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## • REVIEW OF THE JAMESON HOUSE RESTRUCTURING •

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Jameson House Properties Ltd. and Jameson House Ventures Ltd. (the “Jameson Companies”) were incorporated to develop a 37-storey mixed-use building in downtown Vancouver called Jameson House. By 2008, after many years of planning and development, the Jameson House project was well underway. After more than one year of construction under the stewardship of an experienced head contractor, the Jameson companies had pre-sold a majority of the units in the building, and

despite having nearly spent their existing interim financing, the Companies were in the process of finalizing sufficient construction financing to build out the project.

Since the latter part of 2008 was also a time of financial turmoil, capital was in short supply and lenders around the world were taking a serious second look at their loan portfolios. For Jameson House, this environment seemed to give the lenders cold feet, and despite existing financing commitments the Jameson companies found themselves without their construction financing. This left the companies in mid-construction with no available capital, depleted their interim financing, and construction deadlines looming in relation to their existing pre-sale agreements.

By early November, 2008 the Jameson Companies had turned to their restructuring advisors for help. As there was no money left for construction activities, workers were preparing to down-tools. The interim financing loans were about to become due and lenders were anxious to be paid out. However, there was value in the Jameson House project. A majority of the units had already been sold, and based on the existing pre-sale agreements there was significant value in the project if it could be built out. The Jameson Companies needed a new plan, and time to formulate one.

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The solution was to file for protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"). The CCAA is a Canadian statute, which was enacted during the great depression, designed to give a company relief from its creditors when it is in a stressed financial position. The CCAA permits the courts to grant broad relief and effectively pause all actions against a company while the company formulates a plan that will allow it to continue on its business. The purpose is to preserve the social and economic benefits that exist in an ongoing business entity.

The Jameson Companies filed for CCAA protection on November 14, 2008, and commenced what would turn out to be a nine-month restructuring with important implications not only for the restructuring profession, but also for developers and lenders who may find themselves in similar situations down the road. The purpose of this article is to review the Jameson restructuring experience, examine some of the unique aspects of this process, and identify any helpful lessons for future real estate development restructurings.

### 1. THE CCAA — REQUIREMENTS, PROCESS, AND RESULTS

Before reviewing the *Jameson* case, it will be useful to provide an overview of general insolvency processes. A CCAA proceeding is the result of one of three situations (bankruptcy, receivership or restructuring) that an insolvent company may find itself in if pressed by its creditors, or financially stressed as a result of weakened cashflow or capital.

Bankruptcy (insofar as a corporation is concerned) is a statute-driven process designed to liquidate assets quickly, efficiently and transparently. Although the terms "insolvent" and "bankrupt" are often used interchangeably, they are distinct concepts. An "insolvent" company is not necessarily "bankrupt" — the former refers to a state of financial difficulty, the latter means a court has declared a person or company to be "bankrupt". A company may assign itself into bankruptcy, or be petitioned into bankruptcy by its creditors. In a bankruptcy, any active business activities are shut down, and assets are sold off by a trustee appointed by the court.

Receivership is strictly a creditor-driven process. A receiver is appointed under either a security agreement or a statute. There is more flexibility for methods of realization in a receivership; as the re-

ceiver may carry on the business for some period of time, or immediately terminate ongoing operations to sell off assets. Ultimately, however, the receiver's goal is essentially the same as a trustee in bankruptcy — liquidate the assets or business, and distribute the proceeds to creditors.

Finally, there is restructuring. Restructuring is unique from bankruptcies and receiverships in that it is a debtor-driven process. It can only be invoked by a debtor, and the debtor generally retains control of its assets, business and operations during the process. The purpose is to give a debtor a period of time to come up with a “plan” that represents a compromise with the creditors, aiming to preserve going concern value in a viable business entity that has simply fallen on hard times.

Restructurings can take place under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “BIA”), or the *CCAA*. The BIA process is fairly regimented, providing fixed deadlines and procedures. The *CCAA*, on the other hand, is a “skeletal” statute, which gives the court and restructuring advisors the ability to tailor a restructuring process to the particular company. The result is that the *CCAA* can be a more complicated (and therefore expensive) process for restructuring, but it provides the flexibility required to deal with the myriad of issues that invariably arise in the course of most restructurings.

The *CCAA* is only available for mid to large sized companies, in that the company must have at least \$5 million in debt to invoke the statute. In addition, the company must be insolvent; it must be unable to meet its liabilities as they become due, or its total liabilities must be greater than its total assets. Assuming these requirements are met, the first step to initiating a *CCAA* proceeding is to apply for an “initial order”. It is possible to apply for the initial order without notice to creditors, although this approach typically requires extenuating circumstances (*i.e.* a serious risk that creditors will enforce security if given notice). The initial order sets out the procedures that will be followed through the restructuring process, so can vary depending on the type of business filing for protection. However, there are two crucial elements to every initial order: a stay of proceedings, and the appointment of a monitor.

The stay of proceedings is the backbone of a restructuring. The stay prevents all (or most) creditors from attempting to collect on an existing debt, from suing or taking other legal proceedings against the

debtor, or otherwise interfering with the debtor's restructuring efforts. In addition, the stay can extend to non-creditors, such as contracting parties and others doing business with the debtor. The purpose of the stay is to provide a debtor with “breathing space” from its creditors so it may have the necessary time to formulate a plan. The initial stay is limited to 30 days, however it may be extended on subsequent applications so long as the court is satisfied the restructuring is not doomed to failure.

The monitor also plays a crucial role in *CCAA* restructurings. The role of the monitor is to act as the “eyes and ears” of the court. While the monitor does not have authority to carry on business operations, it is given significant access to the debtor company so it may report to the court on the progress of the restructuring. In many circumstances, the opinion of the monitor will carry significant weight with the court when it is deciding whether or not to grant orders. In addition, the monitor can be an effective party in assisting with the development of a plan.

Once the process is started, the debtor needs to come up with a plan of compromise. While technically there is no deadline for proposing a plan, subsequent extensions of the stay will become increasingly difficult if no plan is proposed or no progress is made towards one. A typical plan involves paying most pre-filing creditors a portion of their claim. As the majority of creditors will need to approve a plan, it is necessary to offer something better than what would be received in a liquidation scenario. Methods of funding a plan, however, are virtually unlimited, for example converting debt to equity, refinancing debt, diluting existing shareholders, or selling some or all of the assets.

A plan of compromise must be accepted by the creditors and approved by the court before it becomes binding. Approval from the creditors must be by majority in number of creditors voting, and 2/3 in value of claims. If the creditors approve a plan, the debtor company must apply for court approval. The court will not necessarily “rubber stamp” a creditor approved plan, as it has to assess the fairness and reasonableness of the plan. However, it is relatively rare for the court to refuse approval after the creditors have signed off on a plan.

## 2. VERSATILITY OF THE *CCAA*

As discussed, the major benefit of the *CCAA* is that it provides debtor companies with a flexible ve-

hicle to address a variety of issues that may arise in a restructuring. The *Jameson* proceeding was an example of this flexibility, as there were a number of novel issues that had to be dealt with to complete the restructuring.

The source of the *CCAA*'s flexibility is the "skeletal" nature of the statute. Despite the broad application of the *Act*, it is surprisingly short (just over 60 sections). The main provision is s. 11, which gives the court power to stay proceedings against a debtor, and further broad discretion to grant "any order that it considers appropriate". In addition, the court can (and has) used its inherent jurisdiction to control its own process and supplement the *CCAA* where necessary to facilitate a restructuring. Thus, if a debtor company can convince the court that the circumstances exist to justify a particular order, the court likely has the jurisdiction to grant it.

In the *Jameson* proceedings, one important issue was the enforceability of the pre-sale contracts. In particular, pre-sale purchasers were alleging they had various contractual and statutory rights to rescind their agreements, and were seeking to recover their deposits. The Jameson Companies required certainty that the presale contracts were enforceable to complete their restructuring. As a result, the court was asked to exercise its discretion under the *CCAA* to make orders overriding potential contractual or statutory rights of rescission, to the extent any existed, and bind purchasers to their contracts.

The main problem with this request was that, as pre-sale purchasers were found not to be "creditors" of the Jameson Companies, they were not entitled to vote on the plan of compromise. Thus, the court was being asked to affect the rights of parties that did not have a direct "say" in the terms of the plan. This was not the first time courts had been asked to make such orders in *CCAA* proceedings, but it is an extraordinary form of relief.

In *Jameson*, both the B.C. Supreme Court and Court of Appeal ultimately held that pre-sale purchasers had no right to rescind (either contractual or statutory). However, the B.C. Supreme Court further held that to the extent such rights did exist, it would exercise its discretion to prevent pre-sale purchasers from relying on those rights. From a legal perspective, this is of particular significance as courts generally do not have the authority to override an express statutory right. In this case, the court held it was able to use the *CCAA* to override

statutory rights that arose under the *Real Estate Development Marketing Act*, SBC 2004, CHAPTER 41 ("*REDMA*") (a provincial statute), pursuant to the doctrine of paramountcy.

Beyond the court's versatility to make orders that facilitate restructurings, it will often also assist debtors in resolving issues in an expedited manner. In the *Jameson* case, for example, pre-sale purchasers sought to litigate a number of issues:

1. Did pre-sale purchasers have claims against Jameson such that they were creditors entitled to vote on a plan of arrangement?
2. If not creditors, were the pre-sale purchasers otherwise relieved from their contractual obligations, such that they were or should have been outside the umbrella of the *CCAA*?
3. What was the drop dead date for completion of the units?

These were substantial issues which, in normal litigation, could have required a lengthy process and hearing to resolve. However, in the *Jameson* proceeding, as in most *CCAA* proceedings, there was not enough time to engage in protracted litigation and still succeed in a restructuring. Thus, the court allowed the applications to be brought in a relatively short time span, having all of the issues decided in a matter of months.

As the *Jameson House* proceedings have shown, under the *CCAA* a debtor company may seek broad relief in pursuit of a restructuring, and is typically able to do so on a relatively expedited basis. This versatility was key to a successful restructuring in Jameson, and provides a useful benchmark for companies in the future.

### 3. *REDMA* CONSIDERATIONS

As most real estate development companies are aware, *REDMA* imposes broad disclosure obligations on a developer. *REDMA*, and its attendant policy statements, set out a number of particular facts which a developer must disclose to its pre-sale purchasers. Failure to follow these requirements and disclose these facts can have drastic consequences for a developer, including granting purchasers a right of rescission and allowing them to walk away from their agreements altogether.

In the *Jameson House* proceeding, the main problem that arose as a result of *REDMA* (which would

be common to any insolvent developer) was the need to provide continuous disclosure of changes to “material facts” about the development. The fact that was the focus of those proceedings was the existence (or nonexistence) of construction financing. Under their amended disclosure statements, the Jameson companies had told purchasers there was a firm financing commitment. However, until the conclusion of the *CCAA* proceedings, there was no further disclosure regarding the state of the companies’ financing, or their financial condition.

The regulatory issues contemplated in the *Jameson* proceedings were:

1. Does a *CCAA* filing trigger a requirement to file a new disclosure statement under s. 16(2) of *REDMA*?
  2. Does a *CCAA* filing require a developer to file an amended disclosure statement under s. 16(3) of *REDMA*, and if so when?
1. REQUIREMENT TO FILE  
NEW DISCLOSURE STATEMENT

As discussed above, *REDMA* imposes an obligation on developers to provide ongoing disclosure of all changes to any material facts that affect the development. The definition of material fact and these disclosure obligations are found in the following provisions of *REDMA*:

*DEFINITIONS:*

“**Material Fact**” means in relation to a development unit or development property, any of the following:

- (a) a fact, or a proposal to do something, that affects, or could reasonably be expected to affect the value, price or use of the development unit or development property;
- (b) the identity of the developer;
- (c) the appointment, in respect of the developer, of a receiver, liquidator or trustee in bankruptcy, or other similar person acting under the authority of a court;

“**Misrepresentation**” means:

- (a) a false or misleading statement of material fact; or
- (b) an omission to state a material fact.

### Non-compliant disclosure statements

**16(1)** If a developer becomes aware that a disclosure statement does not comply with the *Act* or regulations, or contains a misrepresentation, the developer must immediately

- (a) file with the superintendent, as applicable under subs. (2) or (3),
  - (i) a new disclosure statement, or
  - (ii) an amendment to the disclosure statement that clearly identifies and corrects the failure to comply or the misrepresentation, and ...

**(2)** A developer must file a new disclosure statement under subs. (1)(a)(i) if the failure to comply or misrepresentation referred to in that subsection

- (a) is respecting a matter set out in paras. (b) or (c) of the definition of “material fact” ...
- (c) is of such a substantial nature that the superintendent gives notice to the developer that a new disclosure statement must be filed.

**(3)** A developer must file an amendment to the disclosure statement under subs. (1)(a)(ii) in any case to which subs. (2) does not apply.

As set out above, certain changes require the developer to file a new disclosure statement, while others require only an amended disclosure statement. The significance of filing a new, as opposed to amended, disclosure statement arises from s. 21 of *REDMA*, which states that receipt of a new disclosure statement gives pre-sale purchasers a seven-day right of rescission. Receipt of an amended disclosure statement, on the other hand, gives no statutory right of rescission.

Under *REDMA*, the obligation to file a new disclosure statement arises in three circumstances:

1. where there has been a failure to comply or misrepresentation in respect of the identity of the developer
2. where there has been an appointment of a receiver, liquidator or trustee in bankruptcy or other similar person acting under authority of a court
3. the nature of the change is so substantial that the Superintendent of Real Estate gives notice to the developer to file a new disclosure statement

The *Jameson* decisions from the B.C. Supreme Court and Court of Appeal contain a number of findings regarding the conditions that require a developer to file a new disclosure statement, especially in the context of a company undergoing a restructuring. First, with regard to a change in the identity of the developer, the court found that such a change does not extend to changes in directors, shareholders, or even control of the developer entity. This was a crucial finding in *Jameson* and is useful for future restructurings. The ability to change shareholders, and even control of the company, without the court viewing the change as a change in the identity of the developer leaves a wide array of restructuring alternatives open to a development company in a *CCAA* proceeding.

Second, the court confirmed that a monitor appointed in a *CCAA* proceeding was not an “other similar person” as that term is used in *REDMA*. The principle difference between a monitor and a receiver or trustee in bankruptcy, as the court found, was that a monitor did not gain control over the business. As discussed, the monitor’s role is limited to “overseeing the operations of the debtor and reporting to court and interested parties” (see para. 14, [2009] B.C.J. No. 1418, 2009 BCSC 964).

The third circumstance, being a direction from the Superintendent, did not occur in the *Jameson* case and therefore was not considered by the court. However, the fact that the Superintendent decided not to require a new disclosure statement in the context of a *CCAA* filing arguably sets an important precedent. Although the Superintendent appears to have discretion to treat any future case differently, the practice for the time being appears to require something beyond mere insolvency for the Superintendent to exercise its discretion. As a practical note, keeping this discretion in mind, it is likely advisable to keep the Superintendent informed as to the status of the project and the restructuring.

## 2 REQUIREMENT TO FILE AN AMENDED DISCLOSURE STATEMENT

In the event there is a change in a material fact (*i.e.* a fact that affects or could reasonably be expected to affect the value, price or use of the development units in question) which does not trigger the requirement to file a new disclosure statement, a developer is still required to file an amended disclosure statement. *REDMA* requires the developer

to file such amendment “immediately”. While filing an amendment does not give rise to a statutory right of rescission under *REDMA*, failure to file an amendment when it should have been filed may result in existing contracts being rendered unenforceable under s. 23. In addition, in light of recent case law, failure to file and deliver an amended disclosure statement after a material change takes place could entitle purchasers to rescind their agreements.

As a result, there were three important issues raised by this obligation in the *Jameson* case. These were:

- was there a “misrepresentation”;
- if so when did it occur;
- when does the disclosure statement need to be filed by.

In the *Jameson* case, the court found there was no “misrepresentation” as that term is used in *REDMA*, so it was not necessary to analyze the second two questions in great detail. The court found the financing commitment which was in place, despite eventually falling away, was nonetheless firm. Moreover, the court found the loss of the expected financing did not affect the “value, price or use of the development unit or property”, per the definition of “material fact” in *REDMA*. Chief Justice Brenner (as he then was), in the course of that decision, held:

The Developer was able to continue work on the project until November 12, 2008. The principals of the Developer held an honest belief, until just prior to the filing that they would have access to sufficient construction financing.

More significantly, if this restructuring is approved by the court and if it succeeds, the purchasers will be entitled to receive precisely what it was they contracted for. If the Petitioners fail to deliver, the purchasers will have their full right of recourse under the terms of the agreements of purchase and sale. This being the case it is difficult to see that the value, price or use of the development unit or property has so far been affected.

Thus, in this case, the loss of “firm construction financing” was not a change in a “material fact”.

In the Court of Appeal decision, the court went on to say that even if there was a requirement to file an amendment, “immediately” in a commercial context should be construed as permitting a “reasonable time

for compliance” (para. 42). This does not provide much certainty on the timing a developer must meet to avoid losing its pre-sale contracts, but it does show the court will likely recognize that a developer is not able to file an amendment the instant a material fact changes.

*REDMA* is relatively new legislation, and has not been considered in many cases (likely due to the fact that, until recently, the real estate market was strong enough that purchasers were not seeking to avoid their pre-sale agreements). These court decisions, therefore provide valuable insight into how this statute will be interpreted going forward, which is useful for real estate developers generally, and not just those in insolvent situations.

#### 4. BENEFITS OF *CCAA* PROTECTION

As discussed, the *CCAA* process is designed to preserve and restructure viable business entities, and provides the flexibility and versatility necessary to address the unique issues faced in restructuring different types of businesses. In the case of insolvent real estate development companies, there are a number of advantages to restructuring under the *CCAA*, as opposed to simply attempting to work through financial difficulties outside a court process.

Prior to the *Jameson House* case, however, the question of whether *CCAA* relief was available to real estate development companies was arguably an unresolved issue. In earlier cases, both the B.C. Supreme Court and Court of Appeal had set aside *CCAA* proceedings invoked by real estate development companies, essentially on the grounds that the process was being misused to prevent secured creditors from enforcing their rights. In addition, real estate development companies are not typically ongoing businesses, but rather one-time entities existing only for the completion of a particular project.

Notwithstanding those legal challenges, there are now a number of proceedings, including *Jameson House*, which confirm that real estate development companies can file for *CCAA* protection. The common theme in those successful proceedings is generally the support of secured creditors — a factor which was not present in any of the decisions setting aside the *CCAA* process. While it has not necessarily been decided that this support is required to permit a real estate developer to seek *CCAA* protection, in practice it is very helpful if at least the senior creditors buy into the process.

There are, therefore, a number of challenges for real estate developers to meet before they can obtain *CCAA* protection in the first place. However, assuming it is available, what are the advantages to this process?

The main advantage, as discussed above, is the stay of proceedings. An insolvent company will typically be faced with a variety of issues which, if it is forced to deal with, could effectively prevent it from developing any kind of meaningful restructuring plan. Courts therefore have the power to prevent third parties from taking any kind of action against the debtor company, ranging from limiting collection remedies to providing broad protections for ongoing directors. All of these powers could be exercised by the court if it is convinced such orders are necessary to facilitate a restructuring.

In addition, the issues which arose in the *Jameson* proceeding illustrate a number of other benefits to the *CCAA* process for real estate developers. First, the *CCAA* provides a controlled environment to work with government regulators. In the course of the *Jameson* proceedings, the court granted an order temporarily preventing the Superintendent of Real Estate from exercising its discretion under s. 16(2)(c) of *REDMA*, to require the filing of a new disclosure statement. This allowed the *Jameson* companies to work with the Superintendent throughout the restructuring without the immediate concern of being compelled to issue a new disclosure statement. In the end, after working with the *Jameson* companies and examining all the changes that took place as a result of the restructuring, the Superintendent decided there had not been any substantial change which required it to exercise its discretion.

A second advantage to the *CCAA* process is the ability to retain contracts valuable to a restructuring. As has now been discussed a number of times, the pre-sale contracts were vital to the restructuring of *Jameson House*. As a result, the court in the *Jameson* proceedings granted an order prohibiting pre-sale purchasers from exercising any right of rescission they may have during the restructuring process. At the end of the process, the court also granted an order permanently preventing pre-sale purchasers from rescinding their agreement as a result of any event that occurred prior to the *CCAA* proceedings (although, as discussed above, the courts had already found no such right existed).

Generally speaking, a real estate development company may wish to preserve a variety of contracts beyond presale agreements. For example, city service agreements, fixed price construction agreements, or favourably-priced supply agreements could all provide value in a restructured enterprise. Even if the insolvency has led to a breach of these valuable agreements, the court may determine that the contracts are binding notwithstanding the breach, if such an order is necessary to the restructuring process.

In addition, new amendments to the *CCAA* allow the court to order an assignment of a debtor company's contracts to a third party. While the provision has not yet been considered by the courts, it may be possible to liquidate valuable contracts (*i.e.* sell and assign the contract to a third party who would benefit from the agreement) in order to provide working capital to facilitate a restructuring.

A further advantage, being the flip side of preserving contracts, is the ability to disclaim agreements that are no longer advantageous to the *CCAA* company. In the *Jameson* case, given the number of changes implemented to the debtor's business, there were a number of pre-existing agreements that would have interfered with the restructuring plan. In the *CCAA*, the *Jameson* companies were able to terminate all of these agreements, and deal with any damage claims in the claims process, thus giving the *Jameson* companies the flexibility necessary to carry out their restructuring.

A third advantage, which is key to many industries that operate on low cash flow for periods of time, is the ability to borrow funds on a priority basis, ahead of all existing secured and other creditors, to facilitate ongoing business operations. This is typically referred to as "debtor in possession" or "DIP" financing. In the context of a real estate development company, this means an ability to borrow funds to continue with construction through the restructuring process. In *Jameson*, DIP financing was important for a number of reasons, but notably two. First, construction on the *Jameson House* initially stopped in the middle of building the parking garage. As a result, the work site was a large hole in the middle of downtown Vancouver, which was causing some concern for the City and neighbouring buildings. By resuming construction under DIP financing, the companies were able to address these concerns in a timely manner without the need for further litigation or dispute.

Second, construction deadlines for *Jameson* pre-sale purchasers were fast approaching. As is common in presale agreements, purchasers would acquire the right to walk away from their agreements if a completed unit was not delivered by a certain date. Ensuring that construction could resume as quickly as possible was crucial to meeting these deadlines and maintaining viability of the project.

As an alternative to DIP financing, a developer may be able to continue with construction under the "critical supplier" amendments to the *CCAA*. Under these provisions, if the court finds a supplier is "critical" to a company under *CCAA* protection, it may order the supplier to continue to provide goods and/or services throughout the restructuring process (with post-*CCAA* expenses secured by a priority charge, similar to DIP financing, ahead of existing lenders). In essence, the court may compel suppliers to provide goods or services on credit, notwithstanding the insolvency. Again, as this provision is new to the *CCAA*, it has not yet received judicial consideration, however in theory it could be a less expensive method of facilitating ongoing construction through a restructuring, or possibly an alternative where a DIP lender is not forthcoming.

The above are a few specific benefits to a *CCAA* filing which came up in the *Jameson* proceeding, and which may be useful to future insolvent real estate developers. However, as the *CCAA* is a flexible statute and may be adapted to suit the particular issues of any restructuring, there may be further benefits to each specific case.

## 5. CONCLUSIONS

The *CCAA* is a valuable tool that an insolvent real estate developer may invoke to resolve its financial difficulties. The *Jameson* proceedings provide an example of the flexibility of the *CCAA* to address unique issues that arise in a restructuring process. In addition, the court decisions made in the *Jameson* proceedings will help insolvent development companies assess their regulatory obligations under *REDMA*. Thus, the *Jameson* proceedings have provided useful insight into how a restructuring could benefit future real estate development companies that find themselves in a similar situation.

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## • NORTEL — ONTARIO COURT OF APPEAL AFFIRMS NON-PAYMENT OF TERMINATION AND SEVERANCE •

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It is not a new concept that debtors in proceedings under the *Companies' Creditors Arrangement Act*<sup>1</sup> ("CCAA") "pay as they go," paying for post-filing goods and services only as they are required.

Nevertheless, a group of former Nortel employees and a Nortel union (CAW-Canada) challenged Nortel's failure to pay certain amounts owed to employees during the CCAA, including termination and severance and other amounts due to former employees. Denied relief by Mr. Justice Morawetz this past spring,<sup>2</sup> the groups appealed. The Ontario Court of Appeal<sup>3</sup> recently upheld the lower court decision.

The Court of Appeal rejected the union's argument that Nortel's obligation to make payments to former employees could not be severed from the collective agreements, but must be considered as part of the compensation for the post-filing services of current employees. The Court confirmed that even if the triggering event is post-filing, the key factor is whether the employee performed post-filing services: if so, he or she must be compensated for such current service.

The former employees questioned whether the Court could exercise its discretion under the CCAA to excuse Nortel as employer from paying pre-filing termination and severance obligations as otherwise required by the provincial *Employment Standards Act, 2000*.<sup>4</sup>

Where provincial and federal statutory provisions are in conflict and cannot both be complied with, the constitutional doctrine of paramouncy will apply

such that the federal law will "trump" the conflicting provincial legislation. The former employees argued that the federal CCAA and the provincial employment minimum standards laws did not conflict, but could operate together.

The Court of Appeal adopted an expanded view of paramouncy, holding that the doctrine can also be triggered when a provincial law is *incompatible* with the purpose of the federal law, where complying with the provincial requirements would have the effect of *frustrating the purpose* of the federal law and therefore the intent of Parliament.

The Court reiterated that the CCAA stay is intended to allow an employer company to freeze its debt obligations in order to facilitate restructuring, for the benefit of all stakeholders. It held that this objective would be frustrated if the stay did not apply to statutory termination and severance obligations, because Nortel did not have sufficient funding to pay these amounts and also to maintain operations. The Court was not swayed by the argument that this proceeding was no longer a restructuring, but had become a going-concern liquidation.

The former employees sought leave to appeal to the Supreme Court of Canada, arguing that the paramouncy doctrine had been misapplied. However, their application was dismissed on March 25, 2010.<sup>5</sup>

The result of this decision is consistent with a number of cases in the Ontario courts over the past few months, which have addressed employees' pre-insolvency obligations such as termination and sev-

erance,<sup>6</sup> pre-filing supplemental pension benefits,<sup>7</sup> and special payments under a pension plan.<sup>8</sup>

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<sup>1</sup> R.S.C. 1985, c. C-36.

<sup>2</sup> *Nortel Networks Corp. (Re)*, [2009] O.J. No. 2558, [2009] 55 C.B.R. (5th) 68, 75 C.C.P.B. 233 (Ont. S.C.J.).

<sup>3</sup> *Nortel Networks Corp. (Re)*, [2009] O.J. No. 4967, 2009 ONCA 833, 256 O.A.C. 131, 59 C.B.R. (5th) 23, 77 C.C.P.B. 161, [2010] CLLC para. 210-005.

<sup>4</sup> S.O. 2000, c. 41.

<sup>5</sup> *Sproule v. Nortel Networks Corp.*, [2009] S.C.C.A. No. 531, [2009] S.C.C.A. No. 531.

<sup>6</sup> *Windsor Machine & Stamping Ltd. (Re)*, [2009] O.J. No. 3195 (Ont. S.C.J.).

<sup>7</sup> *Indalex Limited. (Re)*, [2009] O.J. No. 3165, [2009] 55 C.B.R. (5th) 64 (Ont. S.C.J.).

<sup>8</sup> *Fraser Papers Inc. (Re)*, [2009] O.J. No. 3188, [2009] 55 C.B.R. (5th) 217, 76 C.C.P.B. 254 (Ont. S.C.J.).

## • NEW RISKS AND REWARDS FOR LICENSORS AND LICENSEES IN BIA/CCAA AMENDMENTS •

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On September 18, 2009, after years of Parliamentary delay dating back to 2005, wide-ranging amendments to Canada's *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA"), and *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA"), (the "Amendments") came into force, providing, among other things, new protections to licensees of intellectual property.

It is important to note that the Amendments only apply in the CCAA restructuring and BIA proposal context, and not to conventional bankruptcies or receiverships.

An insolvent licensor presents risk for licensees. Prior to the Amendments, intellectual property licensees were at serious risk of having their rights to use licensed intellectual property extinguished in a restructuring proceeding. The Amendments attempt to mitigate this risk, recognizing that intellectual property licences create unique concerns relative to other types of licences and can be of particular significance to a licensee's business.

Below is a brief summary of the changes licensees and licensors can expect as well as a review of the new bargaining power dynamic as a result of the Amendments.

### ENHANCED PROTECTION FOR LICENSEES

The Amendments create a detailed framework for the disclaimer of contracts generally within a CCAA

or BIA proposal proceeding.<sup>1</sup> Even if an intellectual property licence has been successfully disclaimed by the licensor in accordance with that framework, the licensee's right to use, or its ability to enforce rights of exclusive use of, the licensed intellectual property is not affected for the duration of the licence agreement (which includes any rights of renewal). The right of continued use comes with obligations further described below.

### WHAT IS INTELLECTUAL PROPERTY?

Whereas the U.S. Bankruptcy Code has developed a specific definition of intellectual property for the purposes of legislation analogous to the Amendments and has excluded certain items such as trademarks, the Amendments provide no such definition. Arguably anything with an intellectual or knowledge-based component could be intellectual property, even if it does not fit into one of the categories traditionally thought to be included within the scope of that term.

### UNCERTAIN LICENSEE OBLIGATIONS

The right to continued use is conditional upon the licensee's continued performance of "its obligations under the agreement in relation to the use of the intellectual property." This condition may be problematic if, for example, a single fee is owed for both the use of intellectual property and the licensor's provi-

sion of support — is the licensee expected to continue to pay for all or a pro-rated portion of that fee post-disclaimer? A licence agreement drafted with the Amendments in mind could solve this problem.

#### DEPRECIATION CONCERNS

From the licensee's perspective, the ability to continue using licensed intellectual property may be of dubious value where the licensed intellectual property requires extensive ongoing maintenance, support and upgrade from the licensor. The Amendments create no obligation for the licensor to continue to provide support services in accordance with the disclaimed licence or even maintain the intellectual property (which may have particularly detrimental effects on trade-mark rights). Practically speaking, there is often little incentive for a cash-strapped licensor to invest in maintaining its intellectual property, so this is a legitimate concern.

#### LICENSEES: NEW BARGAINING POWER?

The Amendments establish intellectual property licensees as key stakeholders at the negotiating table in restructuring scenarios, particularly in the case of debtor companies that have extensively licensed their intellectual property.

If the licensed intellectual property can be used exclusively by the licensee without much support or maintenance (or such support or maintenance could be procured from a third-party), it would be difficult or costly to persuade a licensee to agree to concessions in a restructuring context in respect of its rights to exclusively use the licensed property. In such a case, a licensee is in a strong position to resist any concessions or compromises that other stakeholders in an insolvency may attempt to force upon them, or at the very least demand a high price for such concessions.

On the other hand, if the licensor's support and maintenance services are integral to the licensee's continued use of the intellectual property, the licensee would have a greater incentive to waive some of its continued use rights in return for a new licensing arrangement, perhaps with a new licensor, that assured continued maintenance of that property.

#### MARKETING INTELLECTUAL PROPERTY DESPITE THE AMENDMENTS

Insolvent companies often attempt to sell large portions of their assets as part of their restructuring efforts. By making licensed intellectual property less

marketable to potential third party purchasers, the Amendments may frustrate an insolvent company's restructuring efforts. This is the balance that has been struck between the rights of licensors and licensees. Nothing in the Amendments precludes a straight assignment of a licensing agreement to a new licensor. To the degree that assignment provisions can be built into a licence agreement, this would be of assistance in marketing intellectual property in a restructuring. Again, however, this would not dispense with the licensee's continued right to use or exclusive use.

#### BANKRUPTCY AND RECEIVERSHIP CONSIDERATIONS

As stated above, the Amendments do not provide protection to licensees in a standard bankruptcy or receivership scenario. Nothing in the Amendments prevents a receiver or bankruptcy trustee of the licensor from fully disclaiming a licence. Generally speaking, this would leave the licensee only with an unsecured claim against the licensor's estate, which would be worth little or nothing.

However, some argue that a licence (especially an exclusive and perpetual licence) creates a proprietary right for the licensee in the intellectual property. This would present challenges to a receiver or trustee in bankruptcy that attempts to assign that intellectual property or prevent the licensee's continued use of it. This issue has yet to be fully considered by Canadian courts.

#### CONCLUSIONS

The new Amendments clearly enhance the bargaining position of licensees in an insolvency scenario. With that in mind, the consequences of insolvency should become a key consideration for both licensees and licensors entering into new licensing arrangements and reviewing existing licensing arrangements.

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nology Teams. Mr. Newman can be contacted at <bnewman@ogilvyrenault.com>.]

<sup>1</sup> In the event that consent to the disclaimer is not obtained from both the counterparty to the contract and the CCAA monitor or the BIA proposal trustee, as applicable, the court will be called upon to make a determination on the disclaimer. The following factors will frame the court's analysis:

- (a) whether the proposal trustee or monitor approved the disclaimer;
- (b) whether the disclaimer would enhance the prospects of a viable proposal or compromise or arrangement being made; and
- (c) whether the disclaimer would likely cause significant financial hardship to a party to the contract.

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