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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

"...businesses are coming to realize that lawyers involved in corporate and commercial transactions are likely to have a broad range of contacts with potential sources of financing."

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

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

BUSINESSES INCREASINGLY USING LAW FIRMS IN SEARCH FOR FINANCING

John Papadakis

Canadian businesses, particularly smaller and mid-size concerns, are increasingly turning to law firms to help them in the search for financing.

Recent experience in our office suggests that businesses are coming to realize that lawyers involved in corporate and commercial transactions are likely to have a broad range of contacts with potential sources of financing.

It stands to reason. Corporate/commercial lawyers are involved in financing transactions on a daily basis and are exposed to numerous and varying sources of financing. As such they will be aware of sources that would never cross their clients' minds.

Everybody will be aware of the major Schedule A and B banks – CIBC, HSBC, Laurentian, Montreal, National, Royal, Scotia, TD, – the life insurance companies, and such capital lending organizations as Roynat and GE Capital.

At the same time, however, many will not be aware of the scores of smaller investment and merchant banks looking for opportunities to invest in new ideas being proposed for the marketplace by strong management. In Toronto alone there are literally hundreds of these investment companies.

In some instances, it won't even be a matter of knowing the institution. Rather, it will be a matter of knowing the right person within the institution.

Time and time again we have had a client go to an account manager at its bank only to have nothing materialize. We, in turn, have been able to introduce that same client to another person within the same financial institution who may be more aggressive and may be more inclined to do a particular kind of financing, and we have been successful in helping the client get the financing committed.

In other cases, we have had clients look for financing locally only to find no local appetite for either the type of financing or for the terms our clients have been seeking. In these cases, we have been able to put the client together with lenders from other provinces.

In one Ontario real estate case, we were able to put a client together with an institution from British Columbia which was willing to lend on a 75 per cent loan-to-value ratio compared to the

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John Papadakis, a member of Blaneys' Corporate/ Commercial and Real Estate practices, focuses his work on secured lending. He has arranged financing for a wide variety of products and purposes, including aircraft, railway cars, ships, infrastructure projects, car and truck fleets and accounts receivable. He has negotiated and structured loan terms, conducted due diligence and prepared security documentation. He is particularly active in the financing of commercial real estate.

John can be reached at 416.593.3998 or jpapadakis@blaney.com.

65 per cent loan-to-value ratio that had been set by a local lender.

In one Ontario computer leasing situation, we were able to put clients together with lenders from Alberta who were prepared to provide better terms (in this case a smaller deposit and a longer payback period).

We are also well positioned to arrange for complex lending arrangements involving senior lenders, mezzanine financing and subordinated debt. We've had situations in which a company's owners and managers wanted to structure a management buyout but management was not able to put the financing together. We were able to put the management in touch with the appropriate investment bankers and senior lenders to structure a lending arrangement that was feasible and workable.

As a matter of course, then, I encourage our clients who are thinking about looking for financing, or who are in the process of seeking it, to contact us to see whether we can assist them with their requirements. We're a great resource that should be tapped into and utilized.

If a client calls us looking for some assistance with financing, it will often be as simple as providing three or four names and phone numbers and asking the client to wait an hour so we can call the people we have identified and to tell them that they may be hearing from the client.

We have daily contact with a wide range of financial institutions. We know which lenders are specializing in what fields. One bank branch with which we have dealt, for example, specializes in the financing of auto parts manufacturing companies. Another branch of another bank specializes in film financing. Another branch of yet a third bank that we know specializes in financing clothing manufacturers.

And that's just institutional knowledge. When you are in regular contact with the market, you also get to know the lending officers – their specialities, their particular business interests, where they stand vis a vis their loan portfolio targets for the year, their personalities, and so forth.

Some officers, for example, might be more aggressive by nature and therefore might be particularly active in their efforts to work with the client to "get the deal done." Others might be running behind their targets for the year and therefore might be especially motivated to examine a potential piece of business particularly carefully and then run hard with an application.

Others, on the other hand, might have met their targets for the financial year and might be more focussed on trying to book the business for next year rather than moving the application forward immediately.

As I indicated at the outset, recent activity in our office suggests that clients are coming to realize that if they are proposing to shop for some new financing, a contact with us likely will be useful. Our client may know five potential financing sources. Chances are we will know another 20. This is a great value added service that is being underutilized. ■

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"Is it possible to buy the assets of a business in Ontario and then, after you have paid for them, endure an enormous fine…because you failed to follow the letter of a law that comes into play every time all or substantially all of a business's assets are sold?"

Regina Lee has been with Blaneys' Corporate/ Commercial practice since 2002. In the last year she has been a member of Blaneys teams providing counsel in major Canadian corporate matters, including the emergence of Safety-Kleen Corp. from bankruptcy protection and Liberty Health's sale of its insurance business to The Maritime Life Assurance Company.

Regina can be reached at 416.593.3933 or rlee@blaney.com.

SUPREME COURT REVERSES MAJOR FINE

Regina Lee

Is it possible to buy the assets of a business in Ontario and then, after you have paid for them, endure an enormous fine – up to what you paid for the assets to begin with, in fact – because you failed to follow the letter of a law that comes into play every time all or substantially all of a business's assets are sold?

My colleague, Steven Jeffery, posed that question in the December, 2002 issue of *Blaneys on Business*. The question concerned the *Bulk Sales Act* and, at that time, Steve wrote, "a Court of Appeal decision indicates that the answer can be yes."

The Court of Appeal decision, like the trial court decision before it, was rooted in a strict interpretation of the *Act* – "If you do not comply, then you pay twice."

Now, the Supreme Court of Canada has decided that the impacts of such an interpretation are unreasonable and has overturned the trial and appeal court decisions by a 5-2 vote.

The case at the root of this set of events involves two well-known corporations, H&R Block Canada Inc. and the National Trust Company.

As a brief overview of the facts of the case, H&R Block purchased "stock in bulk," consisting largely of goodwill and client lists, from Tax Time Services for $800,000. H&R Block failed to comply with the *Act* in the purchase transaction by failing to demonstrate that notice of the sale had been given to to Tax Time's creditors. Meanwhile, Tax Time used the proceeds of the sale to pay off its debts owed to its two highest ranking secured creditors. The other secured creditors, and the unsecured creditors, including National Trust, remained unpaid.

The trial judge held that the sale was void and that, pursuant to section 16(2) of the *Act*, H&R Block became personally liable for the $205,000 in principle and interest that Tax Time owed National Trust. By virtue of that judgment, National Trust essentially received a windfall by being put in a better position than it would have been in had H&R Block complied with the *Act*.

The issue that the Supreme Court of Canada addressed was this: Where a sale of stock in bulk has been declared void and has been set aside for non-compliance with the *Act*, must the value of the stock in bulk for which the buyer is obliged to account to the seller's unpaid creditors under section 16(2) be reduced by amounts paid by the seller to secured creditors out of the proceeds of the sale?

In other words, in this particular case, should the $205,000 owed to National Trust, an unsecured creditor, be "reduced" – to nil, in this instance, – by the $800,000 from the sale that Tax Time paid to its secured creditors?

The Supreme Court of Canada interpreted the buyer's duty to account under section 16(2) in light of commercial realities and the true purpose of the *Act*. As Mr. Justice Michel Bastarache wrote in the decision:

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"I am of the view that the Bulk Sales Act is not intended to be punitive in nature and that this should be taken into account in its interpretation."

"The *Bulk Sales Act* has at least two significant objectives or purposes: (i) to protect the interests of all creditors whose debtors have disposed of all or substantially all of their assets; and (ii) to ensure the fair distribution of the proceeds of a sale in bulk among the seller's creditors, based on their priority ranking. The clear legislative intent is to deter fraud and to ensure that creditors are properly paid. This said, I am of the view that the *Bulk Sales Act* is not intended to be punitive in nature and that this should be taken into account in its interpretation."

The Court found that the phrase "personally liable to account" was consistent with the interpretation that the buyer must account for what was owed, taking into account what was properly paid out to creditors from the proceeds of the sale in bulk.

The Court looked to the substance and not just the form of the payments made. It also exercised its discretion to consider all of the facts of the case to determine (a) what, if anything should be done to put the unpaid creditors in the position they would have been in had the *Act* been complied with or (b) whether a strict liability to pay, under section 16(2), would lead to an unfair result.

The Court concluded that the creditor should not be placed in a better position than it would have been in had the buyer complied with the *Act* and conversely, that the non-compliant buyer should not be unduly punished.

It was unreasonable that an unsecured creditor, who would not have recovered any payment if the buyer had complied with the *Act*, should benefit from the buyer's non-compliance.

It was clear that Tax Time's payments to its two highest-ranking creditors did not place National Trust at a disadvantage and the Court found that to require H&R Block to pay National Trust the value of the proceeds of the sale would be to place National Trust in a better position than it would have been in had the *Act* been complied with. In essence, it would be an unfair result to allow National Trust to receive a windfall and to unduly punish H&R Block for not complying with the *Act*.

To conclude, although it remains prudent for buyers and sellers to comply with the requirements of the *Act* as emphasized earlier by the lower courts, by overturning the Court of Appeal decision it appears that the Supreme Court of Canada has relaxed the "strict compliance" rule somewhat and it will be interesting to see whether this decision will change how purchasers will comply with the *Act* in future asset purchase transactions. ■

EXPECT THE BEST

Blaney McMurtry
BARRISTERS & SOLICITORS LLP

20 Queen St. West, Suite 1400
Toronto, Canada M5H 2V3
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com

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We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.