NON-COMPETITION CLAUSES AND THE PURCHASE AND SALE OF A SMALL BUSINESS

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Prepared by:

C. EDWARD DANIELSON

and DARA L. WISEMAN

NON-COMPETITION CLAUSES AND THE PURCHASE AND SALE OF A SMALL BUSINESS

1. General:

This is an area of occasional litigation; but many of the more recent cases are situate in the Atlantic Provinces. By their very nature and use, restrictive covenants or non-competition clauses will generate litigation a long way down the road. Decisions are made, clauses are inserted, documents are signed today that provide for eventualities maybe five or ten years down the road, and these provisions will be the ones most likely to be litigated.

I intend to review generally the field of restrictive covenants with references to the leading cases and updates on the more recent and local cases and then offer some practical considerations in drafting a restrictive covenant for use in an agreement of purchase and sale. I have borrowed freely from two excellent articles on the subject: Restrictive Trade Practices and Agreements by Ivan R. Feltham, published in 1975 (Lectures LSUC 449) and Covenants Not To Compete In Common Law by Yvon Marcoux in (1969) 10 Cahiers 251. I recommend these articles, particularly the latter, as a base from which to commence research of the subject.

2. What Is Reasonable?

As you will shortly see and if you are not already aware, the subject area is confused by the question of

"reasonability". It seems that it might be a useful exercise for those who may be interested in testing their ability to identify the "reasonable" as opposed to the "unreasonable" covenant to set out some short fact situations and ask you to indicate whether the Court upheld or struck the restrictive covenant involved.

(1) Doctor restricted from establishing a medical practice in Dartmouth, Nova Scotia, and a radius of 20 miles from the boundaries thereof for a period of five years.

Enforceable?

See Gordon v. Ferguson (1961) 46 M.P.R. 177 (N.S.S.C. in banco)

(2) Doctor restricted from establishing a medical practice within a radius of 10 miles from Cranbrook, British Columbia for a period of ten years.

Enforceable?

See Green v. Stanton (1969) 6 D.L.R. (3d) 680 (B.C.C.A.)

(3) Lawyer restricted from establishing a law office within seven miles of a community forever.

Enforceable?

See Fitch v. Dewes [1921] 2 A.C. 158 (H.L.)

(4) Doctor restricted from establishing a medical practice within 20 miles of Winnipeg, Manitoba for two years.

Enforceable?

See Meszaros v. Barnes (1977) 73 D.L.R. (3d) 407 (Man. Q.B.)

(5) Employee in business of supplying industrial rubber coverings and tank linings restricted within 100 miles of Hamilton, Ontario for three years.

Enforceable?

See Canadian Vapotred Ltd. v. Leonard (1972) 6 C.P.R. (2d) 45 (Ont. Co. Ct.)

But note that the employee was the former owner of the business sold to the covenantee who stayed on to work for the covenantee

(6) Employee in business of selling mobile homes restricted within 100 miles of Portage la Prairie, Manitoba, for three years.

Enforceable?

See Portage Mobile Home Co. Ltd. v. Challenger Home Builders Ltd. (1972) 29 D.L.R. (3d) 191 (Man. Q.B.)

3. The Test and Reasonability

The political balancing of the competing interests of freedom of contract and restraint of trade was discussed by Lord MacMillan in the Privy Council appeal of Vancouver Malt and Sake Brewing Co. v. Vancouver Breweries Ltd. [1934] 2 D.L.R. 310, 313 (J.C.P.C.)

> "... Public policy is not a constant. More especially is this so where the doctrine represents a compromise between two principles of public policy; in this instance, between, on the one hand, the principal that persons of full age who enter into a contract should be held to their bond and, on the other hand, the principle that every person should have unfettered liberty to exercise his powers and capacities for his own and the community's benefit. But that the law against contracts in restraint of trade, whatever be its precise scope

> at any given time, is a doctrine of full force and vitality at the present day cannot be gain said. The law does not condemn every covenant which is in restraint of trade, for it recognizes that in certain cases it may be legitimate, and indeed beneficial, that a person should limit his future commercial activities, as, for example, where he would be unable to obtain a good price on the sale of his business unless he came under an obligation not to compete with the purchaser. But when a covenant in restraint of trade is called in question the burden of justifying it is laid on the party seeking to uphold it. The tests of justification have been authoritatively defined by Lord Birkenhead, L.C., in these words:
>
> > A contract which is in restraint of trade cannot be enforced unless (a) it is reasonable as between the parties; (b) it is consistent with the interests of the public. ...
> >
> > Every contract therefore which is impeached as being in restraint of trade must submit itself to the two standards indicated. Both still survive."

The definitive and modern-day test of the validity of restrictive covenants was first covered in the case of Nordenfelt v. Nordenfelt Guns & Ammunition [1894] AC 535. Therein Lord Macnaghten stated as follows:

> "The true view at the present time I think, is this: The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: Restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is sufficient justification, if the restriction is reasonable - reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public."

The result is a balancing act indeed - ensuring the fair protection of the purchaser's newly acquired interest in the business (that the value does not unreasonably diminish in the future by the vendor's conduct) and at the same time ensuring that the vendor is not so constrained in his future business activities as to unreasonably eliminate the useful application of his business acumen.

This analysis can be restated as a three-part test:

(a) A restrictive covenant is prima facie void as in restraint of trade;

(b) Nevertheless, it may be valid if it is reasonable as between the parties; and

(c) At the same time, in no way injurious to the public.

A caveat should be added here that a restrictive covenant in gross, that is a covenant which does not protect a right or interest of the covenantee, will not be considered effective. This opinion was expressed in Herbert Morris Limited v. Saxelby [1916] AC 688 and approved by the Supreme Court of Canada in Vancouver Malt and Saky Brewing Company Limited v. Vancouver Breweries Limited and also in the more recent case of Newhook v. Elson (1959) 44 MPR 258 (Nfld.) In that case, the Supreme Court of Newfoundland held that a covenant was void being in restraint of trade in gross, there being no transfer of goodwill which might require protection.

The Nordenfelt tests begins with the presumption that a restrictive covenant is void as in restraint of trade. The burden lies with the covenantee to rebut this presumption and show that the covenant is reasonable. See the case of Eze Brew Coffee Service Ltd. v. Harrison (1973) 12 C.P.R. (2d) 19, 21 for a discussion of this procedural aspect.

That litigious word "reasonable" causes substantially all the litigation in this area. What is reasonable? Reasonability is measured

(i) in duration, that is, the length of time the restriction is imposed;

(ii) in area, that is, the geographical regions in which the restriction is enforced; and

(iii) in scope, that is, the business activities which the restriction forbids.

There has developed a "threshold" test of reasonability which is applied by the Courts: that the extent of the restriction should be no more than is necessary to protect the interest of the covenantee in the business assets being acquired.

The assessment of reasonability in any case is determined by reference to the factors in existence at the time the restrictive covnenant is made and not subsequently when the covenant is either applied or challenged. See the case of Green v. Stanton, supra.

The determination of reasonableness is also made in relation to the nature of the business sold and without reference to the nature of the buiness of the purchaser. Therefore, the purchaser can only protect himself in relation to the business acquired regardless of whether he conducts similar businesses or a spinoff business. See the case of Vancouver Malt and Sake Brewing Co., supra.

The question is also raised, reasonable for whom. The vendor? The purchaser? The public? The Supreme Court of Canada is not perfectly reconciled on this point. In the earlier case of Maguire v. Northland Drug Company Ltd. [1935] S.C.R. 412, the Court held that reasonable meant "... no wider than required for protection of the covenantee while at the same time not imposing undue hardship on the covenantor." Therein the Court appears to consider both parties; however, in the more recent case of Hecke v. La Compagnie de Gestion Maskoutaire Ltee. [1972] S.C.R. 22, the Court stated that the test was what was reasonably necessary for the protection of the purchaser. To further confuse the issue, the New Brunswick Supreme Court Queen's Bench Division in the case Bard Transport Ltd. v. Bard (1978) 23 N.B.R. (2d) 304, the Court referred without comment to the interests of the parties concerned and the public. This approach was confirmed in the Nova Scotia Supreme Court case of Greening Industries Ltd. v. Penny, supra. As a further comment in that case, Bissett, J. said at page 654 that "I know of no

case which holds that if the covenant is fair and reasonable in the interests of the parties, it can be inimicable to the public interest." This comment could well be the answer to the otherwise apparent inconsistencies in the various applications.

Time Limitations:

If the covenant fails to state the duration of the restriction, the Court is likely to interpret the lack of a time limit as implying the life of the covenantor. See Marcoux at page 298. The difficulty is that the Court is also more likely to construe an unlimited provision as unreasonable.

Unfortunately, there is no pat answer as to what the Court will consider reasonable or unreasonable. It very much depends on the circumstances of the particular case, the nature of the business, the difficulties of attracting customers, and the degree of permanance associated with a client or customer. This will require that the lawyer drafting the restrictive covenant have a comprehensive knowledge of these aspects of the business. See the cases assessing reasonability by balancing the business factors.

Geographical Restrictions

This part of the test may well be the most frequently litigated, that is, the region for which the restriction will apply. It should be noted in this regard

that if the matter is reduced to a radius of X miles, then unless otherwise stated, this will be X miles "as the crow flies" and not way of public highway or otherwise. See Ernest Char Pit Ltd. v. Demendeiros (1970) 15 D.L.R. (3d) 663 (Ont. H.C.).

The real test is whether the area restricted is confined to that area in which the establishment of a similar business would injure the purchaser. On certain conditions, a Canada-wide or international covenant may be reasonable if the international nature of the business and the location of its customers deem this necessary. See Marcoux on this aspect and also the cases of Greening Industries Ltd. and E.P. Chester Ltd. v. Mastorkis and Acadian Wholesalers Ltd. (1968) 4 N.S.R. 256 (S.C.A.D.).

Scope of Activity

The most difficult area in which to determine reasonability is the range of business activities excluded. Not infrequently the purchaser will try to anticipate any and all eventualities including specific prohibitions against any similar or related businesses or any method of becoming involved in similar or related businesses. The case of Mason v. Provident Clothing and Supply Co. Ltd. [1913] A.C. 724 (H.L.) considered the phrase "similar business" and gave it the meaning "... so like the other as to seriously compete with it." However, the Nova Scotia Supreme Court took a

different position in Greening Industries Ltd., supra, where the Court considered the words "... or any business similar to or competitive with such business" and stated that the covenant was unreasonable because the purchaser is "... only able to protect the business which he purchased..." and not a similar business.

4. Distinction Between Master/Servant and Vendor/Purchaser

The general tests are the same in both relationships; however, the criteria in the determination of reasonability are modified depending on the relationship. A review of the decided cases reveals a more flexible test of "reasonability" in the commercial situation vs. the employment relationship, such that a restraint may be found unreasonable in the context of the latter, whereas it is held reasonable under the former.

The following reasons are suggested for the distinction:

(1) Generally, the Courts have considered that there is more freedom of contract between vendors and purchasers. The parties are more likely to be on an equal footing as opposed to the inherently unequal bargaining position of the parties in an employment situation. See Lord Macnaghten, Nordenfelt and the case of Morris v. Saxelby.

(2) It is also acknowledged that to effectively and completely transfer the business, including its goodwill, a restrictive covenant is necessary to protect the purchaser

so that the vendor's entire interest is conveyed and preclude the vendor for continued dealings with old clientele, for example. See Newhook v. Elson and Morris v. Saxelby.

(3) There is also a disinclination by the Courts to deprive an employee of his only means to earn a living; whereas, the courts have indicated that a seller of a business is more likely to have alternate forms of income.

5. The Saving Doctrine of Severability

If the Court determines that a covenant is unreasonable, all is not necessarily lost. An unreasonable restrictive covenant may be saved by the timely exercise of a little judicial discretion on the part of the Courts.

There is a contradiction in this doctrine, resulting from the generally accepted law of contracts that a court will not make a contract for the parties that the parties themselves fail to make at the time. The contradiction lies in the Court's extensive utilization of the exception that a Court may strike down a provision where the other provisions and the substance of the agreement are unaffected.

The leading Nova Scotian cases far extend the concept of severability. An excellent illustration of the lengths that the Court will go is set out in a case of Greening Industries Limited v. Penney, a 1965 decision of the Nova Scotia Supreme Court reported at 53 DLR (2d) 643. The purchasers in that situation obtained the following covenant from the Vendor:

"1. He will not at any time during the period of five (5) years from the date hereof either individually or in partnership or in conjunction with any person or persons, firm, association, syndicate, company, corporation or other business enterprise as principal, agent, shareholder or in any other manner whatsoever and either directly or indirectly, carry on, or be engaged in or interested in or advise, lend money to, guarantee the debts or obligations of, or permit his name to be used or employed by any person or persons, firm, association, syndicate, company, corporation or other business enterprise engaged in or interested in

(i) within the Province of Ontario,
any business carried on by ADAMSON or any business similar to or competitive with such business;

(ii) within the Provinces of Ontario and Quebec,
any business carried on by ADAMSON or any business similar to or competitive with such business;

(iii) within the Provinces of Ontario, Quebec, Nova Scotia and British Columbia,
any business carried on by ADAMSON or any business similar to or competitive with such business;

(iv) within the Provinces of Ontario, Quebec, British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland,
any business carried on by ADAMSON or any business similar to or competitive with such business;

(v) within Canada,
any business carried on by ADAMSON or any business similar to or competitive with such business.

2. If any covenant or provision herein is determined to be void or unenforceable in whole or in part, it shall not be deemed to affect or impair the validity of any other covenant or provision.

3. Clauses (i), (ii), (iii), (iv) and (v) of paragraph 1 hereof shall be separate and distinct covenants.

4. All restrictions in paragraph 1 are reasonable and valid and all defences to the strict enforcement thereof are hereby waived by the COVENANTOR."

Bissett, J., while recognizing therein at page 653, the test of single as opposed to indivisible restrictions, the blue pencil test, severance without addition or alteration of the words, nevertheless held that the words "any business similar" could be readily severed from the rest of the covenant. In addition, he also isolated the region of the Maritime Provinces from the geographical restrictions. The Court thereby salvaged another otherwise unreasonable restrictive covenant.

This case to some extent reverses the holding in the earlier 1961 Nova Scotia Supreme Court case of Gordon v. Ferguson. However, a legitimate distinction may be made on the basis that in this case, the relationship more closely resembled an employee/employer situation. In the case, a restriction as to practising medicine "... in the vicinity within the Town of Dartmouth, in the County of Halifax, Province of Nova Scotia, and a radius of twenty miles from the boundaries thereof, for period of five years..." was found to be unreasonable and was further determined to be indivisible and incapable of severance so that the Court was unable to give effect to any part of the restriction. In the words of MacDonald, J., the restriction was "... an indivisible covenant, and not merely an agglomeration of independent and several covenants, and therefore one admitting of no curtailment of the area of the prohibited activity by way of severance."

Again, in an employment situation, the case of E.P. Chester Limited v. Mastorkis and Acadian Wholesalers

Limited decided in 1968 by the Nova Scotia Supreme Court, Appeal Division, relied on the law as stated in the Greening Industries case. In that case, a former employee established a business and the employer sued on the following covenant:

> "(6) It is agreed between the parties that if this Agreement is terminated by Chester for any of the reasons as set out in paragraph (5) or if the Employee terminates the Agreement then for a period of two years following such termination the Employee covenants that he will not directly or indirectly own, manage, operate, join, control, be employed or participate in the management, operation or control of or be concerned in any manner with any business carried on in the Atlantic Provinces in competition with that presently carried on by Chester, its Successors or Assigns."

The Court severed from the restrictive covenant the Province of Newfoundland. The Court had found that the inclusion of Newfoundland was unreasonable because the Plaintiff's employer did not do much business there. By so severing, the Court was able to give effect to the balance of the covenant.

Another interesting application of the doctrine is made in the Betz Laboratories case (1969) 70 WWR 304 (B.C.S.C.) wherein the area of restraint was any territory of the employer and the Court severed the Province of British Columbia, and then found that restriction to be reasonable and upheld the covenant.

6. Practical Matters

The question of reasonability will always be a question of law in the sense that it is not one for determination

by the finder of fact. Further, the question of reasonability will always depend on the circumstances of each case. Therefore, it is difficult to recommend an all-purpose clause which can be inserted in your average agreement of purchase and sale. The determination of reasonability requires a knowledge of the circumstances of the business at the time the covenant is made and the practitioner should so familiarize himself.

Given the Court's approach, it has been suggested that the best type of non-competition clause would be a blanket clause calling on the Courts for interpretation. For example, a clause to the effect that the seller cannot engage in a trade so far as the law allows. But, this particular provision was found ineffective in the case of Davies v. Davies (1887) 36 Ch. D. 359 (Engl. C.A.).

Another alternative is to draft the restrictive covenant as broadly as possible, that is, without time limits, throughout Canada, any and all related business and add a caveat stating that to the extent the covenant is unenforceable because it is not required for the protection of the business interests then it is deemed to be severable and so limited. The problem with this approach is the risk that the Courts may decide against severance despite contrary authorities or that the Courts may find the clause too ambiguous to give effect to or practically speaking, the parties will not know what they may or may not do.

It has been suggested by Feltham at page 480-481 of his article that the best approach for the practitioner is to use a "building block" concept. That is in the three areas - time, geopgraphical and scope of work - in gradations from the minimum to maximum protection with a covenant by the parties that they acknowledge all of the provisions to be reasonable and severable. The practitioner should investigate the business and the degree of harm from the seller's competition which the purchaser considers acceptable to assume. Then the draft should be as specific as possible, i.e. as limited as can be achieved in terms of duration, geographic area and scope of business activity. For example, in the case of geographical limits, begin with the Atlantic Provinces, then the Maritime Provinces, then Nova Scotia, the Halifax County, then the City, and so on. Again, the difficulty here is not so much that the Court may not sever, but that the parties will not know how to govern their behavior so that they will fall within the covenant. This is of particular concern where you may be acting for the purchaser who wants eventually to get back into a business or similar business in the area and you are placed in the position of advising him what he may safely do, when and where.

It is important that it be recognized that while most agreements of purchase and sale of assets are signed by the company that it will be necessary to join the principals

of the company in the agreement since the covenant is a personal one. It is preferable so as to avoid the "covenant in gross" problem to include the principals' personal covenant in the agreement of purchase and sale with a statement to the effect that this is the sole reason that the covenantors joined in the agreement.

It is important also to remember that the benefit of the covenant should be assignable, particularly when acting for the purchaser in the event the purchaser wishes to turn the business over within the time frames of the restrictive covenant. This point was discussed in Newhook v. Elson 1959 44 MPR 258 (Nfld.) There is some authority in the case of Fluorescent Sales and Service Ltd. v. Bastien and National Lighting Maintenance (1958) 39 WWR 659 (A.S.C.A.D.) that the benefit of the covenant will pass with a subsequent sale of the business assets even though there is no specific assignment.

7. Interesting Note

In closing, I would note that practitioners should be aware of the line of English authority which may eventually be applied in Canada; although I have not been able to find any application to date. I am referring to the case of Shroeder Publishing Company v. MacAulay [1974] 3 All E.R. 616 (H.L.) In this case, a young songwriter entered a standard form contract with a publishing house agreeing to

give all rights in his material to the publishing house. The publishing house was under no obligation to publish the material. There was a restrictive covenant that the songwriter agreed not to sell or otherwise transfer any of his material to any other publishing company. The company then failed to publish his songs and the songwriter attempted to get out of the contract.

The House of Lords found that the restrictive covenant was unreasonable the reasons given introduce some new factors, that is:

> "The test of fairness is, no doubt, whether the restrictions are both reasonably necessary for the protection of the legitimate interests of the promisee and commensurate with the benefits secured to the promisor under the contract."

The judgment notes the lack of reciprocity in the arrangement, that is, the fact that MacAulay obtained nothing and gave up everything. It also referred to the unequal bargaining power of the respective parties and concluded that the covenant was not a reasonable one, therefore, in restraint of trade and ineffective. Goff and Jones on The Law of Restitution (2nd ed) 1978: London, Sweet & Maxwell, at page 201, discusses the case and the possible lines of argument thereby raised as follows:

> "Lord Diplock suggested that the courts may now scrutinise the terms of some standard form contracts which had not been the product of arm's-length negotiation. However, he cautiously observed:
>
> > 'The fact that the appellant's bargaining power vis-a-vis the respondent was strong enough to enable them to adopt this take-

> it-or-leave-it attitude raises no presumption that they used it to drive an unconscionable bargain with him, but in the field of restraint of trade it calls for vigilance on the part of the court to see that it did not.'
>
> Moreover, the Courts now appear to be more ready than they were to strike down forfeiture and penalty clauses which are oppressive and Lord Simon of Glaisdale has expressed the view that equity has an "unlimited and unfettered jurisdiction" to relieve against penalties and forfeitures."

Perhaps this case will have no immediate impact on restrice covenants for vendors and purchasers. However, it shows the direction that the English Courts are taking and which the Canadian Courts may follow. Perhaps it serves as an indication that the liberal application of the doctrine of severance may be on the decline and practitioners should be more carefully drafting their restrictive covenants so as not to rely on the Court to make the contract where the possible climate of Court opinion may be a finding of unreasonability. This is especially true where the parties are in unequal bargaining position for whatever reasons.

THE BULK SALES ACT

AND

THE PURCHASE AND SALE OF A SMALL BUSINESS

The following article appeared in the Nova Scotia Law News November 1978 and was prepared by Peter Green. The article summarizes the pertinent sections of the Act and provides useful comment on the application of the Act in the sale of a business involving goods and merchandise transferred in bulk.

While the article has not been updated, it provides a useful basis for the practitioners consideration of the application of The Bulk Sales Act. Careful consideration should be given to the difference in the wording of various sections of the Nova Scotia Act and the acts of various other provinces including Ontario under which much of the case law has developed.

THE NOVA SCOTIA BULK SALES ACT

Purpose

The Bulk Sales Act, R.S.N.S. 1967, c.28, protects the general or unsecured creditors of a seller in the event of the sale of any bulk stock of goods outside the normal course of business of the seller. The Act is designed to prevent the seller from disposing of goods in bulk and failing to apply the proceeds of the sale for the benefit of his creditors.

The Supreme Court of Canada stated the object of the Nova Scotia Bulk Sales Act in Re Crouse, Garson v. Canadian Credit Men's Trust Association [1929] 3 D.L.R. 300 (S.C.C.). Lamont, J., at Page 302, puts the matter as follows:

> "The object of the Bulk Sales Act is to prevent a trader from making a sale in bulk of his stock-in-trade, goods and merchandise without the consent of his creditors thereto or the payment of their claims. To effect this object the Act imposes a duty upon any intending purchaser not to complete the purchase or pay any part of the purchase-price without complying with the provisions of the Act. If he fails to perform that duty the Act declares that the sale 'shall be deemed to be fraudulent and shall be absolutely void as against the creditors,' (s.4)."

The purpose and object of the Bulk Sales Act was also dealt with in Higgins v. Elliott (1922), 55 N.S.R. 283 (S.C.). Rogers, J., at Page 301, points out that the legislation is equally applicable whether the vendor is solvent or insolvent and that the legislation places a burden on the purchaser to be satisfied that the vendor satisfies his obligation to his creditors out of the proceeds of the sale.

Coverage of the Act

Section 6 states that the legislation applies only to sales by "traders and merchants" and defines that class as persons who are manufacturers, commission merchants, and persons who buy and sell goods, wares and merchandise which are ordinarily the subject of commerce. It should be pointed out that the Nova Scotia legislation differs from that of other jurisdictions in some fundamental respects, including those covered by the legislation and the nature of transactions subject to it. For example, in Ontario the Bulk Sales Act, R.S.O. 1970, c.52, applies to "every sale in bulk" and the Act defines "stock" to include, among other things, fixtures with which a person carries on a trade or business.

Section 5 of the Nova Scotia Act sets out the types of sales which are subject to the Act. The central element is the sale or transfer of a stock of goods, wares or merchandise out of the usual course of business. Thus, a sale in bulk out of the usual course of business, or whenever all or substantially all of the stock-in-trade of the vendor is sold, or when an interest in the business or trade of the vendor is sold, the sale is subject to the Act.

Norris v. McKenzie, [1933] 3 D.L.R. 713 (N.S.S.C.) held that sale of a business comprised of the sale of equipment and good-will only does not come within the Act and that in order to do so the sale must include "a stock of goods". See

the decision of Hall, J. at Page 718.

Section 1 refers to a sale "for cash or on credit". Questions have arisen in a number of cases whether set-off arrangements for the purchase price resulting in no cash passing to the vendor takes the transaction outside the purview of the legislation. The courts have generally held that it does not and take the view that the legislation is intended to cover every bulk sale of goods and merchandise by the classes of traders and merchants covered by the legislation. See Doucet v. Side Sode (1916), 27 D.L.R. 732 (N.S.S.C.).

The Act does not extend to sale pursuant to seizure under a chattel mortgage.

It would appear that the Act does not extend to sales where the vendor's business is the providing of service. The Manitoba case Bartels, Shewan & Co. v. Peterson (1914), 6 W.W.R. 396 (Man.K.B.) held that legislation in that Province does not extend to sales by a hotelkeeper since he does not fall into the class "traders and merchants".

How does the Act work?

The requirements to observe the Bulk Sales Act are outlined in Sections 1, 2 and 4.

The key requirements of the Act are:

(1) a written declaration by the vendor of the names and addresses of creditors of the vendor together with the amount owing to each creditor;

(2) a written agreement for the purchase and sale of the stock of goods, which agreement must contain an inventory of the property to be sold. The agreement is to be filed in the registry office of the registration district in which the

vendor resides or the registry office in the district in which the property is situate;

(3) no part of the purchase price is to be paid until thirty (30) days have elapsed from the execution of the agreement;

(4) Section 4 provides that if the proceeds are sufficient to pay all creditors then the proceeds of sale shall be paid to a trustee for distribution to creditors. If the proceeds are insufficient to fully pay all creditors, consent to the sale by fifty per cent (50%) in number and value of creditors is required.

The fee of the trustee under Section 4 shall not exceed three per cent (3%) of the proceeds of the sale. The fee may either be agreed upon by the creditors or fixed by a Judge under the provisions of the Assignments and Preferences Act, R.S.N.S. 1967, c.16. See Re Crystal Springs Manufacturing Co. [1935] 4 D.L.R. 331 (N.S.S.C.) at 333.

What is the effect of Non-Compliance?

Section 3 of the Bulk Sales Act renders a bulk sale not completed in accordance with the Act as voidable by creditors of the vendor. In Re Crouse, Garson v. Canadian Credit Men's Trust Association, supra, Lamont, J. puts the matter as follows at Page 302:

> "It is now common ground between the parties that in the Bulk Sales Act the word 'void' means 'voidable' only and that a sale made without compliance with the Act is valid unless and until the creditors of the vendor elect to have it set aside. The fact that the Act avoids the sale only as against the vendor's creditors indicates an intention on the part of the legislature that on the sale the property in the goods shall pass, subject to the right of the creditors to have the sale set aside as fraudulent against them."

An action by one creditor to set aside a bulk sales transaction as void against the creditors of the vendor would be treated as an action on behalf of all creditors of the vendor even though the action commenced by the one creditor does not specifically state that his action is on behalf of himself and all other creditors of the vendor. See Higgins v. Elliott, supra.

Of course, if a vendor and purchaser have failed to comply with the Act, and if the purchaser subsequently sells the stock or merchandise, the purchaser can be required to account for the proceeds of the subsequent sale since a declaration that a sale is null and void raises a statutory presumption of fraud on the part of both vendor and purchaser as against the vendor's creditors. See Re Crouse, supra.

How can the Act be avoided?

Vendors and purchasers, and perhaps solicitors acting for one or both parties, may wish to avoid the procedures of the Bulk Sales Act and the time delay inherent therein before a transaction may be completed. Indeed, it is probably safe to conclude that more bulk sales are completed without following the detailed procedure of the Act than transactions which in fact follow the legislative provisions. However, a purchaser who completes a transaction and pays money for a stock of goods without following the procedures of the Act does so at his peril. He may obtain an indemnification from the vendor against claims by creditors but that indemnification, of course,

is only as good as the vendor's ability to respond to such claims. It appears that the increasing number of sales of businesses between parties at arm's length and who are unknown to each other, and the mobility of the population, will result in greater use of the Bulk Sales Act in the future in order to adequately protect purchasers against claims of creditors where the nature of the transaction brings it within the purview of the Bulk Sales Act.