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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

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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 Business Law Department, Steven Jeffery at 416.593.3939 or sjeffery@blaney.com.

SUPPLIERS CAN TAKE STEPS TO ENSURE THEY GET PAID

S. Steve Popoff

The fragile economy is generating deep angst among suppliers of goods and services whose cash-strapped customers and clients are stretching out bill payments in a major way, prompting the dread questions of when, if ever, and how much, if at all, they will get paid.

Suppliers are typically unsecured creditors – at the bottom of the food chain, the most at risk, the ones who usually do not get a penny in any insolvency proceeding. Typical supply contracts and credit agreements do nothing to advance their lot. In addition, they usually have no bargaining power, no "hammer" to back up demands for payment.

Having said that, there are measures that suppliers can take to become secured creditors and ensure that their invoices will get higher priority. These measures are easier to implement than most people think and merit the consideration of all suppliers. Here are four:

CREDIT AGREEMENTS

Suppliers, when they are supplying customers or clients, will typically ask for a credit application. Transforming this into a form of credit agreement can be helpful. Also, information gleaned from this sort of document (e.g. information on affiliates, financial statements and principals of companies or business entities) can be very helpful.

A credit agreement should be prepared when a supplier first enters into relations with a client or customer. Not only will this form of agreement typically provide for obtaining information regarding creditworthiness, but it can also provide banking information which can be helpful in garnishment proceedings should future court action become necessary.

What I typically recommend in a credit agreement is a clause dealing with reservation of title until payment is made in full. (In other words, when you sell a product, title is only transferred when it is paid for.) Although there may be technicalities involved in this kind of approach, it can be most helpful.

Another typical credit agreement provision to consider is some form of grant of security interest. This can be in the form of a very short paragraph, or even a few sentences, that will give a supplier in most provinces the ability to register under personal property security legislation. [In Ontario, the relevant statute is the *Personal Property Security Act* (Ontario)]. Registration can be done either immediately or later if a customer becomes more of a credit risk.

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"Sometimes, more technical and fulsome agreements are called for, as in the case, for example, of a customer or client on shaky ground or with a fairly spotty credit history."

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Merely having this kind of agreement can elevate a supplier from the lowly status of unsecured creditor to the lofty heights of a secured creditor.

Sometimes, more technical and fulsome agreements are called for, as in the case, for example, of a customer or client on shaky ground or with a fairly spotty credit history. Sometimes it may be prudent to prepare a security package that would contain a general security agreement and/or a purchase money security agreement.

A purchase money security interest is a statutory security interest available in most provinces. Essentially, it is a super-priority interest available to parties who have sold and/or financed product (inventory or equipment) in respect of a certain customer or client. Subject to certain formalities such as notifying prior registered creditors, notwithstanding the time and date of registration, the supplier of a product or of credit can rank ahead of all other creditors in connection with that product. This is a very useful form of security that should be used more often than it is at present.

SUPPLY AGREEMENTS

Ensuring that a supply agreement is in place also can be very helpful, as it can contain a number of provisions that are recommended for credit agreements. However, codifying the terms of a supply agreement (or terms and conditions of supply on, for instance, purchase orders) can also be helpful in a number of other respects. It can reduce uncertainty in respect of a number of situations that I have seen. For instance, there can sometimes be a "battle of the forms" between purchase orders from clients and invoices and other documents from suppliers.

Setting out in a supply agreement the fact that no other terms will override the terms of a supply agreement can be helpful. Also, given the events of the past few years, one recommendation that I typically make to clients is to ensure that the supply agreement contains an expanded *force majeure* clause. (This is the riot, war, flood and disaster clause typically contained in agreements.)

The problem with the typical *force majeure* clause is that it does not relieve parties from merely economic hardship. Therefore, if the cost of a particular raw material increases, a typical *force majeure* clause does not operate to relieve a supplier from its obligations. A more expanded clause can do this. This is nothing to be sneezed at, particularly given the drastic increases in utility costs in the recent past. (You may recall a number of situations where entire manufacturing plants were closed on the west coast because of drastic increases in electricity prices. Consider the hardship on the owners of those plants if they were forced to continue supplying customers at prices that could not be adjusted for unforeseen increases in input costs.)

SECURITY AGREEMENTS

As I mentioned earlier under Credit Agreements, separate security agreements can be entered into with clients and customers. These agreements can be quite handy in that they can provide for expanded default provisions. These can include many items such as default under other agreements with suppliers and events that may cause a supplier to become

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"insecure" (e.g. bad press, uncollectable receivables, and many other conceivable default items).

These forms of security agreements can also be fairly helpful in that there can be a number of expanded remedies in them which could include self-help remedies and remedies of appointing a receiver to run the business and ensure that a particular supplier (along with others) is paid.

GUARANTEES

As I mentioned earlier under Credit Agreements, obtaining information about a business entity to which you are supplying goods and services is a very good idea. Once you have obtained this information, you should also consider whether or not there is a possibility of obtaining guarantees from either the principals or from other corporations or entities in the corporate group.

These forms of guarantee can be very helpful. If a particular company in the United States, for example, files for protection, this does not necessarily mean that all of its affiliates will do the same in other jurisdictions. Conversely, it does not necessarily mean that a U.S. guarantor will file where a particular Canadian company in its corporate group has filed. The same applies for principals of a closely held company.

If possible, it is always a good idea to obtain some form of guarantee of the obligations of a customer or a client. Obviously, however, there are certain business realities involved in this and bargaining power will dictate whether or not obtaining guarantees is possible.

One thing to note is that if guarantees are obtained, they can also be secured, and this is quite helpful. Security need not only take the form of registrations under personal property legislation but can also involve such things as debentures, collateral mortgages and the like. (This, obviously, is not typical supplier security.)

CONCLUSION

There are a number of technicalities involved in becoming a secured creditor. As I suggested earlier, however, it is actually easier than most people think and something that everyone that supplies goods and services should consider.

Whether it involves just the preparation of a credit agreement and not registering any security, or it involves formal security package preparation (including guarantees), considering the points addressed in this article can help to ensure payment. ■

TAX DEBTS – YOU'RE NOT OFF THE HOOK, YET!

Paul L. Schnier

Many people must have been feeling joyous recently as they read the excited newspaper accounts of the Supreme Court of Canada decision in the Markevich case.

In that decision, the Court told the Canada Customs and Revenue Agency (CCRA) that it was too late to collect on a tax debt of some $770,000. Taxpayers likely rubbed their hands with glee as the commentators promptly predicted that this could cost the federal treasury billions.

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Our advice? Not so fast. It is not that we want to rain on anybody's parade, but the decision arises out of a very narrow set of circumstances that might not be found in all that many cases.

Mr. Markevich, a resident of British Columbia, was assessed in June of 1986 for a federal and provincial tax liability of approximately $234,000 arising from a series of assessments and unpaid taxes in respect of his 1980 - 1985 taxation years.

Mr. Markevich did not challenge this assessment and paid nothing on the outstanding amount. The debt was written off internally by the CCRA but was not extinguished or forgiven. From 1987 to 1997, the CCRA made no effort to collect the debt and statements issued to Mr. Markevich during that period did not reflect the 1986 balance. It was not until January of 1998 that the CCRA, for the first time during this period, sent a statement of account to Mr. Markevich that indicated a balance of approximately $770,000 (the amount owing as of June 1986 plus accrued interest).

Sifting through all of the arguments pro and con, the Supreme Court of Canada ruled that the *Crown Liability and Proceedings Act* as well as provincial statutes of limitations apply to the collection of tax debts. (In British Columbia, the limitation period is six years.) The Court therefore held that the Markevitch debt was essentially extinguished because of a lack of enforcement.

The Court's "bottom line" appears to be that, at a point in time, people may reasonably come to expect that they will not be called upon to account for a liability (including a tax debt) and may conduct their affairs in reliance on that expectation. The limitation periods vary in other provinces.

Before everybody jumps for joy at the prospect of not having to pay tax debts, it is important to remember that the circumstances of the Markevich case are highly unusual. Many people are aware of situations where an assessment has been made, a Notice of Objection has been filed and the CCRA has subsequently been silent for months or even years.

These are not situations in which the limitation period is running because the *Income Tax Act* prohibits any collection action before an appeal is resolved. Mr. Markevich did not dispute the debt. Nor did he appeal. This means that, in retrospect, the limitations clock started ticking at his June, 1986 reassessment.

It seems unlikely that there would be many situations in which an assessment is made, an objection is not filed, the bill is not paid, and the CCRA simply doesn't bother trying to collect – let alone for 12 years.

So don't spend that money just yet! ■

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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.

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