

The 30-day goods law: Does it really help suppliers?

Management issue paper

Why these rules, despite their good intentions, fail to deliver

While suppliers are supposed to be granted some relief and protection under the Bankruptcy and Insolvency Act, in reality the rules are restrictive and of limited practical use.

By giving suppliers the right to repossess their most recent shipments, the so-called "30-day goods rules" are intended to prevent them from being penalized when insolvent debtors intentionally bulked up their inventories to maximize the assets available to secured lenders. Unfortunately, taking advantage of this provision is difficult.

How the rules work

Before suppliers can repossess their goods, the purchaser (that is, the debtor company) must already be in bankruptcy or receivership. Suppliers are then required to submit, within 30 calendar days of delivery, a notice of claim in writing (BIA Form 63.1) to those responsible for applying the rules, the debtor company's bankruptcy trustee or receiver.

The goods, to be eligible for repossession, must:

- Be used in relation to the purchaser's business and be in the purchaser's, trustee's or receiver's possession

- Not have been paid for in full by the purchaser
- Be in the same state they were in when the supplier delivered them and clearly marked as originating from the supplier
- Not have been resold or made subject to any arm's-length sales agreement

Suppliers, after being notified in writing by the trustee or receiver of the validity of their claim, have 10 days to remove the goods, at their own expense, or lose their repossession rights.

Timing is everything

Although the legislation might appear to provide the relief necessary to counteract the type of abuse suppliers regularly face from insolvent customers, practical impediments remain:

- Suppliers must be notified of the bankruptcy or receivership if they are to act within the prescribed time
- Trustees must issue notices to all known creditors within five days of a bankruptcy
- Receivers must send notices no later than 10 days following a receivership

Unless suppliers have the good fortune to learn of the insolvency on their own, the 30-day period is bound to have eroded by the

time these notices reach them. Once notified, they must act quickly to file the proper notice of claim and all necessary supporting documentation. What's more, before doing so, they must make certain they have delivered the goods within the 30-day period.

The problem is, the date the bankruptcy or receivership occurred is relevant only in triggering the rights of unpaid suppliers; it has no bearing on measuring the start or end of the 30-day period. That period is measured from the date the supplies were delivered to the date on which the supplier filed its notice of claim.

Suppliers are effectively granted a limited security interest pertaining only to the goods they delivered. That right does not extend to other goods or assets in the debtor company's possession should their own have been sold or used. In other words, they cannot lay claim to other goods or assets in lieu of those they supplied.

Proving the goods are yours

To support their repossession claim, suppliers must include invoice and serial numbers or other proof of identification. This can be a challenge if, say, several shipments of identical items were made around the 30-day cutoff point. Unless invoices or delivery slips clearly delineate the goods delivered within that period, suppliers may be at a loss to prove their claim.

The good news is, a recent decision of the Alberta Court of Appeal, in *Royal Bank v. Stereo People of Canada Ltd.*, concluded that a supplier's repossession claim isn't invalidated by failing to provide complete identification particulars at the time of making the demand. While such details should be provided as soon as possible, "It is

not reasonable," said the court, "to require that complete verification be provided with the claim."

Are the goods in their original state?

That the goods be "in the same state as when delivered" means they cannot have been processed in any way.

Simply unpacking or removing the goods from their shipping pallets doesn't generally change anything. If, however, they are used in a production process or have had any value added to them — say they're liquids that have been mixed in tanks with previous shipments — suppliers will lose out on their claim.

Trustees and receivers are strictly bound to act in a commercially reasonable manner. As a result, they're unlikely to process or sell goods with the intention of defeating a supplier's repossession claim. When advised of a claim, or its imminent receipt, they must identify and segregate, to the degree possible, the claimable items.

What if the debtor proposes to reorganize?

A disappointing aspect of the 30-day rules is that they have no practical application in commercial reorganizations — be it under a BIA proposal or, for that matter, a Companies' Creditors Arrangement Act (CCAA) plan of arrangement. Yet these are now among the most common bankruptcy protection and reorganization avenues taken by insolvent debtors.

Filing a proposal or notice of intention under the BIA not only provides the debtor with a stay of proceedings but also suspends the 30-day repossession period, effectively

preventing unpaid suppliers from acting. Meanwhile the debtor can, in the normal course of business, continue to process or sell the goods. The 30-day period recommences only if the proposal fails and bankruptcy ensues.

CCAA reorganizations also provide no comfort to unpaid suppliers. Consider the case of Woodward's Stores Ltd., which chose to reorganize under the CCAA rather than the BIA. Mr. Justice Tysoe determined that the unpaid suppliers were not prejudiced as a result and therefore decided not to grant them any special rights. This despite the fact that Woodward's had apparently bulked up its inventories by more than \$30 million before filing for bankruptcy protection.

So, what's the bottom line?

While the BIA doesn't actually deny suppliers their rights of repossession, those rights are of little value since, in practice, the 30-day goods rules are nearly impossible to comply with.

The rules have had a measure of success for suppliers, generally wholesale distributors and some retailers, whose inventories have remained intact and unprocessed in a debtor's warehouse or retail store for a period of time following delivery.

However, in cases involving manufacturing companies, or those where supplies are purchased only as required, the rules have proved to be of little or no benefit.

Because the requirements to establish a valid claim for repossession are quite restrictive and so many insolvency cases involve some attempt at reorganization, the reality is that unpaid suppliers rarely succeed in pursuing repossession claims.

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