

## BANKRUPTCY, RESTRUCTURING & CREDITORS' RIGHTS

### CRITICAL SUPPLIER'S HARD-BALL QUEUE JUMPING PAYS OFF – IN RE NORTHSTAR AEROSPACE

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#### Overview

In Canada, foreign critical suppliers may be able to extract payment, in full, for amounts owed to them by a debtor company in a CCAA filing, by virtue of their location in a foreign country and the critical nature of the goods or services that they supply.

#### Critical Supplier Background

In 2009, the *Companies' Creditors Arrangement Act* "CCAA" was amended, and the concept of a "critical supplier" was codified. According to s. 11.4 of the CCAA, a critical supplier is a supplier whose goods or services are critical to the continued operation of the debtor company (the "Debtor"). Though all suppliers are necessary for the proper functioning of a Debtor's business, not all suppliers are critical, and while the determination of whether a supplier is critical depends on the business needs of the Debtor, factors that are considered by the court include:

1. whether the goods and services are integral to the business of the Debtor;
2. the Debtor's dependency on the uninterrupted supply of the goods or services;
3. whether the Debtor has a sufficient inventory of the goods on hand; and
4. the effect on the Debtor's operations and ability to restructure if they are unable to make pre-filing payments to their critical suppliers.

The consent of the monitor is also taken into account when determining whether a supplier is a critical supplier.

When a supplier is declared a critical supplier by the court, payments may be made to the critical supplier for amounts it was owed prior to the CCAA filing. The willing critical supplier may be paid for all or a part of the amount that it was owed, or may not be paid for those outstanding amounts at all.

If the critical supplier refuses to supply the Debtor, the court may order the critical supplier to supply goods or services to the company. If the court makes such an order, requiring the supply either on the same terms as were offered to the Debtor prior to the CCAA filing or on terms determined by the court, then a charge over the property of the Debtor is granted in favour of the critical supplier. This charge only covers the amount which is expected to be incurred after the CCAA filing. This critical supplier charge ranks in priority to the interests of secured creditors, and as such, secured creditors must be given notice and an opportunity to object before the court orders such a charge. In

practice, the designation of such critical suppliers can lessen the need for debtor in possession ("DIP") financing, since the proceeds of a DIP loan tend to be used, at least in part, to pay such suppliers so that the business may continue to operate.

#### Re Northstar Aerospace Inc.

Recently, in *Re Northstar Aerospace Inc.*, 2012 CarswellOnt 9721. ("Northstar"), the court found that ordering a critical supplier to continue to supply may not be sufficient to allow the Debtor to continue to operate its business. Northstar manufactures, among other products, gearboxes. Northstar was being sold as a going concern to a third party and this sale was closing imminently. A Chinese supplier ("Changsha") was the exclusive supplier of gears to Northstar. Without these gears, Northstar's ability to manufacture gearboxes would be compromised and it would not have been able to provide gearboxes to its customers. In addition, it would have taken approximately one year to find an alternative source for these gears, due to their specialized nature. If manufacturing were to be halted due to a lack of gears, there was a significant chance that the sale transaction would not close. There is no doubt that Changsha was a critical supplier.

Changsha refused to provide any more gears to Northstar, in contravention of the court order requiring it to do so, and regardless of the charge that it was granted over the property of Northstar. Changsha required payment of the entire amount it was owed prior to the CCAA filing. The court recognized that the court's order could not be enforced against Changsha in a timely manner in China before the sale transaction was supposed to close. While recognizing that it was "rewarding improper conduct" and "countenancing a form of hard-ball queue jumping," the court ordered that Changsha be paid immediately. No secured creditors objected to this payment, as they were interested in having the sale transaction close quickly.

#### Consequences to Consider

Foreign critical suppliers located in countries in which it is difficult to enforce Canadian judgments have an advantage in this process. A critical supplier that is located in such a country should consider its ability to force the Debtor to pay, in full, pre-CCAA filing debts. While a charge over the property of the Debtor is a useful remedy for a foreign supplier, it only covers post-filing amounts owed; full payment is obviously preferable. It remains to be seen whether payment in full would be ordered over the objection of secured creditors.

Foreign suppliers located in jurisdictions in which it is not difficult to enforce Canadian judgments should be loath to use this strategy, and it should not be attempted by domestic suppliers.

Secured creditors should consider the location of critical suppliers, and should be aware that in this type of time-sensitive situation, foreign critical suppliers may require full payment for amounts incurred prior to a CCAA filing before continuing to supply Debtors in CCAA proceedings.

FOR MORE INFORMATION, PLEASE CONTACT:



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