, and likely be in the process of liquidating, there is no similar obligation imposed upon the buyer. That means the buyer can be a consumer acquiring the property on his own account.

Where does the model home fit in? You can appreciate that there is a fine line between what is covered or not covered. However, the risk is significant. If the Act is not complied with, then the transaction is voidable at the instigation of a creditor.

Application of the Act

There are some exceptions, and here they are:

Application of Act

2. This Act applies to every sale in bulk except a sale in bulk by an executor, an administrator, a guardian of property under the Substitute Decisions Act, 1992, a creditor realizing upon security, a receiver, an assignee or trustee for the benefit of creditors, a trustee under the Bankruptcy Act (Canada), a liquidator or official receiver, or a public official acting under judicial process.

You will see that the Act has general application based on the transaction, and that the exceptions really relate to specific parties.

We are still left with the Act applying to the home builder.

Rules Related to the Operation of the Act

Effect of buyer failing to comply with Act

16. (1) A sale in bulk is voidable unless the buyer has complied with this Act.

Personal liability of buyer

(2) If a sale in bulk has been set aside or declared void and the buyer has received or taken possession of the stock in bulk, the buyer is personally liable to account to the creditors of the seller for the value thereof, including all money, security and property realized or taken by the buyer from, out of, or on account

of, the sale or other disposition by the buyer of the stock in bulk.

Who may bring action

17. (1) An action or proceeding to set aside or have declared void a sale in bulk may be brought or taken by a creditor of the seller, and, if the seller is adjudged bankrupt, by the trustee of the seller's estate.

Where no right of action

(2) No action shall be brought or proceeding taken in respect of real property included in a sale in bulk if the real property has been sold, transferred, charged or mortgaged to a purchaser, transferee, chargee or mortgagee in good faith for valuable consideration without actual notice of non-compliance with the Act by the buyer.

Burden of proof

18. In an action or proceeding in which a sale in bulk is attacked or comes in question, whether directly or indirectly, the burden of proof that this Act has been complied with is upon the person upholding the sale in bulk.

Limitation of action

19. No action shall be brought or proceeding taken to set aside or have declared void a sale in bulk for failure to comply with this Act unless the action is brought or the proceeding is taken either before the buyer complies with section 11 or within six months after the buyer complies with section 11.

And, section 11. (1) provides:

Filings on completion of sale

11. (1) Within five days after the completion of a sale in bulk, the buyer shall file in the office of the court an affidavit setting out the particulars of the sale, including the subject-matter thereof and the name and address of the trustee, if any, and exhibiting duplicate originals of the statement mentioned in section 4, the statement, if any, mentioned in clause 8 (1) (b), the waivers, if any, mentioned in clause 8 (1) (c) and the consent and affidavit, if any, mentioned in subsection 8 (2).

In **summary**, these rules set out the rights of various parties should the transaction fail to be completed in accordance with the provisions of the *Bulk Sales Act*.

- A creditor (secured or unsecured) can apply to the Court
- A trustee in bankruptcy of the seller may apply to the Court

- The obligation is upon the buyer to comply
- A Court may declare that the sale is void, for non-compliance
- The buyer is personally liable to account for the assets
- Real property will not be effected if it has been resold or mortgaged
- It is presumed that the transaction failed to comply with the Act
- Application must be brought within 6 months of buyer filing an Affidavit

Most commercial transactions are completed without strict compliance with the requirements of the *Bulk Sales Act*. Either the seller pays the creditors out of the proceeds, or provides an indemnification agreement to the buyer should a problem subsequently arise. Those are the two most common methods to avoid the onerous provisions of the Act.

However, let's get back to our model home example. Let's presume that the building was listed for sale at \$500,000.00 and there was a first mortgage of \$350,000.00 and a second mortgage of \$75,000.00.

This means that the builder only has \$75,000.00 of equity in the model home. Let's presume that the building was sold for \$500,000.00 and that after the real estate commission, and the first and second mortgages were paid, there was \$50,000.00 leftover. Who gets this money?

Let's add one more complication. The unsecured trade creditors have total debts in the amount of \$200,000.00. The builder decided to be fair and wrap things up by offering twenty five cents on the dollar.

Then, the builder went south to a warmer climate.

Do the unsecured trade creditors have a remedy? Why not set aside the deal by reason of the buyer's failure to comply with the Act? The onus is upon the buyer to prove that he complied. If the transaction is void, then the buyer is personally liable. But, what is the amount of the liability? Actually, the Act says \$500,000.00, and there was no credit for having to pay off the real estate agent, or the first and second mortgagees. So, we are back to another \$500,000.00. Indeed, it might have been a good property, but is it worth one million dollars?

If you were an unsecured creditor would you set aside the transaction? Remember that almost one year ago you did \$85,000.00 worth of work. You were never paid; not even one cent. You "invested" your time and money because you thought that the houses would be sold and you would eventually be paid for them all. Now, that you received absolutely nothing and the builder has fled to

warmer climates, wouldn't it be nice to be paid? Besides, the buyer really won't have to pay; it will likely come from an insurance company on behalf of a real estate agent, lawyer or title company. And, what's good about this, is there is no time limit yet.

Interesting, lawsuit!

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