

CANADA / JUDGMENT

Soccer Express Trading Corp. (Re)

2020 BCSC 749

COURT

Supreme Court of British Columbia

DECIDED

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2020 BCSC 749 Soccer Express Trading Corp. (Re)

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Soccer Express Trading Corp. (Re),

2020 BCSC 749

Date: 20200512

Docket: S204288

Registry: Vancouver

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

- AND -

IN THE MATTER OF THE BUSINESS CORPORATIONS ACT, S.B.C. 2002, c. 57, AS AMENDED

- AND -

IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985, c. C-44, AS AMENDED

- AND -

IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT OF SOCCER EXPRESS TRADING CORP. AND KAHUNAVERSE SPORTS GROUP INC.

Petitioners

Before: The Honourable Madam Justice Fitzpatrick

Oral Reasons for Judgment

Counsel for Petitioners, Soccer Express Trading Corp. and Kahunaverse Sports Group Inc.:

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Place and Date of Hearing:

Vancouver, B.C.

May 8, 2020

Place and Date of Judgment:

Vancouver, B.C.

May 12, 2020

Introduction

- [1] This is a comeback hearing arising from my earlier granting of an initial order on April 30, 2020 pursuant to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the "CCAA") in favour of the petitioners, Soccer Express Trading Corp. ("SX") and Kahunaverse Sports Group Inc. ("KSG"), (collectively, the "Petitioners").
- [2] The significant issue to be addressed is the Petitioners' request for a declaration of critical supplier with respect to one of their major suppliers, adidas Canada Limited ("adidas"), and that adidas be granted a charge for the supply of its goods (the "Critical Supplier Charge").

Procedural History

- [3] On March 11, 2020, the Petitioners filed notices of intention (NOIs) to make a proposal pursuant to the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (the "BIA"). PricewaterhouseCoopers Inc. ("PwC") was appointed as the proposal trustee.
- [4] The NOI filings arose against the backdrop of the Petitioners facing increasing financial challenges, reaching back to early 2019.
- [5] In late 2019, before the NOI filings, the Petitioners entered into a share purchase agreement (the "SPA") with Greyrock Capital Incorporated ("Greyrock") to address continuing liquidity issues. The SPA has not yet closed; it remains subject to a number of conditions.
- [6] The NOI filings were intended to allow the Petitioners to secure interim financing during a restructuring, with the Petitioners intending to present a proposal to their creditors which would allow the sale to Greyrock to close and the continuation of business operations. Since mid-March 2020, generally speaking, the Petitioners have secured the cooperation of their vendors and suppliers of product toward that end.
- [7] The spread of the COVID-19 pandemic across Canada has, not surprisingly, affected the Petitioners, as with most other businesses. Needless to say, the effects of the pandemic, including store closures and staff layoffs, created more uncertainty within the Petitioners' restructuring proceedings.
- [8] Despite these challenges, the NOI proceedings continued with some progress and success. A major issue arose, however, with adidas. As I will discuss in more detail below, adidas' position with respect to the Petitioners was seen as threatening the potential success of the restructuring proceedings.
- [9] On March 30, 2020, Justice Myers granted orders in the BIA proceedings extending the stay period to May 25, 2020, approving an administrative charge and authorizing an interim financing facility with Greyrock of \$1.4 million (the "BIA Orders").
- [10] On April 16, 2020, Aegis Advisory Incorporated ("Aegis") was appointed as Chief Restructuring Officer (CRO) of the Petitioners. Aegis' president, Jeff Johnson, a licensed insolvency trustee, is acting as CRO.
- [11] On April 28, 2020, the Petitioners commenced these proceedings, seeking relief under the CCAA. In large part, the Petitioners considered that the CCAA afforded them broader relief than that obtainable under the BIA, principally in respect of adidas. That broader relief included the possibility of obtaining a declaration that adidas was a critical supplier and that adidas be ordered to continue to supply product to the Petitioners.

- [12] On April 30, 2020, I granted an order continuing the BIA proceedings under the CCAA, in accordance with the CCAA, s. 11.6(a) (the "Initial Order"). I was satisfied that the statutory requirements had been met (including that no BIA proposals had been filed) and that the continuation of the BIA proceedings under the CCAA was consistent with the purposes of the CCAA: *Clothing for Modern Times Ltd. (Re)*, 2011 ONSC 7522 at para. 9.
- [13] In the Initial Order, I continued the relief granted by Myers J. in the BIA Orders, including granting an Administration Charge of \$200,000 (increased from \$150,000) and approving the Interim Lender's Charge in favour of Greyrock.
- [14] I also extended the stay for only a short period to May 8, 2020, in accordance with the CCAA, s. 11.02(1). In addition, over the objection of adidas, I was satisfied that the Petitioners were entitled to temporary and interim relief from April 30, 2020 until the comeback hearing with respect to adidas, as necessary for their continued operations: CCAA, s. 11.001. That relief included a declaration of critical supplier with respect to adidas and an order that adidas continue to supply the Petitioners during that period, but on a cash-on-delivery (COD) basis.
- [15] Evidence on the application for the Initial Order included Mr. Johnson's Affidavits #1 and #2, both sworn on April 28, 2020. In addition, I had the benefit of PwC's Proposed Monitor's Pre-Filing Report dated April 28, 2020, which included PwC's Proposal Trustee's First Report dated March 27, 2020 which was prepared in support of the hearing before Myers J.
- [16] The May 8, 2020 hearing was the comeback hearing. The Petitioners seek an Amended and Restated Initial Order (ARIO) that:
- a) Amends and restates the Initial Order;
 - b) Extends the stay of proceedings to July 31, 2020;
 - c) Declares that adidas is a critical supplier to the Petitioners and orders that adidas continue to supply goods and services to the Petitioners on the terms and conditions that are consistent with the existing arrangements, including but not limited to the 2020 Trade Investment Package - adidas Brand (the "adidas Trade Agreement"), as may be amended by the terms and conditions set out in the ARIO;
 - d) Orders adidas to:
 - i. Maintain KSG/SX as vendors on the MiTeam system to allow MiTeam orders to be processed;
 - ii. Provide access to KSG/SX and their representatives to the B2B system;
 - iii. Permit the Petitioners, their representatives and their customers uninterrupted access to the MiTeam and B2B system;
 - iv. Honour all negotiated net price items in accordance with the supply relationship;
 - v. Honour all customer activation discounts in accordance with the supply relationship; and

vi. Process all purchase orders in a timely manner without delay consistent with the supply relationship.

- e) Grants adidas a charge on the Petitioners' property in an amount equal to the value of the goods and services supplied by adidas and received by the Petitioners; and
- f) Approves the terms of an amended commitment letter between the Petitioners and Greyrock for a credit facility in the maximum amount of \$2.8 million and increases the Interim Lender's Charge to that amount.

[17] In addition, the Petitioners seek approval to implement a claims process.

[18] With the exception of adidas, no person objects to the granting of the relief sought. Adidas remains significantly opposed, although that opposition is limited to the relief sought under the CCAA critical supplier provisions, whether as proposed by the Petitioners or otherwise.

[19] All of the relief sought is supported by Greyrock and the Monitor.

Background of the Petitioners

[20] KSG is in the business of selling multi-brand sporting equipment, apparel and accessories to individuals, institutions and sports teams. It has a wide range of product offerings. KSG is headquartered in Surrey, BC. It has five retail locations across Canada and has an e-commerce platform. It employed approximately 90 employees across Canada prior to recent layoffs due to a decision to close its retail stores as part of the efforts to address the COVID-19 pandemic.

[21] SX is a fully owned subsidiary of KSG. SX specializes in the business of selling multi-brand soccer related sports apparel and equipment to customers across Canada. It has a focus on servicing soccer clubs. SX is headquartered in Coquitlam, BC. It has a retail store in Coquitlam, called the "Superstore", and an e-commerce platform. It employed approximately 60 employees prior to recent layoffs due to the closure of the Superstore.

[22] Aside from intercompany balances, the Petitioners' combined assets include:

- a) Accounts receivable consisting primarily of trade receivables to be collected from sports teams, clubs and institutional customers for the sale of sports apparel, accessories and equipment;
- b) Inventory consisting of sporting goods such as apparel, shoes, accessories and equipment for sale from multiple brands. The inventory also includes team uniforms which have not yet been customized;
- c) Property consisting of equipment, furniture and leasehold improvements; and
- d) Intangibles consisting of goodwill.

- [23] The Petitioners' combined liabilities include approximately \$10.4 million owing to secured creditors. This includes approximately \$8.6 million of secured debt which has now been acquired by Greyrock. The pre-filing amount owed by the Petitioners to unsecured creditors is approximately \$15.5 million, including approximately \$8 million owed to vendors/suppliers.
- [24] Greyrock is also the holder of the Interim Lender's Charge approved in the BIA proceedings and continued in the Initial Order. As of May 2, 2020, approximately \$750,000 had been drawn under that facility.
- [25] One of the conditions under the SPA is that Greyrock would enter into satisfactory arrangements with the Petitioners' vendors and suppliers. This condition related not only to addressing current balances owing by the Petitioners (through proposals and now a plan of arrangement), but also ensuring future supply of goods and services.
- [26] With respect to the latter aspect of that condition, the Petitioners and Greyrock have been in contact with all key vendors and have been making arrangements for the continued supply of product. To date, the arrangements concluded have varied, and include COD purchases, providing retainers on account, in process arrangements for credit card purchases and letters of credit. In addition, the Petitioners have had ongoing discussions with vendors regarding their intention to settle pre-NOI obligations through the filing of formal proposals (and now a plan of arrangement in the CCAA proceedings).
- [27] The Petitioners' evidence is that, with the exception of adidas, vendors and suppliers have generally been supportive of continuing to do business with the Petitioners, even in the present circumstances. The Petitioners are of the view that their vendors and suppliers will be supportive of a proposal or plan to compromise the pre-filing debts as they will receive more through that process than in the event of a bankruptcy.

The adidas Relationship

- [28] In support of this application, I have had the benefit of reading the direct evidence of various representatives of the Petitioners and adidas. I have read John Prisco's Affidavit #1 sworn on May 7, 2020. He is the Vice President of KSG. I have also read Brad Leitch's Affidavit #1 sworn on May 7, 2020. He is the President of SX. Finally, I have read Chris Miall's Affidavits #1 and #2 sworn May 7 and 8, 2020 respectively. Mr. Miall is a Sales Director - Team and Soccer Specialty for adidas.
- [29] What is apparent from this evidence, particularly from Mr. Prisco and Mr. Leitch, is that the relationship between the Petitioners and adidas is significant and long standing. The business relationship between the Petitioners and adidas stretches back not in years, but in decades. I accept Mr. Leitch's evidence that the relationship with SX can be described as "intertwined" and Mr. Prisco's description of their supply relationship with adidas as "symbiotic".

- [30] Adidas is the largest vendor to the Petitioners by a large margin. Adidas supplies products to the Petitioners pursuant to the adidas Trade Agreement. The term of the adidas Trade Agreement expires on November 30, 2020.
- [31] An important aspect of the relationship between the Petitioners and adidas is what is referred to as "Team Sales". The Petitioners, in relation to the sale of product directly to institutional clients and clubs, enter into contracts with customers which include providing access to adidas product. These contracts will usually cover a multi-year period. For KSG, 2019 sales to customers under exclusive buy-sell agreements were approximately \$8 million to about 150 different customers. Of these sales, approximately \$2.7 million related to agreements that provided customers with access to adidas product. For SX, total sales to adidas institutional and contract clubs for the 2019 fiscal year were \$3.8 million, being approximately 40% of SX's total club sales of \$8.4 million.
- [32] In addition, an important aspect of the Team Sales programs is the ability of the Petitioners to source product from adidas by way of purchase orders, using access by the Petitioners and their customers to online services offered by adidas, known as the "MiTeam" and "business to business" or "B2B" platforms. Access by the Petitioners and their customers to these platforms is not addressed in the adidas Trade Agreement; however, it was and continues to be an important service provided by adidas and is an important aspect of the operation of the relationship in terms of the Petitioners and their customers accessing adidas product.
- [33] I acknowledge that issues between the Petitioners and adidas in their business relationship have arisen over the years, most recently arising from the Petitioners' financial challenges that began in 2019.
- [34] Mr. Miall describes that there were material defaults throughout the fall of 2019. Arising from those defaults, adidas began carefully monitoring the Petitioners' order of product to ensure payment was made. At times, the Petitioners' access to the online platforms were temporarily suspended by adidas until matters were regularized.
- [35] In late February 2020, given ongoing concerns, adidas requested that the Petitioners execute a General Security Agreement (GSA) in its favour. Adidas complains that instead, the NOI filings took place, and suggests that the Petitioners were acting inappropriately in holding off providing the GSA while ordering more product from adidas. At the time of the NOI filings, the Petitioners' combined debt owing to adidas was approximately \$1.89 million.
- [36] I see no merit in adidas' arguments in this respect. As Mr. Johnson and the Monitor confirm, the balances outstanding to adidas, while discussions concerning a GSA were underway, were in fact reduced over the period of the discussions by over \$430,000; they were not increased to the detriment of adidas. In addition, the Critical Supplier Charge now sought by the Petitioners is materially better than any such GSA, even assuming that such security would have withstood an attack that granting it on the eve of the NOIs was a preference that should be set aside.

- [37] The NOI filings certainly did not improve the relationship with adidas, despite immediate communications from the Petitioners to adidas to confirm that they wished to carry on business as normal, including with adidas.
- [38] In response to the NOI filings, adidas immediately deactivated the Petitioners' access to the MiTeam and B2B platforms. In addition, adidas continued to supply the Petitioners but it unilaterally decided not to process orders that provided for delivery after what adidas calculated would be a vote on a proposal (despite that no formal proposal had yet been filed). This action was arguably in violation of s. 65.1 of the BIA; however, the Petitioners sought to negotiate an amicable solution with adidas.
- [39] Subsequent to the NOI filings, the Petitioners made substantial efforts to discuss and negotiate a path forward with adidas. At that time, the Petitioners confirmed that all post-filings orders would be paid on a COD basis. The Petitioners and Greyrock had discussions with adidas in the hopes of coming to a long term supply arrangement beyond these CCAA proceedings, or alternatively, to at least confirm ongoing supply and payment terms to the end of the term of the adidas Trade Agreement on November 30, 2020.
- [40] Even so, the Petitioners and Greyrock were singularly unsuccessful in their efforts to secure adidas' cooperation; adidas made it crystal clear that it has no intention of continuing its supply relationship with the Petitioners, unless it is ordered to do so by the Court.
- [41] After the NOI proceedings were commenced and even now during the CCAA proceedings, adidas has advanced a number of allegations against the Petitioners, met to some extent by allegations by the Petitioners against adidas.
- [42] Adidas alleged that there were some post-NOI filings orders that were filled but remained unpaid. I understand that this was an oversight; when brought to the Petitioners' attention, those amounts were immediately paid.
- [43] Adidas also now alleges that the Petitioners are in breach of the adidas Trade Agreement by producing "knockoff" brands. However, adidas has been aware of that activity for some time and only very recently voiced objections, raising suspicions as to the veracity of such allegations.
- [44] The Petitioners allege that adidas has directly contacted some of their customers and attempted to harm their relationship with those customers for its own benefit. Adidas denies these allegations. In my view, it is not necessary to determine that issue on this application.
- [45] At present, the Petitioners have accepted adidas' position, as they must. They now have no choice but to source product from other vendors in terms of their ongoing operations. However, that process will take time and will not happen overnight, particularly given the depth of the current relationship with adidas and the historical supply of adidas products to their customers.

- [46] Given the state of their increasingly fractious relationship with adidas, the Petitioners were unable to process or fulfil customer orders for adidas product in the normal course of their business during the NOI proceedings. That circumstance in turn led to the commencement of these CCAA proceedings and the granting of the Initial Order on April 30, 2020.
- [47] On May 1, 2020, following the reinstatement of the Petitioners' access to the MiTeam and B2B platforms pursuant to the Initial Order, the Petitioners began working through open orders and advised adidas that they would be communicating with adidas on processing orders. The Petitioners proposed to adidas that they would advance a retainer to adidas of \$250,000 to be held against unpaid invoices. That proposal was presented to address the impracticality of paying COD on numerous invoices, some very small.
- [48] The Petitioners' proposed that, once open purchase orders are confirmed or new purchase orders submitted, adidas would ship and invoice in the usual manner. The Petitioners would then batch the invoices received by adidas at the end of each week and submit payment each Monday. The Petitioners did not believe that at any point in time the outstanding invoices would exceed \$250,000.
- [49] Adidas did not accept that this arrangement was sufficient to remove payment risk to it, given the amount of open purchase orders (then some \$1.8 million). Adidas advised that it required \$1 million in cash security, a demand that the Petitioners could not meet.
- [50] In the normal course of their supply relationship, the Petitioners work with adidas to finalize purchase orders for shipment based on reports made by adidas. Purchase orders are made up to six months in advance of shipment, and are open and subject to change during that period. The Petitioners communicate with customers and adidas throughout this period to finalize the open purchase orders based on current demand for and availability of product.
- [51] KSG expects to sell approximately \$2 million in adidas product between July 1 and December 31, 2020. This period is consistent with past years, as customers must make orders for product for the coming sports season that begins every September. These sales are effected by customers placing orders. To ensure the timely delivery of adidas product to the customers, the Petitioners must place these orders in the spring and early summer with adidas, otherwise orders will be backlogged, and delivery will not occur in time for the September sports season. If adidas does not immediately place these orders, KSG may lose any or all of the expected sales from orders throughout this period.
- [52] For 2020, KSG forecasts team sales of \$4 million; \$2 million represents team sales on contract; \$2 million represent other team sales and rebates. If adidas cuts off supply of adidas products to KSG, customers relying on rebates would lose \$192,000.
- [53] In the normal course of business, SX generates adidas purchase orders up to six months in advance of shipment to ensure that its customers will have access to the adidas product when required.

- [54] SX currently has \$1.5 million in open purchase orders with adidas which have been generated by SX to ensure that customers have product available for the fall sports season. From now until the fall, these orders remain open and subject to change. SX communicates with customers and adidas to finalize what products will actually be shipped based on the current demand for and availability of product. As this process is ongoing amongst the customers, adidas and SX, "batches" of adidas product are shipped to customers directly or to third party design companies over the period of time leading up to the fall sports seasons. At the point in time the orders are shipped, adidas issues an invoice for that particular batch of adidas goods and that invoice is paid by SX in the normal course.
- [55] Accordingly, the process of having "open purchase orders" with adidas is underway and is of fundamental importance to the Petitioners' ongoing business operations. That process involves an ongoing discussion between the Petitioners, their customers and adidas concerning the product to be shipped. Once the product is determined, the order is finalized. Once shipment occurs, adidas invoices the Petitioners for payment. Payment terms are as set out in the adidas Trade Agreement, typically net 30, 60 or 90 days.

Critical Supplier Issue

[56] The critical supplier provision in s. 11.4 of the CCAA provides:

- (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring a person to be a critical supplier to the company if the court is satisfied that the person is a supplier of goods or services to the company and that the goods or services that are supplied are critical to the company's continued operation.
- (2) If the court declares a person to be a critical supplier, the court may make an order requiring the person to supply any goods or services specified by the court to the company on any terms and conditions that are consistent with the supply relationship or that the court considers appropriate.
- (3) If the court makes an order under subsection (2), the court shall, in the order, declare that all or part of the property of the company is subject to a security or charge in favour of the person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order.
- (4) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

[57] Accordingly, the decision tree under s. 11.4 requires a number of steps:

- a) The court must determine if a person is a "supplier" and if the goods and services supplied by that person are "critical" to the debtor's continued operations. In that event, the court has the discretion to declare that person to be a "critical supplier" (s. 11.4(1));

- b) If a person is declared to be a "critical supplier", the court has the discretion to order the continued supply of goods and services on certain terms (s. 11.4(2)); and
 - c) If the court declares that a critical supplier must continue to supply specified goods or services, it is mandatory that the court also order security or a charge in favour of the supplier, although the court has the discretion to determine the priority of any security or charge (s. 11.4(3) and (4)).
- (1) Is adidas a "supplier" and are its goods and services "critical" to the Petitioners' continued operations?
- [58] Despite the difficult and acrimonious relationship that has arisen between the Petitioners and adidas, in deciding this issue, I have had the benefit of the independent evidence and analysis of both Mr. Johnson as CRO and PwC in its capacity as both Proposal Trustee and Monitor.
- [59] Adidas opposes any declaration that it is a "critical supplier". It takes the position that its products are not integral to the Petitioners' business and that the Petitioners are not dependent on the continued supply of those products to remain in operation. This position by adidas is, however, untethered to any evidence and in fact, is contradicted by the evidence.
- [60] The numbers, as confirmed by Mr. Johnson and the Monitor, clearly support that adidas is the largest supplier of product for the Petitioners' business:
- a) In 2019, 52% (\$3.5 million) and 21.5% (\$3.2 million) of the top ten vendor purchases by SX and KSG, respectively, came from adidas. On a combined basis this represents 30.9% (\$6.7 million) of the top ten vendor purchases;
 - b) In 2019, KSG sold \$5.3 million of adidas product, accounting for 21.18% of sales for that year;
 - c) SX sells more adidas product than any other brand. SX's total sales in past years are: \$6,451,068 (2019); \$7,264,109 (2018); \$6,273,282 (2017);
 - d) In 2013, SX opened the Superstore and 70% of the Superstore's inventory has always consisted of adidas product; and
 - e) As of March 12, 2020, the Petitioners have open purchase orders with adidas for approximately \$2.2 million, for deliveries into July 2020.
- [61] Mr. Johnson describes the continued supply of adidas product to the Petitioners to the end of the term of the adidas Trade Agreement as "critical" to their business operations and ability to preserve customer goodwill and meet their obligations to customers. He expresses the view that, if this relationship is not reinstated to normal or somewhat normal terms, the completion of the SPA with Greyrock will be jeopardized. In that event, he considers it unlikely that the Petitioners can find another purchaser and, without a sale, no plan can be presented that would see operations continue.

- [62] Similarly, the Monitor confirms that adidas is the Petitioners' largest supplier. The Monitor also describes that the Petitioners have integrated adidas into their sales and purchasing processes. Finally, the Monitor confirms its view that a discontinuation of the supply of adidas product to the Petitioners jeopardizes the viability of the businesses and increases the risk that the SPA conditions can not be met toward a conclusion of the sale to Greyrock. Accordingly, the Monitor opines that without such a declaration, the restructuring is in jeopardy.
- [63] In the above circumstances, I conclude and find as a fact that adidas is a "supplier" to the Petitioners and that the supply of its goods and services are critical to the Petitioners' continued operations at this time.
- (2) Should the Court declare adidas to be a "critical supplier" and order continued supply?
- [64] Section 11.4 of the CCAA is intended to allow the Court to intervene and order continued supply where actions that might otherwise be taken by a supplier might jeopardize the restructuring efforts that are underway. Such relief is not unlike other CCAA provisions that allow relief which adversely affects other stakeholders in aid of these objectives and measures. The stay of proceedings and the priming of existing security are other examples.
- [65] In *Canwest Global Communications Corp. (Re)*, [2009] O.J. No. 4286 at para. 43, Justice Pepall (as she then was) described an order under the provision as "facilitative and practical in nature".
- [66] As always, a balancing of interests is required in determining what is appropriate and fair in the circumstances. In that respect, the comments of the Court in *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 bear repeating:
- [70] . . . Appropriateness under the CCAA is assessed by inquiring whether the order sought advances the policy objectives underlying the CCAA. The question is whether the order will usefully further efforts to achieve the remedial purpose of the CCAA -- avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.
- [67] I readily conclude that this Court should exercise its discretion to declare adidas as a "critical supplier" under s. 11.4(1) of the CCAA given the following circumstances:
- a) The relationship between the Petitioners and adidas is significant, a point conceded by adidas' counsel in argument;
 - b) Adidas supplies unique branded goods to the Petitioners, as their customers wish to purchase and arising from the active promotion of adidas products by the Petitioners to their customers over the course of their long relationship;

- c) The relationship at this point is beyond repair and continues to be acrimonious. Adidas has indicated that it is not prepared to continue to supply without a court ordering it to do so;
- d) The Petitioners do not have the capability to pivot away from the supply of adidas products in the near term to other or similar products;
- e) Any disruption in the continued supply of adidas products at this time would have serious and negative repercussions to the Petitioners' business operations into the near term and would likely cause irreparable harm to their businesses;
- f) If any disruption to the adidas supply occurs, with expected negative consequences, there is serious jeopardy to Greyrock's support of these proceedings; and
- g) Without Greyrock's support of these proceedings, there is significant risk that the restructuring proceedings will fail entirely, with disastrous consequences to most stakeholders in the event of a liquidation of assets. Those stakeholders include the significant supplier group, which includes adidas.

[68] In my view, declaring adidas to be a critical supplier is consistent with the statutory objectives of the CCAA and well supported by the circumstances here. It is so ordered. Adidas is ordered to continue to supply its products and provide services to the Petitioners under the arrangements in place prior to the NOI filings, until further court order. Those services will include providing access to the MiTeam and B2B platforms, as before.

(3) What terms should be imposed with respect to adidas' continued supply of goods and services?

[69] Section 11.4(2) of the CCAA provides the Court with considerable flexibility to impose terms and conditions that are "consistent" with the supply relationship or that the Court considers appropriate. This allows the Court to exercise its discretion to impose the same or similar terms as were in place before the filing, or to impose such other terms as might be appropriate in the circumstances.

[70] Any terms that might be imposed may be informed by the existing contractual terms between the parties, although the existence of a contract is not necessarily a prerequisite under s. 11.4. In addition, any existing terms and conditions may be modified by the Court as appropriate. Other appropriate terms may be imposed.

[71] I have already outlined above the relief sought by the Petitioners in the ARIO with respect to adidas. Essentially, they seek an order moving away from a COD relationship or retainer arrangement and into something akin to the pre-NOI filings relationship, by which supply would occur, and payment would follow within specified time limits as set out in the adidas Trade Agreement.

[72] Adidas takes the position that, if it is declared to be a critical supplier, any further orders or fulfillment of existing orders should be subject to the following conditions:

- a) The Petitioners are required to take delivery in accordance with the date that the orders are ready for shipment for all orders to date moving forward, without rights of cancellation (ie. they are "final" now to avoid "cherry picking" orders);
- b) The Petitioners remedy existing non-monetary defaults, including selling non-branded and knock-off products, alleged by adidas to be in breach of the adidas Trade Agreement;
- c) The Petitioners pay monies into a solicitor's trust account in an amount to be paid to adidas 60 days in advance of shipment, such monies to be on a "rolling basis";
- d) The Petitioners pay a "reasonable" contribution to the repayment of the pre-NOI filings debt (suggested by adidas' counsel at 30% of the amount outstanding or approximately \$600,000);
- e) There be a clear expiration or review date of the compelled supply of July 31, 2020, or in any event, no later than the end of the term on November 30, 2020; and
- f) The Petitioners pay adidas' legal fees in respect of the CCAA proceedings.

[73] Adidas advances its argument, particularly as to the retainer arrangement, on the basis that the cash flows attached to the Monitor's report include budgeting for payment of ongoing supply, including from adidas, on a COD basis. This is said to be accommodated by the proposed increase in the Interim Lending Facility to \$2.8 million, to be funded by Greyrock. Accordingly, adidas takes the position that it is not necessary to allow any outstanding payables to accrue and thereby expose adidas to payment risk. Adidas contends that the Petitioners' evidence only supports that it would be "convenient", not crucial, for the Petitioners to be supplied on credit, rather than continue in a COD supply arrangement.

[74] Again, I return to the independent evidence before me provided by Mr. Johnson and the Monitor.

[75] Mr. Johnson states in his Affidavit #3:

- 41. Based on the position being taken [by adidas], I am concerned that any go forward arrangement that relies on C.O.D. or retainer arrangements is not likely to be successful, will result in an unnecessary and cumbersome level of administration and will be contrary to the normal course of business. The current process between adidas and the Companies will allow for normal processing of orders, which avoids delays and an opportunity to verify that what is shipped, received and invoiced is consistent.

...

- 51. The Updated Cashflows do not reflect normal credit terms with adidas, however, a return to normal credit terms with adidas would provide flexibility in relation to uncertainties inherent in the cashflow projection, would decrease reliance on interim financing and reduce related costs, would streamline the administration process and reduce demands on the Companies finance group.

[76] Similarly, the Monitor states in its First Report that, while the cash flows assume COD payments to adidas:

4.20 . . . it is preferable for the Companies to pay based on pre-filing terms as it is not practical from an administrative perspective for the Companies to pay adidas on a COD basis. . . .

[77] I accept the reasoning of both Mr. Johnson and the Monitor in this respect. I do not agree with adidas that ordering it back to normal supply terms is simply a matter of preference, and a cheaper preference at that, for the Petitioners and Greyrock, rather than having Greyrock finance a COD supply arrangement.

[78] As mentioned, the state of the relationship between adidas and the Petitioners is extremely toxic at this time. I consider that any arrangement - such as a COD or rolling retainer arrangement - would introduce further levels of complexity and risk of conflict between them. If that should occur, as mentioned by Mr. Johnson, there is risk of delays and breakdowns in the ordering of product and shipments, all potentially very detrimental to the Petitioners' restructuring efforts. In addition, the added time, distraction and cost of managing and overseeing such a fractious relationship would detract from those restructuring efforts.

[79] I reject adidas' other proposed terms as unreasonable in the circumstances.

[80] As for the "cherry picking", this is inconsistent with what has occurred in the supply arrangement in the past. There is no reason to compel the Petitioners to accept delivery of products that they or their customers have not ordered and do not want, as confirmed to adidas through the existing arrangements. In my view, the "open purchase order" process should continue as before, which simply restores the status quo as between these parties.

[81] I have already rejected adidas' argument regarding the Petitioners selling knock-offs. This was only very recently advanced by adidas with respect to the Petitioners and was not raised in any fashion prior to the NOI filings. I make no determination of course with respect to that issue as it might be raised in these proceedings or otherwise. I would parenthetically add that adidas' present position on this issue is interestingly inconsistent with its other position that the Petitioners really have no need for adidas products because of their other options for supply.

[82] I also reject adidas' demand for payment toward the pre-NOI filings debt. I acknowledge that it is within the discretion of the Court to order such a payment: see *Canwest Global Communications (Re)* at para. 41; *Cinram International Inc. (Re)*, 2012 ONSC 3767 at paras. 23-24, 66-71; and *Northstar Aerospace, Inc. (Re)*, 2012 ONSC 4546 at paras. 11-15.

[83] However, while factual circumstances supporting such payments toward pre-filing debt will differ, they often involve one or more of the following factors: the debtors having sufficient cash flow for such payment; the support of the debtor; the support of the Monitor; the likely payment of some amount to the unsecured creditor in any event under a plan; need on the part of the supplier; authorization to make such payments only as required and with

ongoing approval and oversight by the Monitor; and, that such payment will secure the ongoing cooperation of the supplier for the continued supply of goods or services.

- [84] Here, none of these circumstances (or any other relevant circumstances) exist that would support the exercise of this Court's discretion to allow payment of such a large pre-filing sum to adidas. In particular, payment of such a large sum to adidas - well beyond what appears to be likely proposed in any plan of arrangement at the end of the day - would be seriously detrimental to other financial stakeholders and the success of the restructuring itself. Adidas would be clearly preferred in respect of other unsecured creditors, without any justification whatsoever.
- [85] In my view, it is not necessary to set any review date for this arrangement. As I will discuss below, I am acceding to the Petitioners' request to extend the stay of proceedings to July 31, 2020. I expect at that time that the matter of the supply arrangements with the Petitioners' suppliers, including adidas, will be the subject of evidence and also, comment and report by the Monitor. The continuation of the supply arrangements as I am ordering now with respect to adidas can be adjusted at that time, as necessary, based on that evidence.
- [86] I accept that the terms sought by the Petitioners in the ARIO with respect to adidas are not strictly set out; however, I do not agree that they are vague, as adidas argues. Those terms, as set out in the Initial Order, have been sufficiently stated and understood by the parties to date without issue: see 7098961 Canada Inc., 2016 QCCS 2115 at para. 187. Those terms simply restore the Petitioners and adidas to the arrangements or status quo in place just prior to the NOI filings. Any further delineation of the terms and conditions of the supply arrangement would only serve to hamstring the dynamic supply arrangements that were intended to and were in place under the former arrangements.
- [87] In addition, it remains the case that the Monitor will continue to oversee the ongoing operations of the Petitioners until the next hearing date at the end of July 2020. As part of that exercise, I expect that the Monitor will continue to determine if suppliers (including adidas) are being paid in the ordinary course, as the Petitioners propose and as provided for in the cash flow projections. I would also expect that, if issues arise, the Monitor can be involved to attempt to sort out the matters between the Petitioners and adidas. Failing a resolution of the matter through that process, it is of course open to the parties to return to this Court.
- [88] Finally, I also reject adidas' request for payment of its legal fees. In large part, I have found adidas' position to be unreasonable and I have rejected its position generally. There is no basis to reward that outcome by granting payment of adidas' legal fees.
- [89] There is, however, one point advanced by adidas with which I do agree. Payment terms under the adidas Trade Agreement include net payment periods of 30, 60 or 90 days. As adidas argues, this essentially amounts to adidas financing the Petitioners' operations to some degree where they might otherwise have been financed by Greyrock at some cost to the stakeholders generally. Net payment terms are a usual term and they were a feature of

the relationship with the Petitioners, by which adidas did essentially agree to advance credit. Having said that, there is added financial uncertainty now given the restructuring proceedings and the current economic state of Canada, principally arising from the COVID-19 pandemic.

- [90] I consider that an appropriate balance between the Petitioners, adidas and the other stakeholders is to shorten those payment terms for adidas. I order that any payment terms under the adidas Trade Agreement shall be in accordance with that Agreement, but no more than 45 days net. This will reduce payment risk to adidas, as it has sought to do.
- [91] In summary, the relief sought by the Petitioners with respect to the terms and conditions of supply by adidas are granted, save and except to shorten the payment period as above.
- (4) What security or charge should the Court provide for adidas and with what priority?
- [92] Having declared adidas to be a critical supplier and required to continue to supply the Petitioners on the above terms, the Court is required to order that security or a charge be imposed on the Petitioners' assets to secure the value of the goods and services to be supplied. As stated above, it is intended that adidas will be paid throughout the restructuring as supply occurs; however, there remains some risk that the restructuring will not be successful, leaving adidas exposed.
- [93] The Petitioners, supported by Greyrock, are proposing that the Critical Supplier Charge rank ahead of the Interim Lender's Charge and of course, the pre-filing security which includes the secured debt now held by Greyrock.
- [94] Both Mr. Johnson and the Monitor share the view that the assets of the Petitioners will be more than sufficient to satisfy any amounts owing under the Critical Supplier Charge should the restructuring prove unsuccessful. Specifically, they point to:
- a) The Critical Supplier Charge would only be subject to the Administration Charge to a maximum of \$200,000;
 - b) The net book value of the Petitioners' current assets as of April 30, 2020 exceeds \$11 million, as represented by:
 - i. Inventory of \$10 million (at average net cost);
 - ii. Accounts receivable of \$1.8 million; and
 - c) The net book value of the Petitioners' fixed assets (property and equipment) as of December 2019 was \$1.9 million.
- [95] I accept that the value of all of these assets could be compromised in the event of a liquidation, particularly given the uncertain and recessionary times into which the Canadian economy has fallen with the COVID-19 pandemic. However, I consider it extremely unlikely that, even with a significant fall in recoveries, there is any material risk of non-payment to adidas in these circumstances. Again, this is particularly so given that

adidas will receive ongoing payments for supply; if such payments are not made in the ordinary course, I would expect that adidas will seek immediate relief in respect of the Critical Supplier declaration and Critical Supplier Charge.

[96] The Critical Supplier Charge as sought is granted.

Approval of Amended Commitment Letter

[97] The Initial Order authorized the Petitioners to continue to borrow under a credit facility from Greyrock and continued the Interim Lender's Charge under the BIA Orders, to the maximum amount of \$1.4 million plus interest, fees and costs. Approximately \$750,000 has already been drawn. The Petitioners seek to increase that amount to \$2.8 million.

[98] As previously stated, the Petitioners' cash flow projections to July 31, 2020 assume that the purchase of product is based on COD terms with most suppliers, which increases the pressure on cash flow and results in a much higher level of borrowings than anticipated. The Petitioners concede that, with the critical supplier declaration in favour of adidas and the requirement imposed on adidas to fund on the above terms, it is very possible that the full extent of this further borrowing will not be required.

[99] Pursuant to s. 11.2(4) of the CCAA, any increase in borrowing involves a consideration of the following factors, among other things:

- a) the period during which the company is expected to be subject to proceedings under [the CCAA];
- b) how the company's business and financial affairs are to be managed during the proceedings;
- c) whether the company's management has the confidence of its major creditors;
- d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;
- e) the nature and value of the company's property;
- f) whether any creditor would be materially prejudiced as a result of the security or charge; and
- g) the monitor's report referred to in paragraph 23(1)(b), if any.

[100] The Petitioners' cash flow sets out the requirements to help fund working capital as sports teams source uniforms and equipment to ready themselves for the spring/summer season. In addition, the Petitioners will require funding for on-going operations as they work towards finalizing the transaction with Greyrock and concluding these proceedings.

- [101] The Monitor will continue to oversee the Petitioners' business and financial affairs during these CCAA proceedings; that will include drawdowns on the Interim Lending Facility so as to ensure that it is being used only as needed. While perhaps the full amount will not be required, increasing the limit affords the Petitioners the flexibility of accessing those funds as circumstances arise, again with oversight by the Monitor.
- [102] No creditor of the Petitioners will be materially prejudiced as a result of the increase in the Interim Lender's Charge, including adidas since the Critical Supplier Charge ranks ahead of the Interim Lender's Charge and the further borrowings will be available, if needed, to fund payments to adidas with respect to ongoing supply.
- [103] The Monitor supports the increase to the Interim Lending Facility and the Interim Lender's Charge.
- [104] I conclude that the s. 11.2(4) factors support an increase to the Interim Lending Facility as proposed.

Claims Process Order

- [105] In conjunction with the Monitor, the Petitioners have developed and are seeking approval of a Claims Process Order to call for the submission of claims against the Petitioners.
- [106] Pursuant to s. 11 of the CCAA, the Court may make any order that it considers appropriate in the circumstances. Courts have in past relied on this broad statutory authority under the CCAA to grant claims process orders.
- [107] The proposed Claims Process Order allows for the usual steps and procedures in such a claims process, consistent with what has been previously ordered in many other restructurings. In particular, the process sets a claims bar date of June 30, 2020 to file claims or, with respect to a restructuring claim, within 10 days of receiving a notice of disclaimer or resiliation.
- [108] The Monitor supports the proposed Claims Process Order. The Monitor opines that this process should facilitate the implementation of a plan and the overall restructuring.
- [109] I conclude that, consistent with the statutory objectives of the CCAA, the claims process will bring some certainty to this restructuring proceeding in determining the claims that must be addressed by the Petitioners in any plan of arrangement. The proposed Claims Process Order is granted on the terms sought, with amendment of the various timelines set out in the proposed order to extend them by two business days, given the delay in giving these reasons.

Extension of Stay

- [110] Finally, the Petitioners are seeking to extend the stay period to July 31, 2020.
- [111] No stakeholder objects to such an extension.

- [112] The Monitor supports such an extension, confirming that the Petitioners have acted and continue to act in good faith and with due diligence, as required by s. 11.02(2) of the CCAA.
- [113] Clearly the extension of the stay is necessary for a number of reasons to advance the restructuring. The further time will allow the Petitioners to continue operations with a view to developing a longer term strategy that does not include supply from adidas. In addition, once the Claims Process is completed, a clearer picture will emerge toward developing a plan of arrangement for consideration of the creditors and the Court. Finally, as matters move along, the Petitioners and Greyrock can move toward completion of the SPA.
- [114] These reasons are consistent with the purpose and objectives of the CCAA and will enable the Petitioners to proceed with an orderly sale of their assets to maximize recovery to stakeholders, including all unsecured creditors which of course includes adidas.
- [115] I am satisfied that an extension of the stay to July 31, 2020 is appropriate in the circumstances and it is so ordered.

"Fitzpatrick J."

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