



INSOLVENCY & WORKOUT GROUP

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REORGANIZATION OF MULTI-UNIT RESIDENTIAL DEVELOPMENTS

BY DAVID MANN, DAVID LEGEY

Over the last two years, with the fluctuations in the economic market, commercial real estate in distress has become a lively topic among insolvency practitioners and even in court decisions.

Starting in 2008, in *Cliffs Over Maple Bay*, the debtor, a real estate development company, sought DIP Financing and a DIP Charge in order to complete the restructuring of its project. The chambers judge granted the relief sought, however, the existing lenders appealed this matter to the British Columbia Court of Appeal. At the Court of Appeal, Justice Tysoe not only denied the DIP Financing, he found the CCAA did not apply to the commercial real estate development company. Justice Tysoe made the following comments:

Although the CCAA can apply to companies whose sole business is a single land development as long as the requirements set out in the CCAA are met, it may be that, in view of the nature of its business and financing arrangements, such companies would have difficulty proposing an arrangement or compromise that was more advantageous than the remedies available to its creditors.

Justice Tysoe found that because Cliffs had not made any reference to developing a plan, the CCAA did not

apply. This case seemed to suggest that single purpose real estate development companies should not seek protection under the CCAA. As a result, in Alberta, a similar finding occurred when K2 Developments sought a super-priority DIP charge over the protestation of the first (and second and third) charge lenders. Again, the application failed and a receivership quickly followed.

However, there have been some changes in this trend in the law. In *Re Jameson House Properties Ltd.*, the petitioners were developing a mixed residential and commercial project on Hastings Street in Vancouver when it encountered financing difficulties. The company was granted protection under the CCAA, and earlier this year a plan of arrangement was approved by the creditors and sanctioned by the Court.

Meanwhile, back in Alberta, there was an application for protection under the CCAA by Octagon Properties Group Ltd. (and its affiliates). Justice Kent denied the entire application, including that for DIP Financing, stating that in this case she could not see the advantages to a restructuring. There was no active business for the company, and there was not a large number of employees. The restructuring would prevent the lenders from foreclosing or accessing any of the other remedies outlined in their security agreements, and she saw no purpose in this given the facts of the case.

On the other hand, in *Re Riverfront Pointe Properties Inc.*, the applicant, a developer of a condominium unit in Calgary's east side, was granted protection under the CCAA and DIP Financing Charge. In this case, the CCAA went with the consent of the secured lender, and the same lender provided the DIP Financing. Though there were no employees to protect, the benefit to the trades involved and the community improvement proposed by this development lead to a smooth entry for this restructuring.

It will be interesting to see if *Jameson* and *Riverfront* become the new trend in this area of the law, and if we see more single purpose real estate developments seeking protection under the CCAA to facilitate with their restructuring.

Fraser Milner Casgrain LLP acted for the debtor in both *Jameson House* and *Riverfront Pointe*.

CCAA COURT APPROVES A KEY EMPLOYEE RETENTION PLAN FOR BOTH CANADIAN AND US AFFILIATES

BY DAVID MANN, DAVID LEGEYT

On October 13, 2009, Arclin Canada Ltd./Arclin Canada Ltee. ("Arclin"), who is restructuring under CCAA proceedings and whose American affiliates are restructuring under Chapter 11 of the U.S. *Bankruptcy Code*, sought the approval of key employee retention program ("KERP") agreements with its Chief Executive Officer and its Chief Financial Officer, and sought sealing orders with respect of the agreements. The KERP was approved by Justice Hoy. The following are some noteworthy points from this case.

The CEO and CFO of Arclin hold the same role with the American affiliates, however, they are paid by Arclin and their services are provided to the American affiliates through a management agreement.

The monitor and Arclin confirmed that the costs of the KERP would be borne by Arclin and that the KERP could not result in increased charges under the management agreement without the approval of the U.S. Court. The board of directors of Arclin had approved the KERP and the first lien lenders and the DIP lender support the approval of the KERP. The Official Committee of Unsecured Creditors ("UCC") appeared at the hearing to oppose the KERP.

In approving the KERP, Justice Hoy found the following factors to be influential to her decision:

1. Given the payments provided for in the KERP, and the level of payments that the UCC was concerned about, she was satisfied as to the reasonableness of the KERP.
2. There was evidence that the CEO and CFO had been approached about other opportunities for long-term and stable employment and had both indicated that they would take advantage of these opportunities if the KERP was not approved. These employees could not easily or readily be replaced, given their intimate knowledge of Arclin's affairs, and it would be a lengthy and costly process to do so.
3. The amounts payable under the KERP are insignificant in light of the total debt outstanding. She found the KERP was reasonable given the CEO and CFO's current compensation arrangements.

4. Looking specifically at the funding of the KERP, it is clear that the U.S. Affiliates will derive a benefit from the KERP. The UCC submitted that the KERP would not meet the rigorous conditions in the U.S. Code to be approved. Regardless of this argument, Justice Hoy placed substantial weight on the strong recommendation of the Monitor. Further she found that given the "goal" of the restructuring was to swap debt for equity, and the primary economic stake holders, the first lien lenders, were in support of the KERP and the CEO and CFO.

Finally, Arclin sought a sealing order to ensure: (1) that other employees are not able to point to the terms offered to the CEO and CFO to attempt to secure retention arrangements, and thereby jeopardize the restructuring; and (2) that third parties desirous of engaging the services the CEO and CFO not know what terms they have to "better" in order to woo them away from Arclin. Though the Monitor submitted a report outlining that disclosure may cause significant prejudice to Arclin and other Canadian participants in the CCAA, Justice Hoy found that the KERP itself did not provide for confidentiality to restrict the CFO and CEO from disclosing the terms. Further, she found that KERPs are controversial, and the CCAA process should be open and transparent to the greatest extent possible. Justice Hoy granted a sealing order for 7 days, to permit Arclin and the Monitor to clarify the significant prejudice to Arclin and the Canadian Participants which would occur as a result of the disclosure, but would not grant a permanent sealing of the agreement.

CLASSIFICATION OF CREDITORS UNDER THE CCAA

BY DAVID MANN, DAVID LEGEYT

In a corporate reorganization under the *Companies' Creditors Arrangement Act* (the "CCAA"), the design of appropriate classes of creditors can be central to the success of the restructuring initiative. The requisite "double majority" for a plan of arrangement to be approved, being a majority in number and two thirds by value of support from creditors, is required per class in order to be binding on that class. The result is that much thought is given to the structuring of creditor classes, on the basis of promoting the aims of the CCAA and attempting to ensure the requisite majority of creditor support.

With the new CCAA amendments now in force, the Act provides, at section 22, several factors that a Court must

now consider in approving a classification for purposes of voting on a proposed plan:

22. (1) A debtor company may divide its creditors into classes for the purpose of a meeting to be held under section 4 or 5 in respect of a compromise or arrangement relating to the company and, if it does so, it is to apply to the court for approval of the division before the meeting is held.

(2) For the purpose of subsection (1), creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account

- (i) the nature of the debts, liabilities or obligations giving rise to their claims;
- (ii) the nature and rank of any security in respect of their claims;
- (iii) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and
- (iv) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed.

In *Re SemCanada Crude Co.*, 2009 ABQB 490 (“*SemCanada*”), the Court presided over a restructuring initiated under the pre-amendment provisions of the CCAA and was therefore not bound by this new provision. The Court canvassed the common law on creditor classification and stated that the new section 22 amendments do not materially change the common law factors that a Court must consider in approving a proposed classification.

The common law factors highlighted in *SemCanada* are then, presumably, the framework for interpretation of the new section 22 of the CCAA. It is interesting to note that, prior to these amendments, there was very little statutory guidance on proper creditor classification, so the law was largely created through contextual appropriateness in each case, as shaped by the overall purposes of the CCAA. Given that the debtor will be

seeking to maximize support, and creditors will be seeking to enhance their bargaining power, the Court must consider these competing interests in light of the overarching aims of the CCAA in making its determination as to the appropriateness of a proposed classification.

The Court described six factors, briefly summarized below, which are seen as a guideline to the Court’s ultimately fact-driven determination:

1. **Commonality of interests:** the interests of creditors in each class should be sufficiently similar such that they can vote with common interest. The Courts have rejected the notion that these interests must be identical.
2. **Legal interests:** the interests of creditors to be considered by the Court are their legal interests as creditors of the debtor, i.e. their rights in respect of the debtor company, as opposed to their interests and rights as creditors in relation to each other. For a simplified example, a group of creditors may all be unsecured in relation to a debtor company, but may hold different debt instruments in relation to each other. There is also a line of cases suggesting that the Court should also consider the rights of the parties in a liquidation scenario.
3. **Purposive approach:** the commonality of interests of creditors to a class is to be considered in perspective of the aims of the CCAA, primarily being to facilitate successful restructurings.
4. **Promotion of viable plans:** in taking a purposive approach, Courts should be wary of classifications that would potentially jeopardize viable plans. Primarily, Courts should avoid the approval of classes where a minority group would be granted unwarranted power or influence over the process, in consideration of their status.
5. **Creditor motivations are irrelevant:** the motivations of creditors to approve or not approve a plan of arrangement are irrelevant. It is anticipated that creditors in the same class can and will have different financial or strategic interests, and the attempted alignment of classes on these grounds, as opposed to in accordance with their legal rights, would lead to inappropriate fragmentation and would potentially defeat the overall aims of the CCAA.

5. **Ensuring proper consultation:** the treatment of creditors before and after the implementation of a plan of arrangement will disclose the likelihood of those creditors to be able to effectively consult with each other as a group. For example, if a part of a proposed class will remain uncompromised by a plan, and another part will not, it is unlikely that these creditors will be able to engage in meaningful consultation as a result of the opposition of their legal interests.

To summarize, the six factors enumerated are interrelated and tend to require the Court to consider the effect of a reorganization process, and ultimately of a plan of arrangement, on the legal rights of creditors as they may be affected thereunder. These rights are juxtaposed with the rights of the debtor company and the policy aims of the CCAA to provide a viable restructuring opportunity for qualifying debtors. It is important not to confuse creditors' motivations with their legal rights, and not to ignore potential conflicts of interest that could defeat effective consultation within a class. It should also be noted that no distinct minority should be afforded unwarranted strength of position, such that they could effectively veto an otherwise viable plan.

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