Court grants receivership application over competing CCAA application

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On Feb. 29, 2024, the Ontario Superior Court of Justice (Commercial List) (the Court) released its reasons in *AFC Mortgage Administrative Inc. v. Sunrise Acquisitions (Stayner) Inc. et al.* in which it granted applications brought by two lenders for the appointment of receivers over a group of real estate development companies and their principals (the Debtors) pursuant to the *Bankruptcy and Insolvency Act* (the BIA). The lenders' applications were granted in the face of a competing application brought by the Debtors for protection under the *Companies' Creditors Arrangement Act* (the CCAA).

This decision sheds light on the factors that come into play when a court considers the choice between granting a secured creditor's receivership application or a debtor's CCAA application in the real estate development context. It affirms that although there is nothing barring real estate companies from obtaining CCAA protection, receivership applications of secured creditors will be granted instead in most cases. The reasons for this inclination include the fact that where a mortgage provides the secured creditor with the express right to seek a receivership, courts have recognized that they should not ordinarily interfere with the agreement between contracting parties, and the fact that real estate development companies often have difficulty proposing an arrangement or compromise that would be acceptable to creditors.

Background

AFC Mortgage Administration (AFC) and Brexit Holdings Inc. (Brexit) (collectively, the Lenders) provided mortgage financing to the Debtors pursuant to two loan arrangements referred to as the Stayner Loan and the Elmvale Loan. In the case of the Stayner Loan, the security given in favour of the Lenders included a first mortgage charge on a parcel of vacant land in Stayner, Ontario (the Stayner Property). Pursuant to the security granted in connection with the Stayner Loan, the Lenders had the express right to appoint a receiver in the event of default. In the case of the Elmvale Loan, AFC had two mortgages (the Elmvale Mortgages) registered against a collection of lands in Elmvale, Ontario (the Elmvale Property), each of which also contained the right for the mortgagee to appoint a receiver in the event of default.

Following defaults on the Stayner Loan and the Elmvale Mortgages, the Lenders took steps to enforce their security, including the commencement of receivership

applications. Although the Debtors did not dispute that the requirements for the appointment of a receiver were met, they argued that in the circumstances, an order under the CCAA would be preferable to a receivership in terms of bringing the matters under the CCAA and maximizing value for all stakeholders.

The analysis and decision

The first issue with the Debtors' position, as noted by the Court, was the lack of a concrete plan as to how the Debtors could accomplish what they aspired to do. The Court was not satisfied with the Debtors' proposal to establish a sales and investment solicitation process (SISP) at a comeback hearing in 10 days, finding that this amounted to saying that nothing had been done, and noting that the Lenders had the right to expect something more tangible.

The Court made an overarching comment about the choice between a receivership and a CCAA proceeding in the real estate development context, noting that while there is nothing barring a CCAA proceeding for a real estate development company, secured creditors' receivership applications will be granted in most cases. The reason for the tendency of receivership applications to prevail over CCAA applications are summed up by the Court in the following observations:

- While the CCAA can apply to companies whose sole business is a single land development, such companies do have difficulty proposing an arrangement or compromise acceptable to secured creditors;
- The priorities of security are often straightforward and there is little incentive for secured creditors having greater priority to agree to an arrangement that involves money being paid to more "junior creditors" before the senior creditors are paid in full;
- If a developer is insolvent and not able to complete a development without further funding, the secured creditors may feel that they will be in a better position by exercising their remedies rather than letting the developer remain in control of the failed development while attempting to rescue it by means of obtaining refinancing, capital injection by a new partner or a DIP financing; and
- Where a mortgagor has provided an express "covenant" agreeing to the appointment of a receiver, the Court should not ordinarily interfere with the contract between the parties.

Citing *BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc.*,[1] the Court pointed to other considerations, including the following principles:

- Although receivership is generally considered to be an extraordinary remedy, its extraordinary nature is significantly reduced when dealing with a secured creditor who has the right to a receivership under its security arrangements;
- The relief becomes even less extraordinary when dealing with a default under a mortgage;
- The court should consider factors such as the risk of the lenders' security deteriorating, the need to stabilize and preserve the debtors' business, the loss of confidence in the debtors' management, and the positions and interests of other creditors.
- In choosing between a receivership and a CCAA process, the court must balance the competing interests of various stakeholders, considering the following factors:

- Payment of the receivership applicants;
- Reputational damage;
- Preservation of employment;
- Speed of the process;
- Protection of all stakeholders;
- Cost; and
- The nature of the business.

Having regard to these principles and factors, the Court found that the Lenders had clear and uncontested rights, under their security instruments to appoint a receiver. They also had a legitimate evidentiary basis for their lack of confidence in the Debtors' management, including uncontested findings of past misappropriation of funds, concerns with the Debtors' financial statements, which are suggestive of further misappropriation of funds, and a lack of cooperation and transparency on the part of the Debtors and their principals. The Lenders also argued that their security was at a significant risk of deteriorating as defaults continued, debts remained unserviced and subcontractors remained unpaid as evidenced by the construction liens being registered against the Debtors. The Court acknowledged that given the nature of the security and the position of secured creditors with respect to a CCAA proceeding, courts have shown a strong preference for granting a receivership application where the debtor is a single-use land development company.

The Court noted that while the Debtors proposed to imbue the CCAA monitor with "super monitor" powers, it was evident that the Debtors intended to retain a role in the CCAA proceedings they were seeking. Given the level of the Lenders' distrust in the Debtors and their management, it was reasonable that their concerns would only be allayed by the appointment of a receiver, instead of a debtor-driven CCAA proceeding, even one where the monitor would purportedly have "super monitor" powers.

Moreover, the Lenders were reasonable in having a strong preference to realize on their security as opposed to a SISP process proposed by the Debtors, which would only forestall the Lenders' recovery and may result in payments to more junior creditors before the Lenders are fully paid out. The Lenders' concerns regarding their prospects of recovery were particularly apt in light of the Debtors' failure to present a concrete plan that would have a chance of success in a CCAA process, and their failure to obtain refinancing or new investors despite having had ample opportunity to do so.

Further, the Court noted that while there was ostensible appeal to the notion that appointing a single monitor under the CCAA, rather than two receivers from a costs perspective, the Stayner Property and the Elmvale Property were very different projects, which gave rise to the need for independent analysis and decision-making for each of them. Any costs savings associated with having a single monitor would be illusory to the extent that two separate and independent exercises would be required with respect to the two properties.

In light of these and other considerations, the Court granted the receiverships sought by the Lenders.

Key takeaways

While there is no presumption that a receivership will inevitably be the more appropriate proceeding in the real estate context, the Court's decision in AFC solidifies the fact that, in a significant majority of real estate cases, courts will be inclined to grant the receivership applications of creditors. This is especially the case when dealing with a default under a mortgage, and where the creditor's security gives the creditor a clear right to a receivership.

In the context of real estate development financing, given the nature of the business and the security, debtors will often have difficulty proposing an arrangement or compromise that would be more advantageous than the remedies available to creditors. In *AFC*, the Court's criticism of the Debtors' lack of a plan reinforces the fact in the real estate context, courts may only be willing to consider granting a CCAA application if the debtor is able to present evidence of a well-developed CCAA plan that has a high likelihood of success and the potential to create benefits to creditors and other stakeholders.

As defaults on real estate loans continue to be on the rise, secured creditors will be examining their enforcement options, including the appointment of a receiver over the secured property, and can take some comfort in the fact that receivership applications in the real estate setting are often granted over competing CCAA applications brought by debtors provided that the threshold requirements for a receivership are met.

Footnote

[1] *BCIMC Construction Fund Corporation et al. v. The Clover on Yonge Inc*., 2020 ONSC 1953.

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