ALBERTA LAW REFORM INSTITUTE

EDMONTON, ALBERTA

THE BULK SALES ACT

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ALBERTA LAW REFORM INSTITUTE

The Alberta Law Reform Institute was established January 1, 1968, by the Government of Alberta, the University of Alberta and the Law Society of Alberta for the purposes, among others, of conducting legal research and recommending reforms in the law. Funding of the Institute's operations is provided by the Government of Alberta, the University of Alberta and the Alberta Law Foundation.

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ACKNOWLEDGMENTS

We have had much help in forming the opinions contained in this report. The topic was first suggested by Board members at a meeting in September of 1988, when the Board reviewed several smaller projects which it was hoped could be fitted into the Institute workload. That choice, and the suggestion for reform, was reinforced by a survey of practicing lawyers across the province, whose views have been a valuable source of information as the report was formulated.

Primary carriage of the report has been the responsibility of Mr. Richard Bowes, who has tabulated and reviewed the survey responses as well as preparing the report itself.

THE BULK SALES ACT

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THE BULK SALES ACT

PART I - EXECUTIVE SUMMARY

The Need for Reform

The *Bulk Sales Act* is intended to protect the trade creditors of retailers and manufacturers who sell their stock without first paying their debts. This protection is achieved by imposing certain duties on the purchaser of the stock. If the purchaser does not fulfil these duties, the sale is voidable at the request of the seller's creditors, which means that the purchaser can lose all that he paid for.

The Act has been much criticized over the years. Many critics suggest that the best remedy for the difficulties caused by the Act is to repeal it. British Columbia repealed its Act in 1985, and law reform agencies in Manitoba and the United States have recommended repeal of bulk sales legislation. In the fall of 1988, this Institute decided it was timely to consider whether Alberta's own Act had outlived its usefulness. An informal survey of Alberta lawyers confirmed our view that it was time to look more closely at the continued need for bulk sales legislation.

History

Bulk sales legislation was first enacted in the 1890's in America. Wholesalers who sold goods on credit to retail merchants complained of a fraudulent practice that was apparently becoming common. A merchant could sell his entire stock of goods to a third party for cash and disappear, leaving his creditors unpaid. Creditors wanted a way to attack such "bulk sales" that did not require proof of the buyer's knowing participation in a scheme to defraud the seller's creditors. The buyer had to be placed under a positive duty toward the seller's creditors. Legislation to accomplish this result was passed by state legislatures at the turn of the century. Canadian creditors wanted similar protection, and Alberta passed its first *Bulk Sales Act* in 1913.

Bulk sales legislation in different jurisdictions shares two characteristics. First, it makes it more difficult for the owners of certain kinds of business to suddenly sell tangible business assets and disappear with the proceeds without paying creditors. Second, it achieves this object by invalidating the title of the bulk sale purchaser as against the seller's creditors unless certain steps are taken before the sale takes place.

In most U.S. states, the buyer must merely ensure that the seller's creditors receive advance notice of the sale. In all Canadian provinces with bulk sales legislation, the buyer

has a heavier duty. The buyer must either satisfy himself that the seller's debts have all been paid, or take steps to ensure that the proceeds are distributed among the creditors, rather than pocketed by the seller.

Alberta's Bulk Sales Act

The Act applies to bulk sales by retail merchants and manufacturers. A sale can only be a bulk sale if at least part of its subject matter is "stock," which includes goods that are ordinarily bought and sold, and the equipment and trade fixtures ordinarily used in connection with a business. The Act applies if the sale is out of the usual course of the seller's business, or if the subject matter of the sale is substantially the entire stock of the seller.

Although both parties to a transaction must comply with the Act's requirements, it is the buyer who suffers the results of non-compliance. The seller provides the buyer with a list of debts owed to trade creditors, verified by statutory declaration; the buyer can rely on a declaration that is correct in form, unless he has actual knowledge that it is false. The seller must then discharge the creditors' claims, or provide the buyer with their waivers or consents.

Often, the parties breach the Act, because strict compliance is expensive in money and time. Non-compliance makes the sale voidable at the instance of the creditors: they can take the property from the buyer, even if he acted in good faith, and even if they have already received all of the purchase price.

Reasons for Repealing the Bulk Sales Act

The Act does more harm than good. There are undoubtedly some creditors who do receive payments because of the Act. The parties to a bulk sale may comply with the Act when the seller would otherwise have disappeared with or squandered the proceeds. Or the creditor may sue or threaten to sue a buyer where the Act has not been complied with. But logic and the available evidence suggest that the Act's protection for unsecured creditors is marginal at best, and is purchased at a substantial cost in time and money. This cost is borne by the participants in commercial transactions that rarely represent a danger to creditors of the sellers.

The experience in British Columbia indicates that repeal of the Act in that jurisdiction had little impact on debtors, creditors, suppliers, or the insolvency area in general. This may be because the circumstances in which businesses operate have changed greatly since bulk sales legislation was first enacted, decreasing the utility it may have had. Potential creditors can now get effective security on inventory. It is easy for a creditor to obtain a credit history of any established business from a credit reporting agency.

In addition to changed circumstances, the Act's inherent limitations are also reasons why the Act does more harm than good. Unsecured creditors of businesses are much more likely to be done in by the swoop of the secured creditor than by a fraudulent bulk sale. The Act does a poor job of protecting creditors from a fraudulent bulk sale, because a rogue can short-circuit the Act simply by swearing a false declaration.

Conclusion

The Institute recommends that the *Bulk Sales Act* be repealed. The Institute considered the alternative of improving the Act, but found that the Act would still do more harm than good. The Institute's final report includes three appendices containing the full text of the Act, a description of the survey of Alberta lawyers, and approaches that could be taken to reforming, rather than repealing, the Act. Report No. 55, *The Bulk Sales Act*, is available from the Alberta Law Reform Institute.

PART II - FINAL REPORT

A. About this Report

(1) Background to this Project

The *Bulk Sales Act*[1] has attracted considerable criticism over the years. Some, although certainly not all, critics have suggested that the best solution for the difficulties created by the Act would be to repeal it. In 1983, the British Columbia Law Reform Commission recommended[2] that the legislature of that province repeal its bulk sales act.[3] This recommendation was implemented in 1985,[4] whereupon British Columbia became the only jurisdiction in Canada or the United States without a bulk sales statute.

In 1988, two other official bodies also called for the repeal of bulk sales legislation. At its conference held in August of that year the National Conference of Commissioners on Uniform State Laws[5] decided to withdraw its support for Article 6 (Bulk Transfers) of the Uniform Commercial Code, and recommended that states repeal Article 6. Shortly thereafter, the Manitoba Law Reform Commission recommended[6] the repeal of that province's bulk sales legislation.

In the fall of 1988, this Institute decided that the recommendations for repeal of bulk sales legislation emanating from other jurisdictions made it timely to at least consider whether our own Act has outlived its usefulness. As a preliminary step, we conducted an informal survey of Alberta lawyers in order to get a better idea of their views about the Act.[7] The response to our survey was such as to confirm our initial view that it would be appropriate to look more closely at the continued need for bulk sales legislation.

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1 R.S.A. 1980, c. B-13 (hereinafter sometimes cited as "the Act").

2 British Columbia Law Reform Commission, *Report on Bulk Sales Legislation*, (1983).

3 *Sale of Goods in Bulk Act*, R.S.B.C. 1979, c. 371.

4 *Law Reform Amendment Act, 1985*, S.B.C. 1985, c. 10, s. 11.

5 This body is responsible, along with the American Law Institute, for the official version of the UCC.

6 Manitoba Law Reform Commission, *Report on The Bulk Sales Act*, (1988).

7 The main advantage of surveying lawyers was thought to be that, in the aggregate, their views would represent pretty well the full spectrum of views on and experience with the Act.

(2) Format of the Report

In this report we describe the *Bulk Sales Act*, and state the reasons for our conclusion that the Act should be repealed. We do so in short compass. We think the subject can be dealt with briefly thanks in large measure to the excellent reports of the British Columbia and Manitoba Law Reform Commissions.[8] A reader who desires a more extensive and detailed discussion of bulk sales law will find it in either of those reports, to which an exhaustive treatise by us could add little.

This report contains three appendices. Appendix A contains the text of the *Bulk Sales Act*. Appendix B describes the survey we conducted of members of the legal profession regarding their views on the Act. It will be seen that most respondents were in favour of repealing the Act. However, Appendix B concentrates on the views of those lawyers who were not in favour of repeal, and who stated the reason why they favoured retention of the Act. Appendix B attempts to summarize the most frequently expressed reasons for retaining the Act, and state why we ultimately concluded that those reasons were overborne by those in favour of repeal.

Appendix C describes some approaches that could be taken to reforming rather than repealing the *Bulk Sales Act*. We considered the possibility that the Act's flaws might not be fatal, and that the proper solution would be to eliminate the flaws, not the Act. However, having considered various possible options for dealing with the issues that any bulk sales legislation must address, we have concluded that it is better to do away with the Act altogether than to retain it in its present or any alternative form. Nevertheless, for informational purposes, Appendix C describes some of the options for dealing with various bulk sales issues.

B. The Origin and Basic Features of Bulk Sales Legislation

Bulk sales legislation is quite a recent phenomenon, at least by the standards of legal history. Its roots lie not in medieval England, but in late nineteenth century America. In the 1890s, creditors - in particular, wholesalers who sold goods on credit to retail merchants - were very agitated over a fraudulent practice that apparently[9] was becoming very prevalent.

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8 *Supra*, notes 2 and 6.

9 We say "apparently" because it has been suggested that even at its inception, bulk sales legislation was less a reflection of a pressing social problem than a testimony to the effectiveness of the propaganda and lobbying efforts of a very well organized special interest group: see note in 33 Harv. L.R. 717; and R. Pound, *Interpretations of Legal History*, (New York, 1923), 113.

In barest outline, the situation that raised the ire of creditors was this. A merchant is possessed of a stock of goods obtained on credit from one or more suppliers. The suppliers are still unpaid. Perhaps the merchant is solvent, perhaps not. Perhaps he originally intended to pay his suppliers, perhaps not. Whatever his original intentions and his present circumstances, he sells his entire stock of goods to a third party for cash and disappears, leaving his suppliers unpaid and unhappy.

At best, the creditors of the merchant might be able to attack the transaction as a fraudulent conveyance. But this remedy was available, even in theory, only if the creditors could establish that the purchaser was privy to the merchant's intentions to defraud his creditors. No matter how nefarious the intentions of the debtor, creditors could not pursue property transferred by the debtor into the hands of a good faith purchaser for valuable consideration. In such a case, the creditors would have no remedy whatsoever with respect to the merchant's former property.

So far as creditors were concerned, what was needed was a method of attacking such "bulk sales" that did not require proof of the buyer's knowing participation in a scheme to defraud the seller's creditors. This required that the buyer in such a situation be placed under some sort of positive duty towards the seller's creditors. This result was achieved, in various manners, by the "bulk bills" that were presented to and passed by state legislatures at a frantic pace around the turn of the century. Such legislation was soon being promoted in Canada, and Alberta passed its first Bulk Sales Act in 1913.[10]

There was and still is considerable diversity in the coverage, requirements and remedies of the bulk sales legislation of different jurisdictions,[11] but all such legislation shares certain basic characteristics. First, it is designed to make it more difficult for the owners of certain kinds of business to suddenly sell tangible business assets and disappear with the proceeds without paying creditors. Secondly, this objective is achieved by invalidating the title of the bulk sale purchaser as against the seller's creditors unless certain steps are taken before the sale takes place.

The steps to be taken prior to the sale vary from one jurisdiction to another. Some jurisdictions merely require the buyer to ensure that the seller's creditors are given advance notice of the impending bulk sale. Having been given notice, creditors are then left to their own devices, and to such remedies as are provided by the general law. In other jurisdictions - a minority of U.S. states but all Canadian provinces - the buyer's obligations

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[10] S.A. 1913, c. 10.

[11] The Conference of Commissioners on Uniformity of Legislation in Canada adopted a Uniform Bulk Sales Act in 1920. Most provinces, including Alberta, (S.A. 1922, c. 47) adopted this Act. However, subsequent tinkering with the basic product has created considerable diversity in the provisions of the various provinces' acts.

are more onerous. In these jurisdictions, the buyer must either satisfy himself that the seller's debts have all been paid, or take steps to actually ensure that the proceeds are distributed amongst the creditors, rather than pocketed by the seller.

C. The Bulk Sales Act in Outline

The *Bulk Sales Act* applies to a fairly narrow range of transactions. Its coverage is limited in three ways: (1) by the kinds of business to which it applies; (2) by the type of property that is sold; and (3) by the circumstances in which the property is sold. The Act applies to a transaction only if it is a sale of a particular kind of property by a particular kind of business in particular circumstances.

It is reasonably accurate[12] to say that the Act applies to bulk sales by two broad categories of business enterprise: retail merchants and manufacturers.[13] A sale can only be a bulk sale if its subject matter - or part of its subject matter - is "stock". This term "stock" is defined so as to include goods that are ordinarily bought and sold as well as the equipment and trade fixtures ordinarily used in connection with a business.[14] Of course, the Act does not apply to just any sale of stock by a retailer or manufacturer. The Act will apply if either of two conditions is met: 1) the sale is out of the usual course of the seller's business; or 2) the subject matter of the sale consists of substantially the entire stock of the seller.[15]

So much for when the Act does or does not apply. If it does apply to a transaction, it imposes certain requirements on the seller and the buyer. These requirements must be met before or at the time the purchase price is paid. Some of these requirements appear to fall to the seller to comply with, but with one important exception it is the buyer who is really responsible for ensuring that all the requirements are met. It is the buyer's responsibility because the buyer is the one who will suffer in the event of non-compliance.

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12 Out of necessity, our short account of the Act will emphasize simplicity at the expense of a completely faithful mapping of its every twist and turn. We shall also largely ignore the many difficult questions of interpretation to which the Act gives rise.

13 *Bulk Sales Act*, s. 2.

14 *Id.*, s. 1(g).

15 *Id.*, s. 1(e). This section also refers to the sale of an interest in the business of the vendor. But no one seems to know what this means, and it has been described as adding nothing to the other two criteria: Manitoba Law Reform Commission, *supra*, note 6 at 14.

The first thing that must happen is that the seller must provide the buyer with a list, verified by statutory declaration, setting out certain particulars of debts owed by the seller.[16] It is only debts owed to trade creditors (secured and unsecured) of the seller that must be shown. Most of the requirements that follow revolve around this list of trade creditors. The buyer is entitled to rely on a declaration that is correct in form, even if it is false. Canadian courts have stated emphatically on numerous occasions that the buyer is under no duty to make independent enquiries to ascertain whether the seller has any creditors who are not shown on the list.[17] So, in the absence of collusion or actual knowledge on the part of the buyer of creditors not on the list, the buyer is protected even if the seller's declaration is totally false.

In terms, the next step is an obligation that falls on the seller, although the consequences of non-compliance will fall on the buyer. The seller must do one of the following: 1) discharge in full the claims of all creditors shown on his list; or 2) provide the buyer with written (a) waivers or (b) consents signed by unsecured trade creditors representing at least 60% in number and amount of the claims over $50 disclosed on the list.[18]

The difference between a waiver and consent is significant. In the case of a waiver, the parties need pay no further attention to the Act: the creditors quite literally waive the need for any further compliance with the Act. By contrast, a seller who provides a consent, is in effect saying that he is insolvent, and is submitting to the distribution provisions of the Act.[19] In a nutshell, they require the entire purchase price to be paid to a trustee, who must then distribute the proceeds between creditors in accordance with the same rules that would govern bankruptcy proceedings under the *Bankruptcy Act*.[20]

It would be misleading to suggest that the process outlined above would actually be followed in every or even a majority of the cases to which the Act applies. In truth, as often as not, the parties to a transaction to which the Act applies deliberately choose not to comply with all its requirements. This lawlessness does not generally signify an intention

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16 *Id.*, s. 4.

17 See e.g., *Paddon* v. *McFarland*, [1930] 3 W.W.R. 632 (Alta. D.C.); *A.G. Canada* v. *Bulletin Publications Ltd.*, [1980] 2 W.W.R. 249 (Man. C.C.); *Larosa Food Importing & Distributing Ltd.* v. *Mel-J Holdings Ltd.*, (1981) 33 B.C.L.R. 113 (Co. Ct.). In the last mentioned case the bulk sale was set aside, but only because the declaration did not comply with the formal requirements of the Act.

18 *Bulk Sales Act*, s. 6.

19 *Id.*, ss. 7-9.

20 R.S.C. 1985, c. B-3.

on anyone's part to defraud the seller's creditors. Rather, it reflects the fact that strict compliance with the Act will often be an expensive, time consuming undertaking. Often, the buyer will be prepared to run what might be regarded as a very remote risk of the sale being subsequently impugned by an aggrieved creditor of the seller. In lieu of compliance with the Act, the vendor will provide the purchaser with an indemnity against claims by the former's creditors.[21]

We have already mentioned that one consequence of non-compliance with bulk sales legislation is that the sale is voidable at the instance of creditors. What this means is that so far as the seller's creditors are concerned, the sale of the assets to the buyer has not taken place. They can follow the property into the buyer's hands so long as proceedings are commenced within six months of the date of sale.[22] This is so even if the buyer has acted in complete good faith, and even if all or some part of the purchase price has in fact found its way into the hands of creditors. This remedy is very much a blunt instrument, and can have consequences for the purchaser which in many cases would seem to be out of all proportion to the gravity of his offence. However, we do not think that further discussion of the Act's remedial provisions would serve any useful purpose here.

D. Reasons for Repealing the *Bulk Sales Act*

(1) The Act Does More Harm Than Good

A variety of arguments can be made in favour of repealing the *Bulk Sales Act*. However, all these arguments can be viewed as elaborations on or evidence for the simple proposition that the Act should be repealed because it does more harm than good.

It cannot be denied that the Act does do some good, that it does provide some protection for unsecured creditors of certain kinds of business. Sometimes, somewhere, creditors undoubtedly do receive payments that they would not have received if there were no Act. This may be the result of the parties to a bulk sale complying with the Act in circumstances where the seller, if left to his own devices, would have disappeared with or squandered the proceeds. Or it may be the result of actual or threatened legal proceedings against a buyer where the Act has not been complied with.

But logic and what empirical evidence there is suggests that the protection provided by the Act to unsecured creditors is marginal at best. This protection is purchased at a

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[21] Of course, such an indemnity will be of limited value. If a creditor of the seller comes after the buyer, it will usually be because he has tried without success to get payment from the vendor. That would not bode well for the seller's agreement to indemnify the buyer being honoured.

[22] *Bulk Sales Act*, ss. 10-12.

substantial cost, a cost that is borne by the participants in the many commercial transactions that are, or might be, subject to the Act's requirements. The amount of time and money that has to be spent in order to comply with the Act may be very considerable. Far more often than not, this cost is borne by participants in a transaction that presents little, if any, danger to creditors of the seller.

It would simplify our task immensely if there were some way to obtain precise data on the net amount paid to unsecured creditors because of the Act, and the amount of money spent by participants in commercial transactions because of the Act. Then we would be in an ideal position to say whether the Act does more harm than good. Unfortunately, no one has been able to think of a way to get such data. It is therefore necessary to draw inferences from less direct evidence of the Act's beneficial and burdensome effects. We think that in the aggregate the evidence clearly supports the conclusion that the negative effects of the Act greatly outweigh its positive effects. We have reached this conclusion for the reasons set out below.

(2) The British Columbia Experience

British Columbia repealed its *Sale of Goods in Bulk Act* in 1985. Recent experience in a neighbouring jurisdiction is obviously instructive for Alberta.

The repeal of British Columbia's Act appears to have caused difficulties for some creditors in specific cases. We received a letter from a lawyer employed by a company that does business in British Columbia, who said that his company is faced with a debt that is either uncollectible or collectible only through expensive litigation to set aside a fraudulent preference. He thought this situation would not have arisen if the Act had not been repealed. We also received a letter from the Western Credit Executives Forum, which considered at a recent meeting our request for information about the effect of repeal:

> Although no one was able to cite statistics or specific cases and dates, virtually all members in attendance made comments of how the Bulk Sales Act had assisted in preventing a bad debt loss, or how the repeal of the Act in British Columbia had prevented a creditor from taking some form of protective measures to possibly avoiding a bad debt loss.[23]

On the other hand, the Manitoba Law Reform Commission, citing a letter received from Mr. Arthur Close, Chairman of the British Columbia Law Reform Commission, reported that repeal in British Columbia has been "wholly uncontroversial".[24] We have also

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[23] Letter from Ms. P.I. Burton, Chairman, W.C.E.F., November 8, 1989.

[24] *Supra*, n. 6 at 78.

received an informative letter from Mr. Clive Bird, a lawyer who practices in the insolvency field in Vancouver. As Mr. Bird's letter speaks directly to our concern about possible adverse consequences of repeal, we quote from it at length:

> I have been practising exclusively in the insolvency field since 1978. I have had a more or less constant dialogue with other B.C. insolvency practitioners, both in my day to day practice and in my capacity as an Executive of the CBA Insolvency Section.
>
> I can tell you, without equivocation, that it has been my observation, and that of other practitioners in this field, that the repeal of the British Columbia Bulk Sales Act had no noticeable impact whatsoever on debtors, trade creditors, suppliers, or the insolvency business in general. Most of us did not even notice it was gone and many of us can't even remember when it disappeared.
>
> In answer to your specific questions, I believe that:
>
> 1. (Your Question 1)
> The repeal of the Bulk Sales Act has <u>not</u> resulted in a noticeable increase in the number of situations in which trade creditors have been left unpaid in situations where they may otherwise have enjoyed the protection provided by the Bulk Sales Act; and
>
> 2. (Your Question 2)
> The repeal of the Bulk Sales Act has not, as far as I can determine, had any effect on the willingness of suppliers to extend credit.
>
> I regret that we do not have any formal statistics.
>
> The above really amounts to little more than (as you put it) a "gut reaction". However, I have attended countless courses, seminars, functions, meetings, etc. and I have never once heard anyone (insolvency lawyers, trustees in bankruptcy, receiver-managers, businessmen, etc.):
>
> 1. make any comments as to the passing of the Bulk Sales Act;
>
> 2. express regret that the Bulk Sales Act was repealed;
>
> 3. relate any instance where creditors got "stiffed" where they may otherwise have received protection from the Bulk Sales Act; or
>
> 4. suggest that there was any need whatsoever for Bulk Sales legislation.

As we have said, bulk sales legislation is intended to make it more likely that certain creditors will be paid when a business, at least a certain kind of business, is sold. The Act is not totally ineffective. It can therefore be assumed that it occasionally does result in payments that creditors would not receive if the Act were not in existence. The question is whether it has this result often enough that the benefits outweigh the burdens and risks imposed upon the many transactions to which the Act applies.

We have concluded that the British Columbia experience supports the conclusion that repeal of the *Bulk Sales Act* would have little negative impact on creditors. We acknowledge that there are likely to be instances in which repeal would be detrimental to certain creditors, as illustrated by the situations referred to by two of our correspondents. However, none of the correspondence asserts, while some of it positively denies, that such instances have been numerous in British Columbia. We note particularly that there is no suggestion in any of our correspondence that repeal in British Columbia has affected the conduct of credit grantors or that it has made credit more difficult to obtain. We can think of no reason to anticipate a different result in Alberta.

(3) Changed Circumstances

Why has the repeal of British Columbia's act had so little apparent effect on creditors there? We think that part of the explanation is that the circumstances in which businesses operate have changed greatly since the beginning of the century. These changes have conspired to rob bulk sales legislation of much of the utility that it might once have had. The most important of these changes are noted below.

Development of Security Mechanisms

It is much easier now (or soon will be, at any rate, when the *Personal Property Security Act*[25] comes into force) than it was early in the century for a potential creditor of a business to get effective security in the sort of property - inventory - with which the Act is mainly concerned. This is especially so in the case of suppliers, who can take purchase money security interests in the goods they supply on credit. Potential creditors therefore have a means of protecting themselves that was not as readily available to turn-of-the-century suppliers.

Less Reliance on Stock as an Indicator of Solvency

One of the main arguments for bulk sales legislation was that suppliers would customarily extend credit on the faith of the financial stability indicated by a merchant's possession of a substantial stock of merchandise. In the modern context, such a method of

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[25] S.A. 1988, c. P-4.05.

checking the credit-worthiness of a potential customer would seem laughably ineffective. Nowadays, the quantity of goods on the shelves of a store, or the amount of raw material in the plant of a manufacturer is likely to be a very minor factor in any decision by a supplier to extend credit to the store owner. So the "reliance" rationale for bulk sales legislation no longer seems very convincing.

Better Methods of Policing Credit

A related point is that the modern supplier of goods or services has a much better opportunity to check the credit-worthiness of his customer prior to extending credit than did his early twentieth century counterpart. The function and value of credit reporting agencies is well known, and it is a relatively simple matter to obtain a credit history of any established business. Indeed, the unavailability of information about the credit-worthiness of a particular individual or company would in itself be regarded as reason for extreme caution in the extension of credit. It is therefore much less likely than it once was that a prudent supplier will extend unsecured credit to the sort of fraudulently inclined, itinerant merchant who was the Act's main target. Hence, in purely quantitative terms, there should be fewer occasions where the protection offered by the Act is necessary.

Some of the Act's Work done by other Legislation

Bulk sales legislation was partially intended to fill the gap left by the repeal of federal bankruptcy legislation. This was especially so regarding its attempts to set up an equitable scheme for sharing the proceeds of sale of the assets of an insolvent business between its various creditors. This function has been made redundant by the federal *Bankruptcy Act*. The *Bankruptcy Act* is far from perfect, but its imperfections are not overcome by the *Bulk Sales Act*'s distribution provisions.

(4) Inherent Limitations

Some of the reasons why the Act does more harm than good have less to do with changes in circumstances than with inherent flaws in the Act's approach to protecting unsecured creditors.

The Act Addresses a Marginal Problem

Given the variety and relative magnitude of the risks faced by unsecured creditors of businesses, the *Bulk Sales Act* is aimed at a relatively minor risk. Even if the Act were 100% effective in preventing the sort of transactions at which it is aimed, the elimination of this risk would have a minuscule effect on the total risk faced by unsecured creditors. Act or no Act, unsecured creditors of an insolvent business are much more likely to be done in by the swoop of the secured creditor than by a fraudulent bulk sale. The

marginality of the risk addressed by the Act must be taken into account when weighing the benefits of the Act against the substantial costs it imposes on the participants in many commercial transactions.

The Act is Relatively Ineffective

Not only is the Act aimed at a relatively minor risk, it does not do a very good job of protecting creditors from this risk.[26] The Act will be of little avail against a determined rogue, because it can be easily circumvented. It will only be of much use in the case of the rogue wimp, the merchant who would be prepared to abscond with the proceeds of a bulk sale, but who would not be prepared to swear a false bulk sales declaration in order to achieve that result. A thoroughly dishonest merchant can completely short-circuit the Act by the simple expedient of swearing a false declaration. It is an ironic feature of the Act that the persons *least* likely to be inconvenienced by it are the persons with the fraudulent aims it is designed to thwart.

Act May Sometimes Harm Unsecured Creditors

It has been suggested that sometimes the Act actually harms the creditors of a marginal business with secured and unsecured creditors. The proprietor is basically honest, and would be prepared to sell the assets of the business and apply the proceeds to payment of his debts. However, the costs associated with compliance with the Act are prohibitive in relation to the value of the business. So the proprietor simply throws up his hands and walks away from the business. The secured creditors move in and the assets of the business are sold for considerably less than they could have been sold with the active participation of the proprietor. The unsecured creditors thus end up in a worse position than if there had been no *Bulk Sales Act* to discourage the proprietor from selling the assets himself.[27]

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26 Much of the protection supposedly provided by bulk sales legislation could be more effectively provided through reform of the law relating to fraudulent preferences and conveyances. That is an area of the law that we hope to be able to look at in the not too distant future. However, given the negligible benefits of the *Bulk Sales Act*, we do not think that repeal of the Act need await reform in the area of fraudulent preferences and conveyances.

27 We do not know how often this situation actually arises. But we are advised that it happens often enough to be taken into account in evaluating the overall utility of the Act.

E. The Alternative to Repeal: "Fixing" the Act

Some commentators have suggested that what the *Bulk Sales Act* really needs is major surgery, not euthanasia. Many suggestions have been made as to how the Act could be improved. Many of these suggestions contradict each other.

We have no doubt that our Act could be substantially improved upon. However, we are also convinced that no matter how much the Act could be improved, it would still be vulnerable to the same basic objection. It would still do more harm than good. Therefore, we do not examine the question of how the existing Act might be improved through amendment.[28]

F. Recommendation

The Institute recommends that the *Bulk Sales Act* be repealed.

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CHAIRMAN

DIRECTOR

January 1990

[28] But Appendix C does describe some of the different possible approaches for dealing with the issues that any bulk sales act must confront.

APPENDIX A - THE BULK SALES ACT

BULK SALES ACT

CHAPTER B-13

1 In this Act,

(a) "creditor"

(i) means a person to whom the vendor of a stock is indebted, whether the debt is due and owing or not yet payable, and

(ii) includes a surety and the endorser of a promissory note or bill of exchange who would, upon payment by him of the debt, promissory note or bill of exchange in respect of which the suretyship was entered into or the endorsement was given, become a creditor of the vendor;

(b) "proceeds of sale" includes

(i) the purchase price or consideration payable to the vendor, or passing from the purchaser to the vendor, on a sale in bulk, and

(ii) the money realized by a trustee under a security or by the sale or other disposition of any property coming into his hands as the consideration or part of the consideration for the sale;

(c) "purchaser" includes a person who barters or exchanges property whether real or personal with any other person for stock in bulk;

(d) "sale", whether used alone or in the expression "sale in bulk", includes a transfer, conveyance, barter or exchange and an agreement to sell, transfer, convey, barter or exchange;

(e) "sale in bulk" means a sale, transfer, conveyance, barter or exchange

(i) of a stock or part of a stock out of the usual course of business or trade of the vendor,

(ii) of substantially the entire stock of the vendor, or

(iii) of an interest in the business of the vendor;

(f) "secured trade creditor" means a creditor of the vendor in respect of

(i) stock, money or services furnished for the purpose of enabling the seller to carry on business, or

(ii) rental of premises in or from which the vendor carries on business,

who holds security or is entitled to a preference in respect of his claim;

(g) "stock" means a stock of goods, wares and merchandise ordinarily the subject of trade and commerce, and the goods, chattels and fixtures ordinarily used in connection with any business;

(h) "stock in bulk" means a stock or portion of a stock that is the subject of a sale in bulk;

(i) "trustee" means

(i) an authorized trustee under the **Bankruptcy Act** (Canada) appointed for the bankruptcy district or division in which the stock of the vendor, or some part of it, is located, or the vendor's business or trade, or some part of it, is carried on, at the time of the sale in bulk,

(ii) a trust company authorized to carry on business in Alberta,

(iii) a person who is appointed trustee under section 13, and

(iv) a person named as trustee by the creditors of the vendor in their written consent to a sale in bulk;

(j) "unsecured trade creditor" means a creditor to whom a seller is indebted for stock, money or services furnished for the purpose of enabling the seller to carry on a business, whether or not the debt is due, and who holds no security or who is entitled to no preference in respect of his claim;

(k) "vendor" includes a person who barters or exchanges a stock in bulk with any other person for other property, real or personal.

2 This Act applies only to sales in bulk by

(a) persons who, as their ostensible occupation or part thereof, buy and sell goods, wares and merchandise ordinarily the subject of trade and commerce,

(b) commission merchants, and

(c) manufacturers.

3 Nothing in this Act applies to or affects a sale by

(a) an executor, administrator, receiver, assignee or trustee for the benefit of creditors,

(b) a public official acting under judicial process, or

(c) a trader or merchant selling exclusively by wholesale,

or applies to or affects an assignment by a trader or merchant for the general benefit of his creditors.

4(1) The purchaser of a stock in bulk, before

(a) paying to the vendor more than $50 on account of the purchase price,

(b) giving any promissory note or notes or any security, for the purchase price or a part of it, or

(c) executing a transfer, conveyance or encumbrance of any other property as payment or part payment of the purchase price,

shall demand of and receive from the vendor, and the vendor of stock in bulk shall furnish to the purchaser, a written statement verified by the statutory declaration of the vendor or his authorized agent, or if the vendor is a corporation, by the statutory declaration of its president, vice-president, secretary-treasurer or manager.

(2) The statement shall show

(a) the names and addresses of the unsecured trade creditors and the secured trade creditors of the vendor,

(b) the amount of the indebtedness or liability due, owing, payable or accruing due, or to become due and payable by the vendor to each of them, and

(c) with respect to the claims of the secured trade creditors, the nature of their security and whether their claims are due or, in the event of sale, become due on the date fixed for the completion of the sale.

(3) The statement and declaration may be in the prescribed form.

5 On and after the furnishing of the statement and declaration provided for by section 4, no preference or priority is obtainable by any creditor of the vendor in respect of the stock in bulk or the proceeds of sale thereof by attachment, garnishee proceedings, contract or otherwise.

6 At the time of the completion of a sale in bulk the vendor

(a) shall discharge in full the claims of all his creditors as shown by the written statement, or

(b) shall deliver to the purchaser

(i) a waiver of the provisions of this Act, other than section 4, which may be in the prescribed form, or

(ii) a consent to the sale,

in writing, signed by unsecured trade creditors of the vendor representing not less than 60% in number and amount of the claims exceeding $50 as shown by the statement referred to in section 4.

7 When a sale in bulk is made with the written consent of the unsecured trade creditors under section 6(b)(ii), the entire proceeds of the sale shall be paid to the person named as trustee by the unsecured trade creditors in the written consent, or, if no trustee is named in it, then to the trustee named by the vendor or appointed under section 13, to be dealt with by the trustee as provided by section 8.

8(1) If the proceeds of sale are paid to a trustee under section 7, the trustee is a trustee for the general benefit of the creditors of the vendor and shall distribute the proceeds of the sale pro rata among

(a) the creditors of the vendor as shown by the statement, and

(b) those other creditors of the vendor who file claims with the trustee in accordance with the **Bankruptcy Act** (Canada).

and the distribution shall be made in like manner as money is distributed by a trustee under the **Bankruptcy Act** (Canada).

(2) In making the distribution all creditors' claims shall be

(a) proved in like manner,

(b) subject to the like contestation, and

(c) entitled to the like priorities

as in the case of a distribution under the **Bankruptcy Act** (Canada).

(3) The creditors, vendor and trustee in all respects have the same rights, liabilities and powers as the creditors, authorized assignor, and authorized trustee respectively have under the **Bankruptcy Act** (Canada), the vendor being for that purpose deemed to be an authorized assignor under the

Bankruptcy Act (Canada) and the trustee an authorized trustee under that Act.

9 The fees or commission of a trustee shall not exceed 3% of the total proceeds of sale that come to his hands, and, in the absence of an agreement by the vendor to the contrary, the fees or commission together with any disbursements made by the trustee shall be paid by deduction from the money to be received by the creditors and shall not be charged to the vendor.

10(1) A sale in bulk not made in compliance with this Act shall be deemed fraudulent and void as against the creditors of the vendor, and every payment made on account of the purchase price, and every delivery of a note or other security therefor, and every transfer, conveyance and encumbrance of property by the purchaser, shall be deemed fraudulent and void as between the purchaser and the creditors of the vendor.

(2) If the purchaser has received or taken possession of the stock that is the subject of the sale in bulk, or any part of it,

(a) he is personally liable to account to the creditors of the vendor for all money, security or property realized or taken by him from, out of or on account of the sale or other disposition by him of the stock, or any part of it, and

(b) in any action brought or proceedings taken by a creditor of the vendor within the time limited by section 12 to set aside a sale in bulk or have it declared void, or in the event of a seizure of the stock in the possession of the purchaser, or some part of it, under judicial process issued by or on behalf of a creditor of the vendor within the period, the purchaser is estopped from denying that the stock in his possession at the time of the action, proceedings or seizure is the stock purchased or received by him from the vendor.

(3) If the stock in the possession of the purchaser at the time of the action, proceedings or seizure mentioned in subsection (2) or some part of it was in fact purchased by him subsequent to the sale in bulk from someone other than the vendor of the stock in bulk and has not been paid for in full, the creditors of the purchaser, to the extent of the amounts owing to them for the goods so supplied, are entitled to share pro rata with the creditors of the vendor in the amount realized on the sale or other disposition of the stock in the possession of the purchaser at the time of the action, proceedings or seizure in like manner and within the same time as if they were creditors of the vendor.

11 In any action, issue or proceeding in which a sale in bulk is attacked or comes in question, whether directly or collaterally, the burden of proof that this Act has been complied with rests on the person seeking to uphold the sale in bulk.

12 No action shall be brought or proceedings taken to set aside or have declared void a sale in bulk for failure to comply with this Act unless the action is brought within 6 months from the date of the sale.

13 If the creditors of the vendor in their written consent to a sale in bulk have not named a trustee and the vendor has not named one, the Court of Queen's Bench shall, by order made on the application of any person interested, appoint a trustee and fix the security, if any, to be given by him.

14 The Lieutenant Governor in Council may make regulations prescribing forms for the purposes of this Act.

APPENDIX B
RESPONSES TO INSTITUTE SURVEY

As mentioned in the body of our report, the Institute conducted an informal survey of Alberta lawyers in the fall of 1988. The survey was included in a regular mailing of The Law Society of Alberta to its members, and solicited reaction to the proposition that the *Bulk Sales Act* should be repealed.

We received just over 1000 responses to the survey. Approximately 70% of the persons who responded indicated some degree of support for the proposition that the *Bulk Sales Act* should be repealed. The other 30% were to some degree opposed to repeal.

We must emphasize that the survey was primarily intended to assist us in deciding whether a project on the *Bulk Sales Act* would be worthwhile. It was not anticipated that the response to the survey would determine our answer to the question: Should the *Bulk Sales Act* be repealed? Both the total number of responses to our survey and the number of lawyers who responded in favour of repeal helped the Institute decide that further investigation of the possibility of repealing the Act was warranted. However, the survey results were not the determining factor in our eventual decision to recommend repeal of the Act.

We were actually more interested in the negative responses to the proposition that the Act should be repealed. In particular, we were interested in the reasons that some of our respondents gave in support of their contention that the Act should not be repealed. We wanted to ensure that the reasons that have been advanced for repealing the Act do not overlook some cogent argument in favour of retaining (and perhaps overhauling) the Act.

In the end, we concluded that all the arguments presented for retaining the Act can be met by the arguments for repeal. This is not to say that most of the points made in favour of retention were not well taken. Most of them were entirely valid. We just did not think that in the aggregate they stood up to the force of the arguments in favour of repeal.

The balance of this Appendix summarizes and comments upon the various arguments given by respondents for retaining the *Bulk Sales Act*. We have not tried to summarize each person's argument. Rather, we have grouped the arguments into a few basic categories. We believe these categories capture the pith of all the arguments put forth.

1. DETERRENT VALUE OF THE ACT

The Argument

The Act prevents fraudulent bulk sales through its deterrent effect. If there were no Act, there would be many more fraudulent bulk sales, to the great prejudice of the creditors of the businesses concerned.

Our Comment

Some variation on this argument was made by a substantial proportion of the respondents who objected to repeal. However, experience suggests that the deterrent effect of the Act, while not non-existent, is marginal. The British Columbia experience seems particularly persuasive in this regard. As noted in the body of the report, repeal of the Act in that province has not led to a flood of fraudulent bulk sales. This suggests that while it was in place, the British Columbia Act was not holding in check the mischievous designs of a huge reservoir of fraudulently inclined debtors. We would not expect the Alberta experience to be different.

2. REPEAL WOULD RESTRICT UNSECURED CREDIT

The Argument

Repeal of the Act would increase the risk associated with extending credit to the types of businesses now covered by the Act. Such businesses would therefore find it more difficult or more costly to obtain credit, especially unsecured credit.

Our Comment

This argument was made by a very few respondents. It seems to be based on an exaggerated assessment of the significance of the risk of fraudulent bulk sales as a component of the overall risk of extending unsecured credit. The risk that a business will simply fail, and that there will be little if anything left over for unsecured creditors after the secured creditors have picked the bones, dwarfs the risk of loss caused by fraudulent bulk sales. Hence, any increase in the overall risk of extending unsecured credit occasioned by repeal of the Act would represent but a drop in the bucket. This assessment is supported by the British Columbia experience, where repeal seems to have had little if any effect on the availability or cost of credit.

3. OTHER PROTECTIVE LEGISLATION IS LESS EFFECTIVE

The Argument

This argument is a response to the suggestion that other legislation, specifically, legislation[1] allowing courts to set aside fraudulent conveyances and preferences ("voidable transactions legislation"), makes bulk sales legislation redundant. The argument against this suggestion has two branches.

The first branch of the argument is that the *Bulk Sales Act* applies to some transactions to which the other legislation would not apply at all. Voidable transactions legislation is generally concerned with such things as the adequacy of the consideration and the bona fides of the participants in a transaction. If a bona fide purchaser pays an adequate price for the assets of a business, voidable transaction legislation does not require the purchaser to be concerned about what the seller does with the purchase price. Bulk sales legislation, by contrast does not fasten upon the adequacy of the consideration or the bona fides of the parties. It is primarily concerned with **what happens to the consideration**, not its adequacy or the bona fides of the parties. It puts a certain degree of responsibility on the purchaser for ensuring that the purchase price is applied to pay the seller's debts. A transaction may be unimpeachable under voidable transaction legislation, but still be liable to attack under the *Bulk Sales Act*.

The second branch of the argument acknowledges that there is considerable overlap between the *Bulk Sales Act* and voidable transaction legislation. As a matter of fact, many transactions that would offend the *Bulk Sales Act* would also be liable to attack as a fraudulent conveyance or fraudulent preference. However, unlike voidable transactions legislation, the Act is designed, through the obligations it places on the seller and the buyer, to prevent the offensive transaction from occurring in the first place. Setting aside a fraudulent conveyance or preference is, at best, an expensive, time consuming and uncertain business. It's the old story: an ounce of prevention is worth a pound of cure.

Our Comment

Both branches of this argument are quite valid. It must be recognized that the *Bulk Sales Act* does provide protection against a risk that voidable transaction legislation does not address. Moreover, it is also true that even for the sort of transaction where the protection provided by the two kinds of legislation overlap, the *Bulk Sales Act* may prevent

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[1] *Fraudulent Preferences Act*, R.S.A. 1980, c. F-18; *Bankruptcy Act*, R.S.C. 1985, c. B-3, ss. 91-101; *An Act against Fraudulent Deeds, Alienations, & c.*, 13 Eliz. 1, c. 5 (1570).

the damage from occurring in the first place, instead of merely providing a remedy after it has occurred.

However, we think this argument only goes so far, and not far enough to outweigh competing considerations. One of these considerations is that the theoretical advantages of the *Bulk Sales Act* over voidable transactions legislation suffer considerably at the hands of reality. For example, the often fatal flaw in the Act's protection is the good faith purchaser's ability to rely on the vendor's declaration, even if it is false. A purchaser with a formally sufficient declaration is in a very strong position. Even if an aggrieved creditor suspects that the purchaser's hands are not altogether clean, his only recourse will be the expensive and time consuming litigation that the Act is supposed to avoid.

But conceding that the Act does have advantages for creditors over voidable transactions legislation, it must be remembered how these advantages are achieved. They are achieved by placing obligations on the participants in all transactions of a certain description, regardless of the bona fides of the parties. The Act's recipe for protecting creditors requires that compliance with the Act be exacted from the participants in the many transactions that do not present a real bulk sale risk in order to catch the few that do. While the message of voidable transactions legislation is "Scoundrels beware!", the message of the *Bulk Sales Act* is "Everyone beware!".[2]

Unfortunately, in order to achieve (so far as it achieves it) the desired result, the Act places significant burdens on the shoulders of many participants in ordinary commercial transactions. These participants pay a heavy price in time, money and aggravation for the benefits the Act sprinkles on creditors. As a simple matter of fairness, it may be wondered why they should be made to bear this burden. The question becomes all the more urgent when it appears that in purely quantitative terms, the burdens greatly outweigh the benefits.

4. SOME PROTECTION IS BETTER THAN NO PROTECTION

The Argument

The Act may not provide perfect protection for unsecured creditors: far from it. However, it does provide them with some protection. It prevents some fraudulent bulk sales and can provide creditors with a remedy when they do occur. At the very least, it does force the participants in the transactions to which it applies to give some consideration to the rights and interests of the vendor's creditors. The lot of unsecured creditors is grim enough without depriving them of any of their existing protection.

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[2] A cynic might point to the scope for evading the Act through an artful bulk sales declaration, and suggest that the message is really "Everyone **but** scoundrels beware!".

Our Comment

There were, of course, many variations on this argument in the responses we received. The argument has some force. No one can deny that unsecured trade creditors of insolvent businesses are in an unenviable position. If we were convinced that the Act provided significant protection to creditors without imposing disproportionate costs on others, we would favour its retention. However, the argument does not answer the fundamental objection to the Act, that it is of marginal benefit to creditors while imposing significant burdens on the participants in legitimate commercial transactions.

5. COMPLIANCE WITH THE ACT IS NOT ALL THAT ONEROUS

The Argument

The cost and difficulty of complying with the Act is not all that great. Compliance will only be difficult where the vendor is insolvent, and that is the very situation where the Act's protection is required.

Our Comment

This argument was not advanced by very many supporters of the Act. It is, like most of the arguments for and against the Act, essentially an empirical claim. Based on other responses to our survey, and other sources, we believe it is a claim that would be hotly contested by many lawyers and business persons. The evidence suggests that the cost in time and money of complying with the Act can be substantial, whether the vendor is solvent or not.

6. THE ACT SHOULD BE AMENDED, NOT REPEALED

The Argument

The Act is far from perfect. However, instead of burying it, we should be amending it to make it more effective.

Our Comment

This argument was made by a good number of our respondents. Indeed, it was made by several persons whose response to the survey question indicated that they favoured the repeal option. So there is considerable support for the proposition that what the *Bulk Sales Act* needs is a good overhaul.

We have no doubt that the existing Act could be considerably improved through amendment. However, we are also convinced that no matter how much it was amended, it would still be subject to the same basic objection. It would still impose significant burdens in return for marginal benefits. The gap between burdens and benefits could be narrowed, but not eliminated.

APPENDIX C
ALTERNATIVE APPROACHES TO BULK SALE ISSUES

Both the British Columbia and Manitoba Law Reform Commissions evaluated the option of repealing their bulk sales legislation against the option of amending it. In order to do so each Commission described what it thought an overhauled Act might look like. In both cases, the Commission then stated its conclusion that repeal was to be preferred to the overhauled Act it had described. The National Conference of Commissioners on Uniform State Laws took a slightly different approach. It first expressed its view that states should repeal Article 6 of the Uniform Commercial Code. It then went on to set out, for the benefit of states that preferred to retain a bulk sales law on the books, a considerably revised Article 6.

We do not propose to describe what we think an "optimal" bulk sales statute would look like. The main reason for not doing so is that we are quite sure that there is little hope for achieving any sort of consensus on the fundamentals, let alone the details, of what an optimal act would look like. In this regard, a comparison of the approaches taken by the British Columbia and Manitoba Commissions is instructive. The British Columbia view seems to have been that the best alternative to repeal was a "minimal" act. Thus, the optimal act for the British Columbia Commission was one that applied to a vary narrow range of businesses and transactions, and imposed minimal requirements where it did apply. The Manitoba Commission's approach was exactly the opposite. It's optimal act would have greatly extended the scope of the existing legislation, and would have imposed somewhat more onerous requirements on the participants in transactions to which it applied.[1]

We point out this difference between the British Columbia and Manitoba approaches simply to illustrate that reasonable persons are likely to have fundamentally different ideas about what an optimal bulk sales act would look like. In light of this fact, we do not think it would be a profitable exercise to set out our particular vision of the most satisfactory possible version of bulk sales legislation. Instead, we shall simply set out, with an occasional comment, the more common or interesting approaches that have been taken or suggested with respect to the major issues that any bulk sales act must address. We have divided the issues into the following categories: 1) coverage, 2) requirements and 3) remedies.

Every alternative that we describe is either embodied in existing legislation, or has been put forward for serious consideration by some official body or reputable

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[1] The revised Article 6 propounded by the NCCUSL lies somewhere between the British Columbia and Manitoba positions.

commentator.[2] The source for each alternative is indicated by way of a footnote. We should point out that we have made no attempt to mention every jurisdiction that follows a particular approach. Nor indeed have we tried to capture every possible wrinkle in the different approaches that could be taken to each issue.

The following is an explanation of the abbreviated references contained in the footnotes.

Abbreviation	Reference
Alberta Act	*Bulk Sales Act*, R.S.A. 1980, c. B-13
Manitoba Act	*The Bulk Sales Act*, C.C.S.M., c. B100
Ontario Act	*Bulk Sales Act*, R.S.O. 1980, c. 52
UCC Article 6	Uniform Commercial Code, Article 6, *Bulk Transfers*
BCLRC	"Optimal" legislation considered and rejected by British Columbia Law Reform Commission as an alternative to repeal
MLRC	"Optimal" legislation considered and rejected by Manitoba Law Reform Commission as an alternative to repeal
NCCUSL	Revised Uniform Commercial Code, Article 6, as adopted and recommended by the National Conference of Commissioners on Uniform State Laws for those states choosing to retain a bulk sales law

I. COVERAGE

The coverage of a bulk sales act depends on its answer to the five basic questions set out below.

1. What sorts of businesses are potentially subject to the act's requirements? 2. To the disposition of what sort of assets by those businesses does the act apply? 3. In what

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[2] To which we should add the caveat that we have not ignored any suggested approach on the basis that it was put forward by a disreputable commentator.

circumstances does the act apply to dispositions of such assets? 4. What exceptions or exclusions, if any, are there? 5. What kinds of creditors is the Act designed to protect? Obviously, both the benefits and costs associated with an act will vary depending upon how it addresses each of these issues.

A. To what sort of businesses should the act apply?

The Options

1. It applies to the appropriate sort of disposition by any type of business.[3]

2. It applies only to dispositions by businesses of a particular description. The "particular description" might be one of the following:

   (a) (i) persons who sell goods, wares, and merchandise ordinarily the subject of trade and commerce, (ii) commission merchants and (iii) manufacturers;[4]

   (b) persons mentioned in (a), and proprietors of hotels, rooming houses, restaurants, motor vehicle service stations, oil or gasoline stations or machine shops;[5]

   (c) persons whose principal business is the sale of inventory from stock, including those who manufacture what they sell.[6]

Our Comment

The first approach does seem more logical. If bulk sales legislation is a good idea for some kinds of business, it should be a good idea for every kind of business that has the sort of assets that might be disposed of to the prejudice of creditors.

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3 Ontario Act; MLRC.

4 Alberta Act.

5 Manitoba Act. There are, of course, many more kinds of business that could be specifically identified. Neither the Alberta nor the Manitoba formula would cover, for example, a video rental outlet, unless it also sold some merchandise.

6 UCC Article 6.

B. **To the disposition of what sort of assets by the relevant kinds of business should the act apply?**

The Options

1. It applies to the disposition of any kind of property.[7]

2. It applies only to property of a particular description, roughly, goods. Variations on this principle restrict the act's coverage to dispositions of:

   (a) (i) goods, wares, merchandise or chattels ordinarily the subject of trade and commerce, (ii) the goods, wares, merchandise or chattels in which a person trades or that he produces or that are the output of a business, and (iii) fixtures, goods and chattels with which a person carries on a trade or business;[8]

   (b) property, both real and personal, that together with property mentioned in (a) is sold in bulk.[9]

   (c) inventory, and other personal property used in the seller's business and sold in connection with the inventory.[10]

Our Comment

If one is going to have a bulk sales act, it will be of more benefit to more creditors if it applies to dispositions of a broad range of assets. The sudden conversion of land owned by a retailer into money has at least the same potential for embarrassing the retailer's creditors as would the sudden conversion of his stock into cash. So there would seem to be a good case for an act that applied to dispositions of a much broader range of assets than do existing acts.

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7 MLRC.

8 Ontario and Manitoba Acts. The Alberta Act is basically the same, but it lacks (ii), and the reference to chattels in (i).

9 Ontario Act.

10 NCCUSL.

C. **To what sort of dispositions of the relevant kind of assets by the relevant type of business should the act apply?**

The Options

1. It applies to the sale of (a) a stock or part of a stock outside the usual course of business of the seller, (b) substantially the entire stock of the seller, or (c) an interest in the business of seller.[11]

2. It applies to the sale of a stock or part of a stock out of the usual course of business or trade of the seller.[12]

3. It applies to a sale not in the ordinary course of the seller's business of more than half of the seller's inventory, as measured by value.[13]

4. (a) Subject to (b), it applies to sales described in 3, but **only if** the buyer has notice, or after reasonable enquiry would have had notice, that the seller will not continue to operate the same or a similar kind of business after the sale.

   (b) In the case of a sale by auction or a sale or series of sales by a liquidator on behalf of the seller, it is notice to the auctioneer or the liquidator, rather than notice to the buyer, that is necessary.[14]

Our Comment

Any bulk sales act must contain a provision that limits its application to transactions of a certain sort, transactions that are likely to give rise to the danger at which the act is aimed. The problem is that there is no magical way to precisely identify and target the dangerous transactions. The narrower the provision, the more likely it is that transactions prejudicial to creditors will slip by. The broader the provision, the more likely it is to impose burdens on participants in innocuous transactions. To a large extent, the choice of where to draw the line is a question of how many innocuous transactions one is prepared

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11 Alberta, Manitoba Acts. The cases suggest that (c) is really meaningless. As interpreted in the cases, it adds nothing to what is covered by (a) and (b).

12 Ontario Act.

13 UCC Article 6.

14 NCCUSL. In the case of auction sales or sales by a liquidator, it would be the auctioneer or liquidator, not the buyer, who would suffer the consequences of non-compliance.

to subject to the act's requirements in order to reduce the number of dangerous transactions that slip through the net.

D. **What specific exceptions should there be to the coverage of the act?**

The Options

1. The act exempts a category of transactions that, roughly speaking, consists of sales by public officials or persons selling in a representative capacity who owe special duties to creditors, and sales for the benefit of creditors. The precise specification of this class varies from act to act.[15]

2. The act exempts transactions that create a security interest in the "seller's" property, and transactions for the purpose of realizing on a security interest.[16]

3. In addition to the standard exemptions different acts exempt a variety of other transactions. The list of "other exemptions" includes the following:

   (a) sales by merchants selling exclusively by wholesale;[17]

   (b) specific transactions for which an exemption is granted on application to the court;[18]

   (c) sales of assets worth less than a certain amount (net of encumbrances);[19]

   (d) sales of assets worth more than a certain amount;[20]

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15 All acts. The differences between the acts seem to represent a different assessment of what sort of sellers can be trusted to "do the right thing" with the proceeds.

16 All acts. It should be noted that the Canadian acts do not contain an express exemption. It has been "read in" by the courts.

17 Alberta Act; Manitoba Act.

18 Ontario Act.

19 NCCUSL. The actual amount proposed is $10,000. It should be noted that several of the respondents to our survey suggested that the *Bulk Sales Act* should only apply to transactions involving assets above a certain value. Some also suggested that the Act not apply to very large transactions.

20 NCCUSL. The actual amount proposed is $25,000,000.

(e) sales where a solvent buyer agrees to assume all debts of the seller of which the buyer has knowledge, either from a list provided by the seller or through the buyer's own reasonable enquiries;[21]

(f) sales to a new organization formed to take over the business of the seller, where the organization assumes all debts incurred in the seller's business, the seller receives no consideration other than an interest in the new organization that is subordinate to claims of creditors, and notice is subsequently given to creditors.[22]

Our Comment

This is an area that can easily generate controversy. One exemption - the exemption for wholesalers - is obviously inappropriate.[23] However, good arguments can be made both for and against most of the exemptions. For example, it is generally conceded that there are good reasons for including some security-creating transactions within the Act. Certain of these transactions - especially the granting of security to secure an existing indebtedness - have just as much potential to prejudice unsecured creditors as an outright sale. But the blanket exemption is said to be justified on the basis of "commercial necessity" or by the fact that other statutes govern the creation of security interests.

E. **What creditors or claimants of the debtor should the act protect? Should the act distinguish between trade creditors and non-trade creditors, or between secured and unsecured creditors?**

The Options

1. The act does not distinguish between different kinds of creditors: all creditors are treated identically.[24]

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21 NCCUSL. There would be certain conditions: e.g. notification of affected creditors within a certain period after completion of the sale.

22 UCC Article 6.

23 This exemption has often been the subject of adverse comment. The best explanation we can think of for its existence is that the main promoters of the original bulk sales legislation (to which this exemption can be traced) were wholesalers. Apparently, they did not hold to the theory that what's sauce for the goose is sauce for the gander.

24 Manitoba Act; UCC Article 6.

2. The act distinguishes between different classes of creditors or claimants. Some of the act's provisions may afford protection to all creditors or claimants. But other provisions apply to or protect one class of creditors.[25]

Our Comment

This is one of the many issues about which even the proponents of bulk sales legislation cannot reach a consensus. The "reliance" rationale for such legislation would suggest that it should only protect unsecured trade creditors. However, other considerations would suggest that its scope should be wider. For instance, simplicity would be served by making as few distinctions as possible: the Alberta Act's complex set of distinctions seems calculated to create as much confusion as possible.

II. REQUIREMENTS

Issue A, below, is the fundamental issue to be addressed by any bulk sales act. Different responses to this issue lead to two fundamentally different kinds of bulk sales acts. On the one hand are acts that simply require the participants in a bulk sale to give advance notice of the sale to the seller's creditors. These latter are then left entirely to their own devices to make such use of this notice as they can. On the other hand are acts that contain provisions intended to place some onus on the buyer to ensure that the sale proceeds are actually applied to pay the seller's debts.

In theory, at least, whether an act falls into one of these categories or the other will greatly influence both its value to creditors and the aggravation it causes to participants in

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[25] Alberta Act; Ontario Act; NCCUSL. Both the Alberta and Ontario acts make two basic distinctions: 1) between trade and non-trade creditors; and 2) between secured trade creditors and unsecured trade creditors. The Alberta Act applies these distinctions to achieve the following rather complicated scheme of protection:

(a) only **trade creditors** need to be listed in the seller's declaration;

(b) the Act is complied with if all **trade creditors** shown in the seller's declaration are paid in full;

(c) if the listed trade creditors are not paid in full, waivers or consents must be obtained from a certain percentage of the listed **unsecured** trade creditors;

(d) if the "consent" route is followed, **all creditors** who would be able to prove their claims in bankruptcy proceedings share in the distribution under the Act;

(e) **any creditor** may attack the sale in the event of non-compliance.

the transactions to which it applies. It should also become apparent that some of the issues mentioned below will be irrelevant for a "notice only" act.

A. **Should the act simply require advance notice of a bulk sale to the seller's creditors, or should it take more active steps to ensure that the sale proceeds are applied (so far as may be necessary) in payment of the seller's debts.**

The Options

1. The buyer is only responsible for ensuring that certain steps are taken to give creditors advance notice of the impending bulk sale. It is then the responsibility of the creditors to avail themselves of such measures as the general law of the jurisdiction may provide to protect themselves against any adverse consequences of the sale.[26]

2. The buyer is required to ensure that creditors of whom he has notice are paid in full, or that the proceeds of sale are distributed to creditors in accordance with a statutory scheme.[27]

3. Same as 2, except that buyer can rely on the seller's affidavit that all of the creditors of whom the buyer has notice have been paid in full.[28]

Our Comment

It would be impossible to achieve any consensus on which of these approaches is better than the other. Each is a rational response to the problem. The choice between the two approaches depends on one's assessment of the appropriate balance between the competing interests involved. It has been said of the statutes based on the "notice only" version of UCC Article 6 that they provide virtually no protection for creditors. The notice period is so short - 10 days - that creditors will very rarely have any real opportunity to do

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[26] BCLRC; UCC Article 6 (subject to optional section 6-106, which has been adopted by only a minority of states); NCCUSL (which deletes optional section 6-106). Under the NCCUSL proposal, the notice to creditors must include a schedule of distribution. The buyer will be liable if the proceeds are not distributed in accordance with the schedule. However, the schedule may simply call for payment of the entire purchase price to the seller, and the proposed Article 6 would provide creditors with no right to interrupt the sale or intercept the proceeds.

[27] All Canadian acts; UCC Article 6, optional section 6-106.

[28] Ontario Act.

anything about the bulk sale before it is completed. The NCCUSL proposal would partially address this point by increasing the notice period to 45 days.[29]

B. **How must notice of an impending bulk sale be given to creditors?**

The Options

1. Public notice (e.g. by newspaper advertisement or publication in official gazette) suffices.[30]

2. Personal notice (e.g. by mail) to creditors required.[31]

3. There is no express requirement that notice be given to any creditors, but in some circumstances there is an implicit requirement that some creditors be given personal notice.[32]

4. Personal notice is required unless there are more than a certain number of creditors, in which case public notice suffices.[33]

5. Public **and** personal notice is required.[34]

Our Comment

Again, the type of notice required to be given to creditors will reflect a balancing of the competing interests. Permitting public notice will ease the burden on the participants in the transaction, but will obviously reduce the chance that any given creditor will actually receive notice.

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29 See below, Issue C.

30 BCLRC.

31 Ontario Act; UCC Article 6.

32 This rather strange proposition applies to most existing Canadian acts, including Alberta's. These acts contain no explicit requirement that any creditor be given notice of the sale. However, if creditors' consents or waivers are required, it will obviously be necessary to notify enough creditors to get the required number of consents.

33 NCCUSL. The proposed threshold figure was 200 creditors, exclusive of employees.

34 MLRC. The idea was that the public notice requirement would partially address the problem of the incomplete seller's list.

It should also be noted that choices on other issues may constrain the choice on this issue. Where creditor consents or waivers are required, personal notification of some creditors will be necessary, whether the Act specifically requires it or not.

C. **How much advance notice is required?**

The Options

1. 10 days notice is required.[35]

2. 45 days notice is required.[36]

Our Comment

The two periods mentioned - 10 days and 45 days - simply illustrate the choice between a relatively short period and a relatively long period. The amount of advance notice provided to creditors is most important for the "notice only" acts. The advance notice is the only protection such acts provide creditors. Obviously, if the period is very short, the protection will be slight. But the disadvantage of a relatively long notice period such as 45 days is that it can cause inordinate delays in completing transactions. This problem is alleviated somewhat by the NCCUSL's definition of the date of sale. It would allow the closing of a transaction at any time so long as the purchase price was paid into an escrow account and held there until the expiration of the 45 day period.

D. **If personal notice of some sort is required, how are the creditors to whom notice must be given to be identified?**

The Options

1. The buyer's obligation is limited to ensuring that notice is given to creditors disclosed by a list of creditors provided by the seller, and possibly to other creditors of whom the buyer has actual knowledge.[37]

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35 UCC Article 6.

36 NCCUSL.

37 All acts. The NCCUSL expressly provides that notice must be given to claimants of which the buyer has knowledge even if they are not on the list.

2. The buyer is obliged to ensure that notice is given to creditors on the list, as well as to any other creditors whose existence he could discover by making reasonable enquiries.[38]

Our Comment

It is well recognized that the ability of the buyer to rely on the seller's list of creditors greatly diminishes the protection provided to creditors. It has been suggested by some commentators that the buyer should have some obligation to make reasonable enquiries to verify the accuracy of the seller's list. But this suggestion has been consistently rejected on the basis that it would place too great and uncertain an obligation on buyers. As previously noted, the compromise position of the MLRC was to allow the buyer to rely on the seller's list, but to require public notice in addition to personal notice to creditors on the list.

E. **If the Act requires the buyer to ensure that certain creditors are paid in full or that the proceeds are used to pay creditors:**

(1) What creditors must be paid in full?

(2) If creditors are not going to be paid in full, should the act allow them to prevent the transaction from being completed?

The Options (Issue 1)

1. All creditors shown on the seller's list must be paid in full.[39]

2. The creditors mentioned in Option 1 must be paid in full, or adequate provision must be made for payment in full of the claims of all listed unsecured trade creditors, and the claims of all listed secured trade creditors that are due upon completion of the sale, and those claims must be paid in full forthwith after completion of the sale.[40]

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38 No existing or officially proposed legislation follows this course. But it has been proposed by some commentators as one means of making the bulk sales acts more effective. Indeed, the drafting Committee of the NCCUSL at one point favoured such a provision.

39 Alberta Act; Manitoba Act; UCC, Article 6, optional section 6-106. S. 6-106 also applies in favour of creditors not on the seller's list if the buyer has notice of their claim. The Ontario Act is similar.

40 Ontario Act. Provision does not have to be made for payment of the claim of a creditor who has delivered a waiver.

Our Comment

The Ontario option provides a little flexibility for dealing with long term (secured) obligations of the seller.

The Options (Issue 2)

1. If the listed creditors are not to be paid in full, the sale cannot be completed without the waivers or consents of a certain percentage of their number.[41]

2. The act does not give creditors any right to prevent the sale from being completed, whether their claims are going to be paid in full or not. A creditor who objects to the sale (perhaps because he thinks the price is too low) can only prevent the sale from going ahead by resorting to such remedies as are provided by the general law.[42]

Our Comment

As we have observed of several other issues, the options here represent a different assessment of the proper balance between the competing interests. The first option goes beyond the basic bulk sales rationale of preventing the seller from absconding with (or simply spending) the proceeds of a bulk sale. It allows the creditors to judge the adequacy of the consideration (not that they are likely to have any means of judging its adequacy), and to prevent the sale going ahead if the consideration is inadequate.[43] Of course, this also gives creditors the opportunity to torpedo a perfectly legitimate transaction.

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[41] All Canadian acts. The percentage is 60% "in number and value." Under the Alberta Act, it is only the **unsecured** trade creditors whose consent or waiver is required.

[42] UCC Article 6, optional section 6-106.

[43] Inadequacy of consideration is presumably the basis upon which creditors would not provide consents. But a creditor can withhold his consent for any reason at all, or for no reason.

III. REMEDIES

A. What should be the basic remedy for non-compliance with the act?

The Options

1. In the event of non-compliance with the act, the transaction is void as against creditors. Creditors of the seller can thus pursue the assets into the hands of the buyer. The buyer has a duty to account for the proceeds if he resells the assets.[44]

2. The transaction is valid, but the buyer is liable to pay damages to any creditor of the seller who suffers damage a result of the non-compliance.[45]

Our Comment

Of course, either of these approaches gives rise to numerous secondary questions and issues, but we need not explore them. We are interested in the basic structure of the remedy.

The difference between the two approaches might be summarized by describing the first option as a hammer and the second as a scalpel. In theory, at least, declaring the whole transaction to be void provides creditors with very effective protection. It also may produce harsh results that are very difficult to justify on any plausible remedial theory. It may result in creditors of the seller receiving much more than they ever would have received if the parties had complied with the act.[46] The second option, although not without its drawbacks, seems a much fairer approach, and one more in keeping with normal remedial principles.

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[44] Existing legislation, both Canadian and U.S.

[45] UCC Article 6, proposed revision; B.C. Law Reform Commission.

[46] For example, suppose that the parties to a bulk sale do not strictly comply with the Act, although they act in complete good faith. The buyer pays the purchase money to the seller, who then uses the funds to pay his creditors on a *pro rata* basis. The creditors have received exactly what they would have received if the act had been complied with. Nevertheless, since the act was not complied with, the transaction is fraudulent and void. A creditor could pursue the subject matter of the sale into the hands of the buyer.