

## Dealing with Insolvent Customers

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Doing business with customers who are insolvent can be dangerous for a supplier who delivers goods on credit. Fortunately, there are steps that can be taken to reduce this risk, without jeopardizing the supplier/customer relationship.

When an insolvent company defaults on payments to creditors, there are typically three routes to be taken: restructuring, receivership, or bankruptcy.

### Restructuring

If the company has sufficient creditor support and the cash-flow wherewithal, it may try to restructure its debt under the *Bankruptcy and Insolvency Act* or the *Companies Creditors' Arrangement Act* (the latter only if debt is over \$5 million). Both of these Acts give the company some breathing room for a specific period within which it must come up with a plan of compromise and propose that plan to its creditors for approval. Typically, a small to medium-sized business will be granted a 6-month window to prepare and present the plan.

During that time, the debtor company continues to operate but has the benefit of a protective shield from creditors, called a stay of proceedings (the "Stay"). The Stay prevents creditors from taking any proceedings against the company until either the creditors have voted on the proposal, or a court orders that the Stay be lifted to allow for a bankruptcy order.

Creditors may register liens in the face of the Stay, however, they may not take steps to enforce their lien rights. The Stay prevents creditors, even those who have already obtained a judgment, from taking enforcement proceedings. The debt becomes a claim provable. To be paid on that claim, the creditor must follow the claims process by submitting the required forms to a designated trustee. There are only a few exceptions to the Stay, such as the 30-day goods rule (discussed below).

The Stay also prevents those parties in a contract with the insolvent company from

terminating or accelerating payment by reason only of the insolvency proceedings. The Stay only affects debts incurred prior to filing for restructuring. The insolvent company must make all future payments, otherwise the supplier may terminate based on the post-filing defaults. If goods are supplied to the insolvent customer on lease or consignment, the supplier is entitled to seize its property should the customer default after filing for restructuring.

In the case of long-term supply contracts, if there has been no prior default, the Court can enforce the contract by causing the supplier to uphold its end of the agreement, despite a provision in the contract that states otherwise. So long as post-filing payments are kept current, a supplier must continue to supply those goods pursuant to the contract. However, suppliers not under a contract are under no obligation to extend additional credit and can demand C.O.D. terms.

### Receivership

When a viable business is experiencing temporary problems for some non-fundamental reason, its lender may opt to obtain a receivership order, so the business can be offered for sale as a going concern. A Stay is imposed in the same way as if the company were restructuring.

### Bankruptcy

If there is no hope of a successful restructuring, the lender might choose to petition the business into bankruptcy or, the business might make a voluntary assignment into bankruptcy. Similar to the Stay in a restructuring scenario, creditors can take no action against the bankrupt company (subject to the 30-day goods rule). However, this stay only applies to unsecured creditors. Secured creditors' enforcement remedies against the collateral continue to be governed by non-bankruptcy law principles such as mortgage foreclosure law and personal property security law.

Unsecured creditors must submit a claim to the trustee and will receive their proportionate share of the assets available to unsecured creditors. A secured creditor will typically only submit a claim if the value of the collateral is insufficient to satisfy the debt.

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In all of these scenarios, a supplier's ability to collect money or recover its property is severely limited. Extra precaution should be taken when supplying goods to a restructuring company or a company in receivership, especially if switching to C.O.D. terms is not possible. The best protection is to be proactive. Use a conditional sales agreement, register builder's liens whenever possible, and be alert to the possibility of using the 30-day goods rule.

### 30-Day Goods Rule

If a supplier delivers goods to a customer who later becomes bankrupt, the supplier may repossess those goods that were delivered within 30 days of the customer entering bankruptcy, provided the goods are repossessed within 15 days after the bankruptcy.

The goods must still be in the same state as they were on delivery and not have been transferred to a bona fide subsequent purchaser. The supplier must first issue a written demand for the return of the goods to the trustee. The rule only applies to goods, not services.

Beware of savvy customers wanting to take advantage of the 30-day limitation - they will pay for goods recently shipped but delay paying for goods delivered some time ago in order for the 30-day window to lapse on those prior delivered goods. Doing so allows the customer to build up inventory right before bankruptcy and then hide behind the Stay.

### Builders Liens

Suppliers of construction materials or services can protect themselves by registering a builder's lien within 45 days of furnishing the last of the materials or services (90 days when supplying an oil or gas well site). This gives the supplier a secured interest in the land upon which the materials or services were supplied.

### Security Agreements

If a customer orders substantially large quantities on a regular basis, consider entering into a secured credit agreement. This allows the supplier to set credit terms and register a security interest as a secured creditor. For large individual orders that must be delivered on credit, consider using a conditional sales contract, which can likewise be registered and create a security interest in the goods.

Field can assist your business in setting up a template security agreement or conditional sales contract to be used for such orders. The relatively small cost of implementing such a purchasing contract might well pay for itself if it facilitates the collection of just one otherwise bad debt.

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