

Rights Of Unpaid Suppliers Under The *Bankruptcy And Insolvency Act (Canada) (“BIA”)*



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A. Overview

Section 81.1 of the BIA¹ had its genesis in the 1992 amendments to the BIA (then the *Bankruptcy Act*). Section 81.1 creates a right similar to the right of revendication under the Quebec Civil Code.

At its root, section 81.1 was designed to address the all too familiar problem of the unscrupulous debtor increasing its stock of inventory immediately prior to bankruptcy in an attempt to increase realization for its secured creditor(s) (and thereby reduce exposure on any personal guarantees) to the detriment of all unsecured suppliers.

The intention of the legislation is to allow suppliers to reclaim goods which are delivered within thirty (30) days of a customer’s insolvency or, alternatively, to receive payment for such goods. However, in the main, the protection afforded by section 81.1 to suppliers is extremely limited given the onerous preconditions which must be met by a supplier and the fact that such protection can be rendered impotent through the imposition of a statutory or judicial stay to facilitate restructuring or the appointment of an interim receiver.

B. Preconditions to Entitlement

The mandatory components of an effective claim by a supplier to reclaim goods are as follows:

- (a) a sale of goods by a supplier to a purchaser;
- (b) a delivery of the goods to a purchaser;
- (c) the sale must be for use in relation to the purchaser’s business;
- (d) the purchaser must not have fully paid for the goods;
- (e) the supplier must present a written demand for repossession to the purchaser, trustee or receiver in prescribed form;

¹ For ease of reference, section 81.1 is reproduced in its entirety as Appendix “A” to this paper.

- (f) the written demand is to be presented within a period of thirty (30) days after delivery of the goods to the purchaser;
- (g) when the demand is presented, the purchaser is bankrupt or a receiver has been appointed in relation to the purchaser within the meaning of subsection 243(2) of the BIA;
- (h) when the demand is presented, the goods are in the possession of the purchaser, trustee and/or receiver;
- (i) when the demand is presented, the goods are identifiable as the goods delivered by the supplier;
- (j) when the demand is presented, the goods are in the same state as they were on delivery; and
- (k) when the demand is presented, the goods have not been resold at arm's length and are not subject to any agreement for sale at arm's length.

C. **Judicial Interpretation**

Section 81.1 has been in existence for over a decade and there is still a paucity of cases which have interpreted its various components.² An overview of these cases is set forth below:

(a) **Sale of goods**

What constitutes "goods"?

Although the term "goods" is not defined in the BIA, some guidance may be found by reference to the term "property" which is defined in the BIA to include money, goods, things in action, land and every description of property whether real or personal...³ It follows that for the purposes of the BIA, "goods" is something other than "money" or "things in action".

The concept of "goods" includes, but is not limited to, inventory. Goods may include equipment, inventory and virtually any personal property supplied to a purchaser for use in relation to that purchaser's business.⁴

Assuming one is dealing with "goods", there must be a sale of those goods for section 81.1 to be applicable. Under the *Sale of Goods Act (Ontario)* ("SGA"), a contract for sale of goods is a contract where the seller transfers or agrees to transfer the property in the goods to the buyer for money consideration, called the price. The contract may be absolute or conditional. Specifically, the transaction may be a "sale" or it may an "agreement to sell". Accordingly, it

² The most comprehensive article dealing with section 81.1 was written by Ray C. Rutman and entitled "30-Day Goods and Section 81.1 of The BIA – A Five Year Review" 49, CBR (3d) 289.

³ BIA, section 2

⁴ This is consistent with the definition of "goods" under the *Sale of Goods Act (Ontario)*.

follows that if the transaction between the supplier and the purchaser is one where title in the goods does not pass until some later point in time or until some condition has been met, the remedy of the supplier is not under section 81.1.

(b) Delivery of goods

What constitutes “delivery” within the meaning of section 81.1?

This question has been addressed by the British Columbia Supreme Court in *Re: Zachary's Furniture Ltd.*, 24 C.B.R. (3d) 238. In this case, goods were shipped f.o.b. from Ontario to be delivered in British Columbia. The goods were shipped subject to *acceptance* on delivery. The Court held that, under these circumstances, the goods were required to arrive at the place of intended delivery in order for delivery to be complete. As a consequence, the thirty (30) day time period under section 81.1 ran from the date of arrival of the goods and not from the date of delivery to the common carrier. It should be noted, however, that in the *Zachary's Furniture* case, the Court referred to, and placed some reliance upon, the industry custom of requiring acceptance of the goods delivered. Accordingly, in the event industry custom does not necessitate “acceptance” of the goods delivered, and the delivery terms are f.o.b. the suppliers place of business, it is an open question whether the supplier will lose a portion or all of its thirty (30) day window due to transportation related delay.

In this regard, it should be noted that in Ontario, section 31(1) of the SGA provides that “[w]here in pursuance of a contract of sale the seller is authorized or required to send the goods to the buyer, the delivery of the goods to a carrier whether named by the buyer or not, for the purpose of transmission to the buyer, is, in the absence of evidence to the contrary, delivery of the goods to the buyer”. Accordingly, absent evidence of intention to the contrary, it is entirely possible that the goods delivered to a carrier at the request of a purchaser may be construed as having been “delivered” to the purchaser as at the time of collection by the common carrier. Such a construction would be detrimental to the interests of a supplier as the thirty (30) day period of revendication is eroded by the amount of time required to deliver the subject goods to the purchaser’s place of business.

(c) Sale and delivery for use in relation to the purchaser’s business

To the best of our knowledge, there are no reported cases respecting the “use” requirement of the section.

(d) Purchaser must not have fully paid for the goods

Although evidence of non-payment will typically be easy to show, potential difficulties may arise where a purchaser owes a supplier money by reason of a number of deliveries of goods, some within the thirty (30) day period and some before the thirty (30) day period. As always, good record keeping by the supplier will enhance the possibility of success in asserting a claim under section 81.1.

(e) The supplier presents a written demand for repossession to the purchaser, trustee or receiver in prescribed form containing the details of the transaction

Section 81.1 requires that the supplier must present a written demand for repossession to the purchaser, trustee or receiver in the prescribed form. The prescribed form for a supplier making a claim is Form 75. For your ease of reference, a copy of the prescribed Form 75 is included at Tab A of these materials.

At a minimum, the form requires the following information:

- (i) the name of the debtor in bankruptcy or receivership;
- (ii) the name of the purchaser, trustee or receiver;
- (iii) the name of the supplier;
- (iv) a description of the goods sufficient to enable them to be identified;
- (v) dates of sale and delivery of the goods; and
- (vi) date of the bankruptcy or receivership.

In *Royal Bank v. Stereo People of Canada Ltd. (Trustee of)* (1996), 43 Alta. L.R. (3d) 389, the Alberta Court of Appeal held that Form 63.1 (now Form 75) must be completed in a manner that is generally satisfactory in terms of compliance with the form and with generally satisfactory supporting documents attached to allow the trustee to identify the goods which are the subject of the claim.

The Court found that section 81.1 does not require that complete identification information be supplied with the demand, only that the details of the transaction be provided. It should be noted that the Court commented that the prescribed form encourages claimants to provide as much information respecting identification as possible, along with the supply of supporting documentation. The form, however, is only notice of a claim, it is not proof of the claim.

As a practical matter, counsel are wise to deliver a demand for repossession as soon as possible even if all of the information is not available. It is far better to send an incomplete demand for repossession than delay and risk losing the right to utilize section 81.1 at all. The Court in *Stereo People* also recognized that identification may only be possible after the physical inspection of the goods. The Court further recognized, as did Parliament, that the timing of the demand is critical to the supplier's ability to avail itself of section 81.1 rights and, of necessity, the demand may have to be made without lengthy consideration as to the description of the goods or the means of identification of the goods.

(f) Demand presented within Thirty (30) days of delivery

The thirty (30) day time limit for presentment of a claim has been considered in a number of cases. It should be noted that in *Stereo People*, the Court held that where a supplier makes a *bona fide* effort to provide details of the transaction and the goods claimed in the demand, then, notwithstanding the possibility that the details and supporting documents accompanying the claim may not enable the trustee or receiver to identify the goods claimed, the supplier may supplement the information at a later date either in writing or orally.

(g) The purchaser be bankrupt or a receiver be appointed in relation to the purchaser within the meaning of subsection 342(2) of the BIA

Section 81.1 does not apply unless (i) the purchaser is bankrupt or (ii) unless a receiver has been appointed within the meaning of section 243(2) of the BIA in relation to that purchaser.

- (i) A bankrupt person is one who has made an assignment for the general benefit of its creditors or against whom a receiving order has been made.
- (ii) Section 243(2) of the BIA provides:

Subject to subsection (3), in this Part, “receiver” means a person who has been appointed to take, or has taken, possession or control, pursuant to

- (a) an agreement under which property becomes subject to a security (in this Part referred to as a “security agreement”) or
- (b) an order of a Court made under any law that provides for or authorizes the appointment of receiver or receiver/manager, of all or substantially all of
- (c) the inventory,
- (d) the accounts receivable, or
- (e) the other property of an insolvent person or a bankrupt that was acquired for or is used in relation to a business carried on by the insolvent person or bankrupt.

However, in the event the purchaser avails itself of some form of insolvency protection which involves a judicial or statutory stay, the effect of such a stay is often to prevent the appointment of a receiver or the bankruptcy of the purchaser and thus a supplier is denied access to relief under section 81.1. Although the BIA provides that the section 81.1 thirty (30) day time period is suspended during the existence of the stay, the fact that the protected purchaser is able to continue its business in the ordinary course effectively means that the goods supplied will be either consumed or sold before the stay is lifted, thereby denying the supplier any benefit of section 81.1.

In *Re People’s Department Stores Ltd. (1992) Inc.* (1994) 37 C.B.R. (3d) 78, an application was made by suppliers pursuant to section 69.4 of the BIA to lift the stay of proceedings which arose when a debtor had filed a notice of intention to make a proposal and in respect of which an

interim receiver had been appointed. Section 69.4 of the BIA provides that the Court may lift the stay under whatever terms it considers appropriate if satisfied that a creditor is likely to be materially prejudiced by the continued operation of those sections or if it is equitable on other grounds to make such a declaration.

In *People's*, the Court noted that lifting the stay would prevent the preparation of a proposal which probably would have benefit for the general body of creditors and accordingly the stay would not be lifted.

Similarly, in *Bruce Agra Foods Inc. v. Proposal of Everfresh Beverages Inc. (Receiver of)* (1996), 45 C.B.R. (3d) 169 (Ont. Gen. Div.), an interim receiver order had been granted pursuant to the provisions of the BIA with respect to a purchaser of goods. The Court drew a distinction between a receiver as contemplated pursuant to section 243(2) and an interim receiver appointed pursuant to section 47.1 of the BIA. It was noted that Part II of the BIA encompasses the reorganization sections found in Part IV of the Act, which fundamentally require the absence of physical possession by anyone other than the debtor. The interim receiver was authorized to take control or possession of certain assets but was not obliged to do so under the interim order granted. Accordingly, it was held that an interim receiver appointed pursuant to section 47.1 where a notice of intention to file a proposal had been filed was not a receiver within the meaning of section 243(2) and accordingly the rights of a supplier under section 81.1 of the Act were not available to the applicants.

The decision in *Bruce Agra Foods* was followed in *Harris Trust and Saving Bank* 24 C.B.R. (4th) 203. In this case, Mr. Justice Farley commented that an appointment of Ernst & Young Inc., as an interim receiver, not as a receiver, contained a comeback clause (paragraph 27) and it was open to the supplier to challenge the appointment as really a “de facto receivership” under section 243(2). In this case, the fact that the supplier did not bring such a motion led Mr. Justice Farley to dismiss the same for, in his view, section 81.1 rights cannot be “slept on” and neither can “come back” rights.

(h) When the demand is presented, the goods are in possession of the purchaser, trustee and receiver

The requirement of possession by the trustee, receiver or purchaser is interwoven with the requirement of delivery and the requirement that the purchaser be bankrupt or a receiver be appointed in relation to the purchaser within the meaning of section 243(2) of the BIA. Assuming, however, that the other preconditions are met, possession by the purchaser, trustee or receiver must be proven for an effective claim to be made by a supplier.

In the case of *Thomson Consumer Electronics Canada Inc. v. Consumers Distributing Inc. (Receiver of)* (1996), 43 C.B.R. (3d) 77 (Ont. Gen. Div.), the goods claimed by suppliers were in possession of a party that was not a trustee, not a purchaser and not a receiver within the meaning of section 243(2) of the BIA. The third party was holding the goods pursuant to contractual arrangements with the purchaser and was physically preventing the receiver of the purchaser from taking the goods.

It was held that section 81.1 presupposes a supplier dealing with a purchaser, trustee or receiver with respect to repossessing the subject goods. It does not contemplate a supplier dealing with some other person with respect to repossession and accordingly, no protection was afforded of the supplier. The Court stated that the operation of section 81.1 required that there be an element of physical possession.

(i) When the demand is presented the goods are identified as the goods delivered

The onus on proving identifiability is on the supplier.

In the case of *Stokes Building Supplies Ltd.* (1994), 30 C.B.R. (3d) 36, the Newfoundland Supreme Court concluded that identification need not be apparent on the face of the goods (i.e. that is serial numbers or other distinctive stamps are not required). Identification can come from records such as invoices, purchase orders and from the evidence of representatives of suppliers and purchasers. The Court used the example that if evidence is presented that the supplier had only supplied the purchaser with goods within the preceding thirty (30) days, that would be sufficient identification even though the goods are not stamped, marked or otherwise distinctive.

Parenthetically, it is interesting to note that in the *Stokes* case, the Court was not prepared to accept the application of the supplier in total. The Court concluded that given the state of the evidence it was prepared to make an order to allow repossession of a portion of the goods which were clearly identified as having been supplied in the thirty (30) day period but it was not prepared, based on the paucity of evidence, to conclude that the balance of the goods were delivered within the same period. The Court concluded that section 81.1 does not confer broad discretion on the Court to make a general equitable adjustment between the parties. Accordingly, the Court did not allocate goods between the receiver and the supplier on the assumption that old stock was sold first. It was held that the items which are taken to be under repossession must themselves be identifiable.

In the case of *Bruce Agra Foods*, it was held that when concentrated orange juice from one supplier was poured into a vat which contained concentrated orange juice from other suppliers, the goods supplied by the first supplier could not be identified within the meaning of section 81.1 as they could not be distinguished from the goods supplied by the other suppliers. Accordingly, relief under section 81.1 was not available.

In the absence of way bills or serial numbers that can be cross-referenced to particular goods in the possession of the purchaser, receiver or trustee with goods delivered within the thirty (30) day period, identification becomes problematic. This is particularly the case where the same or similar product has been delivered both before and after the relevant thirty (30) day period. Again, good record keeping and product tracking are essential if a supplier is desirous effectively of utilizing the provisions of section 81.1.

(j) When a demand is presented the goods are in the same state as they were on delivery

There are a great many ways in which the “state” of a good may be altered subsequent to its delivery to a purchaser. For example: ⁵

- (i) goods may be moulded, cut, shaped, frozen, etc.;
- (ii) the integrity of the good may be retained but the good itself may be divided into smaller parts. (For example, a drum of motor oil may be emptied and the oil placed into smaller containers);
- (iii) packaging may be added, altered or removed;
- (iv) a good may be added to the goods supplied such that the good added becomes an accession to the goods supplied;
- (v) the goods supplied may be installed or affixed to other goods such as to become an accession to the other good;
- (vi) the goods supplied may be attached or affixed to real property such as to become fixtures;
- (vii) the goods supplied may be co-mingled with other goods such that the inherent quality of the component goods are lost in the mass;
- (viii) the goods supplied may be damaged; and
- (ix) the processes of nature may intercede to alter the state of a “living” good. (For example, the seedling may become a flower, the shipped cattle may have died.)

It will always be a question of fact whether an “alteration” has caused the goods in question to have changed state.

In the case of *Thomson Consumer Electronics Canada* the Court concluded that the removal of bulk shrink wrap constituted a change to the packaging of goods but not a change to the state of the goods themselves.

(k) When a demand is presented, the goods have not been resold at arm’s length and are not subject to an agreement for sale at arm’s length

In the case of *IT Education Corp., Re* (2002) 34 C.B.R. (4th) 46 the Nova Scotia Supreme Court (in Chambers) addressed the issue of whether computer books supplied by the supplier to a debtor (which was in the business of providing courses on information technology) were subject to an agreement for sale at arm’s length by virtue of a student contract between the purchaser and its students which had enrolled in the program prior to the date of the receivership.

Apparently, prior to the commencement of the program, each student, upon enrolment, was required to enter into a student contract which provided, among other things, that the purchaser would, at its discretion, supply textbooks and courseware needed for the program as described”.

The Court found that this particular provision of the contract was essential to the issue to be decided. In reviewing the terms of section 81.1 the Court found that the student contract

⁵ *Supra*, Note 2

obligated the receiver to deliver the course materials that the purchaser previously contracted with each student to provide. The discretion that the purchaser reserved for itself was to select the course materials that best supported the course contact it undertook to provide in the delivery of its stated program objectives. Once it had exercised that discretion and entered into the contract with the students prior to the commencement of the program it had no option but to provide these course materials.

Accordingly, the Court found that the purchaser was contractually obligated to do so as part of the agreement entered into with each student and, as a result, the receiver was correct in refusing to return those books that were in its possession but that had not yet been distributed to the students. These goods were subject to an agreement for sale at arm's length, and consequently the supplier was not entitled to relief under section 81.1 of the BIA.

D. Liability of Trustees and Receivers

Where a trustee or receiver sells goods after having received a proper demand for repossession, personal liability can be incurred and damages would be assessed in terms of the value of the goods or proceeds obtained from the sale of same. If the debtor is bankrupt, the supplier may also resort to section 37 (application by an aggrieved creditor) or section 215 (action against trustee with leave). Presumably, when money damages are sought, an action under section 215 is the preferable proceeding.

E. What Does The Future Hold?

At present, the BIA is undergoing its statutorily mandated five (5) year review process. Various working groups have been struck and the lobbying from various interest groups is in full swing. There are those commentators who are pushing for the repeal of section 81.1 and others who want to extend the thirty (30) day time period to forty-five (45) to sixty (60) days. Only time will tell the future of a supplier's right to revendicate, but given the less than successful application of the revendication provisions thus far, it is a good bet that the section will not be left unamended.

F. Conclusion

In summary, it is fair to state that section 81.1 has not had as significant an impact in insolvencies as had been anticipated when the legislation was first passed.

One reason for this is the virtual exclusion of the remedy in the event of reorganization proceedings. The suspension of the thirty (30) day time period during BIA proposal stays and the inapplicability of the same under CCAA proceedings is of little comfort to suppliers who see their goods being dealt with in the ordinary course of the insolvent purchaser's business, certain in the knowledge that by the time the stay is lifted, such goods will almost certainly have been consumed or sold to a third party.

A second, more subtle but perhaps more important reason stems from the fact that a supplier will normally have much less than a thirty (30) day period extending from delivery of goods to put

forward an effective claim. While insolvency practitioners loosely refer to the thirty (30) day goods section, this presupposes delivery the day of bankruptcy or receivership. If delivery occurred three weeks before bankruptcy or receivership, a supplier is dealing with nine (9) day goods if it is going to make an effective claim.

Indeed, for the window of opportunity to extend to even nine (9) days, one must presuppose instantaneous knowledge on the part of a supplier of the fact of a bankruptcy or receivership. This, of course, does not accord with reality. Occasionally, a supplier will receive extremely prompt notice of an insolvency from the debtor or otherwise. In many, if not most, instances, however, a supplier will not have notice of a bankruptcy until receiving notice of the first meeting of creditors of the bankrupt. This must be mailed within five (5) days of the trustee's appointment (assuming no extension). Having regard of the time between posting and mail delivery, there would usually be a period of seven (7) to ten (10) days between the bankruptcy and receipt of notice of the same by the supplier.

In the case of a receiver appointed pursuant to section 243(2) of the BIA, the supplier is even less fortunate. In that case, the receiver has ten (10) days to send notice of the appointment to the creditors of the insolvent person of which the receiver is aware. When coupled with the delay associated with the mailing of the notice, a time frame of twelve (12) to fifteen (15) days would not be uncommon from the date the receiver is appointed to the date the supplier became aware of the appointment.

The essential truth is that, in most cases, the right of most suppliers to reclaim thirty (30) day goods in event of an insolvency is more conceptual than real.⁶

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⁶ In the *Thompsons Consumer Electronics Canada* case, Farley J. comments that “[t]he functionality of section 81.1... has been otherwise questioned; one wonders if it present an illusory hope to suppliers.”