

RESTRUCTURING BULLETIN

February 2006

BC COURT EXPANDS RIGHTS OF UNPAID SUPPLIERS

In an apparent departure from the interpretations previously given to section 81.1 of the *Bankruptcy and Insolvency Act* ("BIA"), the British Columbia Court of Appeal held that commingled fungible goods may be "identifiable" for the purposes of repossession by an unpaid supplier. The decision in *Port Alice Specialty Cellulose Inc. Estate (Trustee of) v. ConocoPhillips Co.* creates uncertainty for ABLs and other lenders that lend on the security of inventory and may trigger a re-examination of borrowing base practices.

Conoco supplied four of five deliveries of fuel oil to a pulp mill operated by Port Alice. Following its bankruptcy, Conoco made a demand for repossession pursuant to section 81.1 of the BIA. That section allows a supplier to demand repossession of goods for which it has not been fully paid, within 30 days of the delivery, provided the goods are "identifiable". Since each delivery of fuel oil had been deposited in the same storage tank, the trustee in bankruptcy argued that oil delivered within the 30-day period was commingled with and could not be separated from oil deposited before that time. Relying on previous decisions, the trustee took the position that the oil remaining in the storage tank could not be identified as oil delivered within the statutorily prescribed period.

The Court of Appeal dismissed the trustee's appeal and held that fungible goods are not excluded from section 81.1 of the BIA. Rejecting what it referred to as an overly narrow or legalistic approach to the interpretation of section 81.1, the Court of Appeal agreed with the lower Court's conclusion that the intent of the section, to protect unpaid suppliers, would be denied if the section were not applicable to suppliers of fungible goods. The Court of Appeal approved of the chambers decision to allow Conoco to repossess a *pro rata* share of the oil in the storage tank, (i.e. the same proportion of the remaining fuel oil that the recently-delivered oil was to the total oil on the date of delivery) and rejected Conoco's argument that its entitlement to fuel oil should be determined by applying the "first in, first out" principle.

Prior cases decided in Ontario and Newfoundland adopted a more conservative definition of "identifiable". In *Re Stokes Building Supplies Ltd.* a supplier of windows was unable to identify which of the windows in the bankrupt's possession had been delivered within the 30-day period immediately preceding the demand for repossession. The Court stated that section 81.1 does not confer a broad discretion on the Court to make a general equitable adjustment between the parties and held that it could not allocate goods between the receiver and the supplier on the assumption that old stock was sold first. Similarly, in *Bruce Agra Foods Inc. v. Everfresh Beverages Inc. (Receiver of)* Justice Farley based his decision on other grounds but commented that the pumping of a shipment of concentrated orange juice into a continuing mixture destroyed the identifiable nature of the fungible good.

The *Port Alice* decision represents a departure from the interpretation of "identifiable" goods adopted by the Ontario and Newfoundland Courts. Financial institutions that lend against fungible inventory should be aware of this broader approach both at the origination and workout stages of a loan. Trustees in bankruptcy and court appointed receivers should also be aware of the decision and resulting uncertainty which may give rise to disputes between secured creditors and unsecured suppliers.

Written by Adam Maerov and Melissa McBean, Student-at-Law

For further information, please contact one of the McMillan Binch Mendelsohn restructuring lawyers listed below:

Patrice Beaudin	514.987.5006	patrice.beaudin@mcmbm.com
Lisa Brost	416.865.7186	lisa.brost@mcmbm.com
Hilary E. Clarke	416.865.7286	hilary.clarke@mcmbm.com
Jeffrey B. Gollob	416.865.7206	jeff.gollob@mcmbm.com
Andrew J.F. Kent	416.865.7160	andrew.kent@mcmbm.com
Lisa H. Kerbel Caplan	416.865.7803	lisa.kerbel.caplan@mcmbm.com
Daniel V. MacDonald	416.865.7169	dan.macdonald@mcmbm.com
Paul G. Macdonald	416.865.7167	paul.macdonald@mcmbm.com
Adam Maerov	416.865.7285	adam.maerov@mcmbm.com
Alex L. MacFarlane	416.865.7879	alex.macfarlane@mcmbm.com
Kathy Martin	416.865.7889	kathy.martin@mcmbm.com
Max Mendelsohn	514.987.5042	max.mendelsohn@mcmbm.com
Marc-André Morin	514.987.5082	marc-andre.morin@mcmbm.com
Julie Normand	514.987.5012	julie.normand@mcmbm.com
Wael Rostom	416.865.7790	wael.rostom@mcmbm.com
Nicholas Scheib	514.987.5091	nicholas.scheib@mcmbm.com
Martin Scheim	514.987.5039	martin.scheim@mcmbm.com
Éric Vallières	514.987.5068	eric.vallieres@mcmbm.com
Tushara Weerasooriya	416.865.7262	tushara.weerasooriya@mcmbm.com

MCMILLAN BINCH MENDELSON

TORONTO | TEL: 416.865.7000 | FAX: 416.865.7048

MONTRÉAL | TEL: 514.987.5000 | FAX: 514.987.1213

www.mcmbm.com