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# "Distress-Red Flags and Red Tape"

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# DISTRESS - RED FLAGS AND RED TAPE

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A landlord can walk into (or send a bailiff into) a non-residential tenant's premises who is in arrears of rent and by a simple statement "I do hereby distrain" seize possession of sufficient chattels to satisfy the arrears and costs of distress. It is an ancient common law remedy, that has been confirmed, expanded, and modified in the *Commercial Tenancies Act* (the "Act"). There is an almost medieval aspect to it that is enhanced by the resonance of words like "levy", impound", and "replevy". Unless the lease states otherwise, no prior notice is required. It can be done immediately after the arrears arise (one minute after midnight following the day the rent should have been paid). No court order is required. It is a seductively attractive procedure. It allows the landlord in an instant to effectively shut down a tenant's business.

Although prior notice is not normally required to levy distress, a notice under Section 53 of the Act must be given before the goods are sold. The goods cannot be sold until five days after the notice under Section 53 is left on a "most conspicuous place on the premises charged with the rent distrained for". Before selling the goods the landlord must also cause the "goods and chattels so distrained to be appraised by two appraisers who shall first be sworn to appraise them truly, according to the best of their understandings, a memorandum of which oath is to be endorsed on the inventory". In the five day period the tenant must "replevy" the goods and chattels if the sale is to be blocked.

This ancient, arcane, remedy is very risky for a landlord. Recently it has become even more so as the result of the *Red Tape Act*. Before dealing with *Red Tape Act* it is useful to consider some of the salient, and familiar difficulties of distress.

Here are some of its salient troublesome features:

1. A landlord cannot distrain in respect of fixtures (not even trade fixtures) but the case law relating to what constitutes a trade fixture, as opposed to a chattel, is not coherent or consistent. It is often hard to know whether a particular item is a chattel and is therefore distrainable. Items such as the following have been held to be chattels: an advertising sign attached by screws; a boiler installed for the purpose of operating a dry-cleaning business; shelving attached to walls by screws; and equipment used for cooking and baking in a pizza business. On the other hand, the following items have been held to be trade fixtures: counters, light fixtures, an air-compressor, and machinery and equipment used in an auto-body shop.

2. Items that are leased are not distrainable and, there is no system for determining whether any particular item is leased.

3. Goods held on consignment are not distrainable and, it is often difficult to know when particular goods are held on consignment or not.

4. There are significant procedural pitfalls. There are complex rules relating to how access to the premises is gained and the time of day at which distress can be levied. You have to gain access by ordinary means, not by breaking in, deception, or even by use of a master key. It has to be done before sunset and after sunrise. Failure to comply with those requirements can result in the distress being held to be illegal with the result that the landlord may be liable for claims from the tenant.

Law reform commissions in Ontario, British Columbia, and Manitoba have recommended major changes to legislation relating to distress. A law reform commission in England has strongly recommended that distress be abolished. A similar recommendation was made by a law reform commission in New Zealand. In 1993, the Civil Code of Quebec was changed to remove the remedy of seizure before judgment (which corresponded to the right of distress). Many jurisdictions in the United States do not permit distress. The remedy has also been abolished in four jurisdictions in Australia, and in Northern Ireland.

However, in Ontario distress is insidiously alive and well, and unchanged. (It is interesting that the law reform commission recommendations referred to above all seem to have been ignored.)

Even if the landlord does follow the proper procedure for distraining, and does in fact distrain only in respect of chattels against which it is entitled to distrain, there is always the risk that the tenant may have given a personal property security interest or some other security interest to a third party that has a prior claim in them. A search under the Personal Property Security system will disclose

whether the tenant has granted security but, it then becomes necessary to obtain a copy of the form of security agreement to determine whether the security is a title retention form of security, such as a conditional sales contract, or a lease to purchase type financing, or is instead a chattel mortgage or a non-title retention form of security. Usually, a landlord has priority over a chattel mortgagee, but it can only distrain in respect of the tenant's interest in goods that are subject to title retention forms of security. If it sells goods subject to a title retention form, it must pay out the secured creditor before being able to retain the proceeds.

The Landlord must also determine whether the Tenant has given security to a Bank under Section 427 of the *Bank Act*. If that has happened, and the Bank has given the required notice of its security, it has priority over the Landlord.

Once these hurdles are passed there is always the possibility that a secured creditor may choose to put the tenant into bankruptcy with the result that the landlord's distress priority is subject to attack either on the basis of it being a fraudulent preference (because it occurs within three (3) months of the date of the bankruptcy), or on the basis that the landlord's priority is lost on the bankruptcy of the tenant.

Recently, the risks inherent in distress have become intolerable (at least where the landlord goes beyond the step of imposing the distress and actually sells the distrained goods). The Federal Government claims a super priority lien in respect of unremitted source deductions such as amounts withheld from employees on account of Income Tax, Canada Pension and Employment Insurance.

It also claims this super priority over G.S.T. remittances. That is problem by itself but it is exacerbated because it is very difficult to determine whether distrained property is subject to such a lien. Clearance certificates are not issued. A purchaser of distrained goods is always at risk that if the Federal Government claims a lien in respect of them, the landlord may not be able to give good title to a purchaser.

The provincial government has, added an additional, very significant impediment to distress. On December 18, 1998 its "Red Tape Bill", amended both the *Retail Sales Act* and the *Tobacco Tax Act* to provide for an increased penalty on creditors who seize assets of a debtor who is liable to remit taxes under either statute. Under the revised Section 22, of the *Retail Sales Act*, if the seizing creditor (ie. landlord) does not obtain a tax clearance certificate from the Ministry of Finance, before selling the goods seized, it becomes personally liable for all unpaid taxes, interest and penalties owing by the debtor effective from January 1, 1998. A landlord distraining in respect of only $1,000.00 of arrears of rent may find itself liable for several thousands of dollars of liability. Similar changes to the *Tobacco Tax Act*, the *Fuel Tax Act* and the *Gasoline Tax Act* will have the same result.

Even before the *Red Tape Act*, the seizing creditor (landlord) would have been liable for unpaid tax which had accrued over the prior year. That was certainly a significant exposure, but the revised Section 22 opens that exposure up dramatically.

The landlord can, protect itself by obtaining clearance certificates but one wonders, in how many instances a tenant that is in arrears of rent will also be up to date in its retail sales tax payments. The

same comment also applies to G.S.T. and employee deductions. All things considered, it is difficult to understand why a landlord would sell distrained goods and even more difficult to understand why a purchaser would buy distrained goods. The purchase and sale of distrained goods is a very public, visible kind of transaction and one that persons with competing claims would have no difficulty in scrutinizing.

Perhaps, the original common law version of distress should be reverted to. At common law the lessor had no right to sell the distrained goods. (The right to sell the distrained goods was provided for in Section 53 of the CTA.) The old notion of seizing the goods and simply holding onto them until the rent is paid may be the only relatively safe means of proceeding with distress in light of what is set out above.

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