

Compliance with the Bulk Sales Act



By Brian Madigan LL.B.

In Ontario, unsecured creditors of a vendor of a business are protected by the *Bulk Sales Act*.

The Act is designed to protect trade creditors where the tangible assets of a business are sold in bulk. A sale of substantially all of the assets of a business would be a sale in bulk.

Compliance

The *Bulk Sales Act* provides for a number of procedures to ensure that creditors are paid, including:

- obtaining a list of creditors and discharging them on or before closing,
- obtaining consents from the creditors, or
- obtaining a court order exempting the transaction from the requirements of the Act.

If the assets being sold represent all or substantially all of the vendor's assets, then a Court Order would be unlikely. Unless the *Bulk Sales Act* has been complied with, any creditor (secured or unsecured) could make an application to Court and have the sale declared void, and the Court will likely further order that the purchaser will be liable to the vendor's creditors for the value of any property received.

Waiver

Frequently, a purchaser will waive compliance with Act, providing:

- 1) that a portion of the sale proceeds are held in escrow, or
- 2) an indemnity from the vendor is arranged.

The bulk sales issue is often considered in the context of the size of the acquisition and the creditworthiness of the vendor. The larger the transaction and the less creditworthy the vendor, the more likely that actual money will be set aside in the transaction to deal with creditors.

However, what type of position would a purchaser be in if they had accepted a written indemnification agreement from General Motors on the acquisition of a small GM subsidiary, factory or plant? This question is posed as GM rests on the

brink of bankruptcy protection and without any long term commitment of a government bailout.

The onus is placed upon purchasers to prove that the vendor has complied with the legislation. If a purchaser closes the deal without compliance, it is the purchaser himself who suffers by having to account to the vendor's creditors. After the transaction has been completed, it will be too late. The money will likely have been dispersed within a few days. Recovery will be impossible.

Methods of Compliance

There are basically three ways to comply:

- 1) *Court Order*: the seller obtains a Court Order exempting compliance. Here, evidence is necessary to prove to a judge that all creditors associated with the assets being sold will be paid,
- 2) *Payment in Full*: pay all creditors on closing. This can be arranged utilizing the closing funds and directing payment to them, and holding funds in trust as required, and
- 3) *Trustee Appointment*: if all the creditors cannot be paid (because the proceeds are inadequate), the proceeds have to be paid to a *Bulk Sales Act* Trustee who will distribute the funds to the creditors.

In practice, there is usually no compliance with bulk sales legislation since the purchaser is confident of the vendor's solvency and ability to continue to pay its debts and obligations.

In a recent case, the Court set aside a sale because it fell under the bulk sale provisions of the Bulk Sales Act, and there was no compliance. Without compliance, the sale was voidable upon application of the trade creditors whether secured or unsecured. The result was clear. The secured creditors were paid off on closing. The Court set aside the acquisition and forced the purchaser to pay again. But, this time since the secured creditors had all been paid, the extra money went to the unsecured creditors.

So, the purchaser paid twice for the same business! Why not simply follow the Act? Compliance is risk free!

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