LICENCES TO KILL:

PRESERVING THE VALUE OF LICENCES IN A REALIZATION

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THE INSOLVENCY & LITIGATION BOUTIQUE

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The scope of this paper is perhaps more accurately defined by those areas that are *not* covered, either because they are dealt with in other current papers or they are beyond the scope of a paper to be presented within the allocated time. In particular, this paper will not address the following:

(i) the airline and telecommunications industries, or other industries that are regulated pursuant to federal statutes and regulations or pursuant to municipal licensing powers;

(ii) businesses that are regulated pursuant to *Securities Act*[1] regulations; and

(iii) intellectual property licences between private parties.

This paper will focus on licences, permits and quotas granted by provincial regulatory authorities that are often encountered in insolvency situations. In particular, the purpose of the paper is to provide an overview of the more common types of licences and the restrictions and specific characteristics that must be considered in the course of realization, the judicial treatment of licences and quotas to date, and practical tips for maximizing value in a realization.

If a lender client refers a new file to you and identifies it as being involved in one of the following types of industries, your first consideration may not be to conclude that you are becoming involved in a "regulated business":

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[1] R.S.O. 1990, c. S.5.

- private investigator/security guard business
- home daycare or daycare facility
- farm
- recreational facility (such as a bowling alley or curling rink)
- nursing home
- funeral home/cemetery
- water bottling plant
- waste recycling or disposal facility
- pawn broker business
- theatre
- race track

Recognizing when you are, in fact, dealing with a "regulated business" is the first step towards ensuring that you are providing your client with a complete analysis of its options in the case of enforcement and relevant risks that it must consider. Attached to this paper is an extensive Schedule "B" listing a number of Ontario statutes and regulations containing provisions dealing with licences or quotas.[2] Schedule "B" can be used as a reference in reviewing the extent of regulatory control that exists within the framework of provincial statutes, but its stated limitations and exclusions should be noted.

What is a Regulated Business?

Broadly speaking, a regulated business can include any business that depends upon a licence or permit issued by a governmental authority pursuant to a statute or regulation in order to effectively carry on its business. It is also important to note that while many businesses are not subject to specific regulation in regard to the actual *activity* they undertake, they may derive a significant portion of their revenue through an activity that *is* regulated (such as the sale of alcohol). Accordingly, it is critical to determine whether an element of the business essential to its success or to its revenue is regulated.

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[2] The author gratefully acknowledges the extensive research undertaken by Miraldina Moreira and Kyla Mahar (associates) and Victoria Loh (student-at-law) of ThorntonGroutFinnigan LLP in reviewing Ontario statutes and regulations, and in the preparation of Schedules "A" and "B" to this paper.

“Look Before You Leap!”

Nowhere is this saying more applicable than in the steps to be taken by counsel and their clients prior to implementing a strategy for realization involving a regulated business. The effect of not understanding the business or the nature of the regulated aspect of the business can mean the difference between realizing its highest and best value, or being forced to sell assets on a piecemeal basis with no prospect of a going concern sale. Ideally, prior to enforcement, a secured lender will have had an opportunity to have a consultant or monitor review the business and operations of the company and advise the secured creditor of issues that may affect its realization strategy. Obviously, in many cases, lenders are not afforded the luxury of time or cooperation from their borrowers. In all cases, it is imperative that a lender take certain steps to satisfy itself as to any conditions or restrictions that may exist, which could materially affect its ability to realize value upon any enforcement of its rights.

(i) Type of Review to be Undertaken

Counsel acting for a lender should assist his or her client in reviewing and considering the following issues:

- Who holds the licence? (Is it held by the borrower from whom the lender holds security, or a related party with whom the lender has no contractual or other relationship?)

- If the borrower is the licensee, is the licence capable of assignment or can rights be conferred by way of a security interest or otherwise? Does the statute prohibit

the granting of a security interest in the license? What is the effect of a security interest being granted?

- If the licence is capable of being pledged, have all steps required by the relevant statute or otherwise been taken to ensure that the licence has been properly pledged in favour of the lender?

- If the licence is not capable of being pledged, has the lender obtained a proper assignment of the borrower's rights in the grant of rights resulting from the licence and any proceeds derived therefrom?

- Does the licence terminate on the happening of certain events (such as the appointment of a receiver or an assignment in bankruptcy)?

- Does the licence or the statute creating the licence give rise to deemed trusts, other security interests or claims in favour of the regulatory authority that could be asserted in priority to the interest of the lender? (This priority could be either legal priority or "practical" priority, if the legislation includes a wide discretion for approval of assignments or transfers, as this may be made subject to or conditional upon payment of fees or other amounts owing to the regulatory authority.)

- Is the borrower complying with the regulations that govern the use of the licence, or is it in breach, so as to allow the regulatory authority to revoke or suspend the licence?

- Is the borrower's insolvency or financial difficulty only *incidental* to the regulated aspect of its business, or does it *result* from the regulated aspect of its business?

- Can the business be successfully restructured in view of the existing regulatory environment?

(ii) Other Research to be Conducted

- What is the nature of the regulated business, and is the government's mandate to expand or contract that particular business? (For example, the government's decision to eliminate "D" class long-term care beds by 2006 in Ontario will have a significant impact on those "D" class nursing homes.)

- Will the regulatory authority's own agenda serve to frustrate your client's restructuring efforts?

- Does the enforcement of security require prior notification to the regulatory authority? To what extent are you authorized to discuss the borrower's affairs with the regulatory authority, in the course of notifying it of the impending enforcement?

- Is the regulated activity one that could involve public health or safety and if so, will a receiver/manager or trustee in bankruptcy be able to obtain appropriate liability insurance?

- Does the nature of the business or the degree of regulation require a Court supervised process as opposed to a private enforcement remedy?

- What conditions are likely to be attached by the regulatory authority to a transfer of the licence or the issuance of a replacement licence to a purchaser of the business?

Does a Security Interest Cover a Licence?

A lender holding a general security agreement ("GSA") and a real property mortgage over the assets of a borrower may feel that its options for enforcement in any particular scenario are limited only by its creativity and flexibility. If a business derives a significant portion of its revenue from its use of a licence or quota, or if the continued existence and good standing of a licence are required in order to operate the business, a lender should reconsider its original position. The borrower may or may not have been able to grant a security interest or assign any other rights in respect of the licence in favour of a lender. To the extent that it purported to do so, such security interest or assignment may not be enforceable as against third parties including the relevant regulatory authority. If the licence is one that is capable of being subject to a security interest, a great deal of uncertainty still exists with most licences as to how a Court will resolve a dispute arising between a lender seeking to assign its rights to the licence as part of a going concern sale, and the regulatory authority charged with enforcing the licensing regime.

A starting point for determining whether something is capable of being subject to a security interest is a review of the *Personal Property Security Act*[3]. As with most statutes, the definitions include reference to other defined terms, as follows:

"**collateral**" means personal property that is subject to a security interest;

[3] R.S.O. 1990, c. P.10 [PPSA].

> "**goods**" means tangible personal property other than chattel paper, documents of title, instruments, money and securities, and includes fixtures, growing crops, the unborn young of animals, timber to be cut and minerals and hydrocarbons to be extracted;
>
> "**intangible**" means all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, money or securities;
>
> "**personal property**" means chattel paper, documents of title, goods, instruments, intangibles, money and securities and includes fixtures but does not include building materials that have been affixed to real property.

While the definition of "goods" is limited to tangible personal property, the definition of "intangible" is left open for interpretation, by reference to the exclusion of particular things such as goods, money or securities. Of particular note, is the fact that "licence" is not included in any of these definitions under the PPSA, nor is it separately defined.[4] This has led to inconsistencies arising from a number of conflicting Court decisions, in interpreting the rights in favour of various parties operating within a regulatory framework.

Judicial Treatment of Particular Types of Licences

To date, the judicial consideration of security interests in licences and quotas has been limited, with the results being rather unpredictable. However, as Ontario courts are given more opportunities to consider this issue, trends are emerging, particularly as it relates to certain types of licences and quotas.

As is evident from the overview of Ontario statutory licences set out on Schedule "B" to this paper, there are a multitude of licences that a lender and its professional advisors must be

[4] By comparison, "licence" is specifically defined in the PPSA legislation in each of British Columbia, Saskatchewan, Northwest Territories and Nunavut. The Northwest Territories PPSA and the Nunavut PPSA are contained in the same statute. The definitions are set out on Schedule "A".

aware of as part of any enforcement strategy. Due to the lack of judicial authority with respect to most types of licences, this paper will focus on three general categories of licence:

(a) agricultural licences and quotas;

(b) nursing home licences; and

(c) liquor licences.

(a) Agricultural Licences and Quotas

Farms and fisheries are regulated by statutes in a number of different respects. This can include quotas relating to milk production and distribution, production quotas in the growing of tobacco, licences for the sale of cattle and for the production and marketing of turkeys, to name a few. One case that brought this issue to the forefront was the decision of the Ontario Court of Appeal in *National Trust Co. v. Bouckhuyt, et al.*[5]. That case involved a basic production quota for the production of tobacco, enacted pursuant to the regulations made under the *Farm Products Marketing Act*, R.S.O. 1970, c. 162 (now R.S.O. 1990, c. F.9).

At the time the quota was originally issued in 1968, it was referred to as a basic tobacco acreage quota and was allocated to particular land on which a farm was operated, which meant that it could not be sold separate from the farm. New regulations enacted in 1970 changed the quota to a "basic production quota" ("BPQ") expressed in pounds rather than acres, and allocated the quota to the operator of a farm, which meant that it could be dealt with independently from the farm itself. The Tobacco Board kept a register of all quotas, including a record of the interest of any encumbrancer of a farm or a BPQ, if notified of such interest by the encumbrancer.

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[5] (1987), 61 O.R. (2d) 640 (Ont. C.A.) [*Bouckhuyt*].

In *Bouckhuyt*, a mortgage was taken back by the vendors upon a sale of their farm in 1978, pursuant to which the BPQ was deemed to be part of the land secured by the mortgage. The mortgage prohibited the sale, transfer or disposition of the BPQ without the consent of the mortgagee. While the mortgage was registered on title, it was not registered under the PPSA. In accordance with the governing legislation, the "transfer" of the BPQ to the purchaser of the farm was effected not by way of transfer by the vendor to the purchaser, but by the cancellation of the existing BPQ by the Tobacco Growers' Marketing Board and the issuance of a new BPQ. Some time later, the mortgagor (in contravention of the terms of the mortgage), granted a chattel mortgage of the BPQ to a trust company, which duly registered the chattel mortgage under the PPSA. A priority dispute subsequently arose between the trust company and the mortgagee under the vendor take-back mortgage.

The two issues to be determined on appeal were as follows:

(a) Does the BPQ constitute intangible personal property as defined in the PPSA?

(b) If the BPQ is found to be intangible personal property, would perfection of the interest under the PPSA allow the holder of the perfected security interest to obtain priority over an unregistered security interest of which the holder had specific notice prior to taking and perfecting its security interest?

In answering the first question, Cory, J.A., as he then was, writing for the Ontario Court of Appeal, reviewed the extensive controls exercised by the Tobacco Board and concluded that the very essence of the authorizing legislation and the regulations passed pursuant to it was the control of every aspect of the industry, which was based upon their control of the quotas themselves. The BPQ was characterized as no more than the manifestation of permission to do

that which would otherwise be prohibited by statute and regulation. In other words, the quota represented the extension of a privilege, and it was subject to such discretionary control and was so "transitory and ephemeral"[6] in its nature that it could not, in the view of the Court, be considered to be property. In the Court's view, the control exercised by the Tobacco Board was "absolute and complete"[7]. While the quota was capable of being sold in a limited market (such as to another licenced producer of tobacco) the fact that it could be exchanged, sold, pledged or leased was not sufficient to make it property.

The Ontario Court of Appeal has subsequently had a number of opportunities to reconsider the characterization of a farm quota as set out in the *Bouckhuyt* case. This included a trilogy of cases, each one dealing with the issue of whether a milk quota constitutes personal property within the meaning of the PPSA.[8] Perhaps not surprisingly, the Court of Appeal was reluctant to overturn its decision in *Bouckhuyt* rendered only a few years earlier, but the trilogy of cases opened the door for a recognition of the realities inherent in commercial transactions within a regulatory framework. Without reaching a different conclusion, the Court granted substantially the same relief to the parties in one of the cases as it would have if the Court had held that a valid security interest attached to the milk quota.[9]

In contrast to the decisions rendered by the Ontario Court of Appeal in *Bouckhuyt* and the subsequent trilogy of cases, the Saskatchewan Queen's Bench reached a different conclusion in expressly finding that a milk quota, issued by the Saskatchewan Milk Control Board, was

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6 *Ibid.* at 648.
7 *Ibid.* at 647.
8 *CIBC v. Hallahan* (1990), 69 D.L.R. (4th) 499 (Ont. C.A.); *Bank of Montreal v. Bale* (1992), 4 P.P.S.A.C. 114 (Ont. C.A.); *Ontario Dairy Cow Leasing Ltd. v. Ontario Milk Marketing Board* (1993), [1993] O.J. No. 464 (Ont. C.A.).
9 *Bank of Montreal v. Bale*, *ibid.*

intangible personal property.[10] The Court placed more emphasis on the realities of commercial transactions in recognizing that it should be treated as property, and was more easily persuaded to reach that conclusion on the basis that the new personal property security legislation soon to be enacted in that province expressly included a licence in the definition of personal property.

While the trilogy of cases decided by the Ontario Court of Appeal since *Bouckhuyt* has indicated the Court's willingness to consider the commercial realities of the underlying value of a business subject to regulatory authority, no Ontario decision to date has confirmed that an agricultural licence or quota constitutes personal property that can be subject to a valid security interest.[11] A further difficulty is that property rights and security interests are governed by provincial legislation, leading to different results in the various provinces.

(b) Nursing Home Licences

Unlike agricultural licences and quotas that are regulated by a number of different statutes, nursing homes in Ontario are licenced pursuant to the *Nursing Homes Act*[12]. That statute, and the regulations made pursuant to the statute, provide that a nursing home cannot operate in the absence of a licence being issued. Accordingly, the existence and good standing of a licence issued in respect of a nursing home usually represents its most valuable asset from a lender's perspective. Nursing homes are constructed in such a manner that the facility has a very limited and specific use. As such, if a lender is not able to sell a nursing home as a going concern (together with the relevant licence to allow a continued operation) its options for

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10 *Saskatoon Auction Mart Ltd. v. Agricultural Credit Corp. of Saskatchewan,* [1993] 1 W.W.R. 265 (Sask. Q.B.).

11 In *Enterprises Rosaire Choquette Inc (Trustee of) v. Fédération des producteurs de volailles du Québec* (1983), 51 C.B.R. (N.S.) 71 (Que. S.C.) the Quebec Superior Court does consider an agricultural quota to be property of the bankrupt capable of vesting in a trustee in bankruptcy. However, that decision has not been considered or followed in any subsequent Ontario case.

12 R.S.O. 1990, c. N.7.

recovery are limited. There is not likely to be any meaningful realization from "accounts receivable" as fees are generally paid on a monthly basis, in advance. The real estate and building will have been constructed in such a manner that the individual rooms are not self contained with kitchens or related facilities to allow them to be easily converted to another use. Accordingly, it is imperative for a lender and its counsel to take all necessary steps to ensure that the lender holds appropriate security and is aware of issues affecting the enforceability of its security and the transferability of a nursing home licence.

Prior to the Ontario Court of Appeal's decision in *Sugarman v. Duca Community Credit Union Ltd.*[13] in 1999, a great deal of uncertainty existed as to the characterization of a licence issued pursuant to the *Nursing Homes Act* and any rights of secured parties that could attach to such a licence. In *Sugarman*, Lederman, J. sitting at first instance in the Ontario Court (General Division), was asked to determine whether a nursing home licence could constitute personal property within the meaning of the PPSA, such that it could be subject to a security interest.[14] That same issue had been before the Court in 1998 in the case of *Re Green Gables Manor Inc.*[15] wherein it was held by Ferrier, J. that a nursing home licence was not personal property that could be subject to a security interest. In *Sugarman*, Lederman, J. held that a nursing home licence is personal property such that a security interest could attach to it, and a secured creditor could enforce its rights as a secured creditor. On appeal, Lederman, J.'s decision was upheld. In reaching its conclusion that a nursing home licence was personal property that could be the subject of a security interest, the Court of Appeal accepted the analysis of the caselaw reviewed by Lederman, J.

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13 (1999), 44 O.R. (3d) 257 (Ont. C.A.), [*Sugarman*].
14 (1998), 38 O.R. (3d) 429 (Gen. Div.)
15 (1998), 1 C.B.R. (4th) 26 (Ont. Gen. Div.).

As a result of the conflicting decisions rendered in a number of decisions prior to *Sugarman*, Lederman, J. reviewed those decisions in detail, and summarized the Court's treatment of licences as follows:

> Ontario Courts have generally regarded licences issued under a regulatory regime as being either a privilege or right depending on the extent of discretionary control over transferability maintained by the overseeing regulatory authority. If the discretion was considered broad, then the licence would be characterized as a privilege, whereas if the discretion was of a limited nature, then the licence would be viewed as a property right in the licence holder.[16]

In reviewing the decisions rendered to date, Lederman, J. placed considerable emphasis on an analysis conducted by Lane, J. in the decision *Re Foster*[17] in which the existence of a security interest in a taxi owner's licence was before the Court. He summarized the cases to date and confirmed that there is no strict rule as to whether or not a licence constitutes personal property. Rather, he recognized, as was illustrated by the cases decided, that a real tension exists between recognizing that licences are valuable assets in the commercial market place, and recognizing the legislator's desire to maintain control over a particular industry.

Of particular importance, the lower Court decision in *Sugarman* suggests that an analysis of the relevant regulatory framework is a decisive factor in determining the nature of the licence in issue. Such an analysis should be devoted to the degree of control or discretion vested in the issuing board, with the inference being that the more unfettered the discretion, the more likely it is that the licence will be characterized as a *privilege*, whereas as the discretion becomes more confined, the licence may be in the nature of a *right* resembling property. This has become known as the "discretionary control over transferability" test. The lower court and the Court of

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16 *Sugarman, supra* note 14 at 438.
17 (1992), 89 D.L.R. (4th) 555 (Ont. Gen. Div.) [*Re Foster*].

Appeal concluded that, while embraced by a regulatory framework, a nursing home licence is neither "transitory nor ephemeral"[18] (using the language of the Court of Appeal in the *Bouckhuyt* decision).

While some of the earlier cases involved an interest acquired pursuant to a chattel mortgage, the *Sugarman* case involved a GSA. Unlike a chattel mortgage, where there is an actual transfer or assignment by the mortgagor, a security interest pursuant to a GSA does not involve an actual transfer but simply an acknowledgement that the secured party has been granted certain rights which may be exercised over particular collateral. To the extent that there may be limitations on the secured creditor's exercise of those rights as a result of the regulatory framework, it was held by the Court to be a risk that the secured creditor is assumed to take.[19] The distinction between a transfer of rights under a chattel mortgage and the granting of a security interest pursuant to a GSA is also relevant in view of the restrictions on transferability of a licence or quota contained in many of the statutes, as set out on the attached Schedule "B".

Unlike many statutes dealing with licences, as listed on Schedule "B", the *Nursing Homes Act* not only contemplates the existence of a security interest, but includes a specific definition of "security interest" as follows:

> 1(1) In this Act, …
>
> "**security interest**" means an agreement between a person and a licensee that secures the licensee's payment or performance of an obligation by giving the person an interest in the licence.

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[18] *Sugarman, supra* note 14 at 446.
[19] *Sugarman, supra* note 14 at 446.

By way of comparison, the PPSA provides the following definition:

> 1(1) in this Act, …
>
> "**security interest**" means an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation, the interest of a transferee of an account or chattel paper.

As mentioned above, the definitions contained in the PPSA do not explicitly include reference to a licence, and in cases argued prior to *Sugarman,* parties took the position that a nursing home licence was not an interest in personal property and therefore could not constitute collateral within the meaning of the PPSA. In *Sugarman* the appellant argued further that, while the *Nursing Homes Act* made reference to an agreement constituting a security interest in the licence, such interest was not intended to be read in conjunction with or by reference to the PPSA, so as to give the holder of such security interest the rights of a secured creditor pursuant to the PPSA. In dismissing that argument, the Court of Appeal confirmed that the definition of "security interest" in the *Nursing Homes Act* has no real significance *except* in connection with the PPSA, and that the reference to security interest in the *Nursing Homes Act* was a recognition of the realities of the market and an attempt to clarify that the interest of a licensee in a nursing home licence could constitute collateral within the meaning of the PPSA.

While the lower court decision of Lederman, J. provides a detailed analysis of the conflicting caselaw on the issue of whether a licence could constitute a property right so as to give rise to a security interest, the Court of Appeal appears to have focussed on the existence and recognition of a "security interest" under the *Nursing Homes Act* and the corresponding rights that flow to the holder of such a security interest. While the matter of nursing home licences in

Ontario may be considered settled as a result of the Court of Appeal's decision in *Sugarman*, Lederman, J.'s analysis of the nature of a licence and whether it could constitute a property right (which was expressly approved by the Court of Appeal) is of more general application and is very relevant for borrowers and their lenders involved in other regulated industries.

As a result of the analysis conducted by Lederman, J. in *Sugarman* and by Lane, J. in *Re Foster* as to the degree of discretion exercised by the regulatory authority, a party who seeks to assert a security interest over a licence should carefully review the provisions of the relevant legislation.

(c) Liquor Licences

Perhaps the most common type of licence that lenders and their counsel encounter is a liquor licence issued under the *Liquor Licence Act*[20]. Many businesses, such as bowling alleys, curling rinks or other recreational facilities are not regulated in respect of the activity undertaken, but derive a significant portion of their revenue from their ability to legally serve and sell alcohol to their patrons. In the case of restaurants, hotels or convention facilities, the ability to serve alcohol is crucial to its ability to carry on business. A lender enforcing its security over a hotel facility will quickly realize that, if arrangements are not made to ensure the continuity of the liquor licence, weddings, conventions and other sources of significant revenue will immediately cancel reservations, leaving an empty building that is extremely difficult to sell on a going concern basis.

The *Liquor Licence Act* contains detailed provisions restricting the sale, delivery, brewing and soliciting of liquor unless the person is the holder of a licence to do so. The obvious

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[20] R.S.O. 1990, c. L.19.

purpose of the Act and the regulations under the Act, is to ensure that the government maintains strict control over all aspects of the sale of alcohol.

Unlike many statutes, the *Liquor Licence Act* actually contemplates a change of ownership of a business carried on under a licence, and specifically provides that the licence cannot be transferred except in accordance with the Act and the regulations. Pursuant to the Act, a licensee may apply to the Registrar for a transfer of the licence to sell liquor, unless a proposal to revoke or suspend the licence has been issued by the Registrar. The *Liquor Licence Act* also specifically contemplates a transfer of the licence when a trustee in bankruptcy or Court-appointed receiver "acquires the business of a licensee"[21]. In order to allow for an orderly disposition of the business carried on under the licence, the provisions relating to such transfer also extend to a mortgagee who takes possession of the premises to which the licence applies. However, the *Liquor Licence Act* does not make reference to the most common situation, that being the private appointment of a receiver under a GSA. An argument could be made that, as a debtor company's assets vest in a trustee in bankruptcy and a Court-appointed receiver takes possession and control of a debtor's assets upon its appointment, those scenarios represent a transfer of interest in the licence, which requires the Registrar's approval. However, most types of GSA provide that, upon the appointment of a receiver by the secured creditor, the receiver is *deemed* to be the agent of the debtor. As such, the privately appointed receiver could be considered to be acting as agent of the debtor in all respects, including with respect to its rights under the liquor licence. This strategy would be extremely risky, and is not a recommended course of action.

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[21] R.R.O. 1990, Reg. 719, s.18, s.96.

One of the most significant obstacles faced by a secured creditor in respect of a business that derives a significant portion of its revenue from the sale of alcohol, is the inordinate delay involved in obtaining a transfer of the liquor licence. In some cases, this has resulted in a secured creditor proceeding by way of the appointment of an interim receiver whereby the debtor remains in possession and control of its assets, or cooperating in a proceeding under the *Companies' Creditors Arrangement Act*[22] if an irreparable disruption in the business would occur from a failure to immediately obtain a transfer of the relevant liquor licence.

It should also be noted that, pursuant to section 6(6) of the *Liquor Licence Act*, the Registrar will not renew or transfer a liquor licence if the holder of the licence is in default of paying any amounts owing pursuant to the *Retail Sales Tax Act*[23]. This can represent significant leverage in favour of the regulatory authority to enforce payment of amounts that may not otherwise be paid, as a condition of a transfer of the licence. Payment of such amounts need not be made where the request for the renewal or transfer of a licence to sell liquor is made by a trustee in bankruptcy or a Court-appointed receiver.

Enforcement Considerations

As is evident by the cases decided to date, there is still a great deal of uncertainty surrounding the nature of a licence, the ability to obtain a security interest in a licence or quota and the ability of a secured creditor to preserve the underlying value of the business in a realization scenario through enforcing its rights in relation to the licence. Caselaw has developed to a point where there is some certainty as it relates to nursing home licences, as a result of the Court of Appeal's decision in *Sugarman.* However, the status of agricultural licences and quotas

[22] R.S.C. 1985, c. C-36, as amended [CCAA].
[23] R.S.O. 1990, c. R.31.

and other types of licences remains unsettled in Ontario. As a large number of businesses in Ontario are regulated (whether federally, provincially or municipally), legislative clarification by way of an amendment to the PPSA would provide the appropriate certainty that parties require in commercial transactions involving regulated businesses. This could be accomplished by the inclusion of "licence" in the definition of "intangible" under the PPSA.

In part as a result of the existing uncertainty on the part of secured lenders to regulated businesses, it is most often the case that realization of security involves a Court supervised process, which is usually more costly than private enforcement remedies. While this is often accomplished through a Court appointed receivership, it can also be achieved through an interim receivership or a proceeding commenced under the CCAA.

Recently, a CCAA proceeding was commenced by a group of applicants involved in the bottling of water for resale.[24] The source of water used by the applicants was a third party who was not an applicant in the CCAA proceeding. That third party water supplier required and relied upon a licence issued pursuant to the *Water Transfer Control Act*[25]. Any termination, revocation or failure to renew the licence granted to this supplier of water would have resulted in the immediate cessation of the applicants' business. In that case, the stay of proceedings granted pursuant to the Initial Order included a stay preventing the regulatory authorities from terminating, revoking or failing to renew the licence issued to the water supplier, notwithstanding that the licensee (supplier) was not an applicant under the CCAA proceeding. While such an extension of the stay of proceedings should only be sought on notice to the relevant regulatory authority, there may be cases where the urgency of the application does not

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[24] *Re Echo Springs Water Corp., et al.*, Initial Order issued by Ontario Superior Court-Commercial List, Court File No. 03-CL-5110, (August 18, 2003).

[25] R.S.O. 1990, c. W. 4.

allow such notice to be given. In all cases, the regulatory authority should be immediately provided with a copy of any Order made, which should include a "come back" provision specifically allowing the regulatory authority an opportunity to seek appropriate relief, if necessary.

Unlike a privately appointed receiver who takes possession and control of a debtor's assets, or a trustee in bankruptcy that is vested with the property of a bankrupt, in a CCAA proceeding a debtor remains in possession and control of its business and assets, under the supervision of a Monitor. Similarly, an interim receivership can be structured in such a way that the debtor remains in possession and control of its assets and operations, with an Interim Receiver either monitoring its receipts and disbursements or having control of only its receipts and disbursements. Each of these options should be thoroughly reviewed to determine whether it may be advisable (or necessary) for the debtor to remain in possession and control of its assets and operations in order to maximize value in a realization, particularly where a licence is involved.

Over the last several years there have been an increasing number of situations in which professional accounting firms are unable to obtain appropriate insurance to allow them to operate a business as a going concern if they accept an appointment as receiver and manager, in order to effect a going concern sale of the business. Many industries are considered to be involved in matters of public health and safety such that the blanket policies otherwise available to such firms are insufficient to include carrying on business in a particular industry. In many cases, obtaining specific coverage as it relates to a business in an industry that involves public health or safety is not possible, as a result of prohibitive insurance premiums or the time required for the insurer to do an analysis of the risks. In a Court supervised process with an appropriate stay of

proceedings, a Court order can be sought which allows the Court appointed receiver and manager to maintain the existing insurance policies currently in place (provided premiums continue to be paid after the date of its appointment), and to prohibit the insurer from terminating coverage as a result of the insolvency of the debtor or the enforcement of a secured party's rights through a Court proceeding. However, it is still usually necessary for receivers to obtain some form of extended coverage for any claims that may arise after their appointment terminates.

Practical Tips for Lenders and Counsel

In addition to all of the usual preparation and review that a lender and its counsel will undertake in the course of developing a realization strategy, lenders and their counsel should take particular precautions when dealing with a regulated business. The following points may assist in that analysis:

- Ask yourself each of the questions set out above (under the heading "Look Before You Leap") and ensure that you are satisfied with the answer to each question or have performed sufficient due diligence to be aware of the risks.

- Review the security held by the lender to confirm whether it purports to include a security interest or other rights in respect of the licence or quota. If the security is in the nature of a chattel mortgage, review any restrictions that may exist in the governing legislation regarding the ability of the licensee to *transfer* its rights in the licence. Be aware of the difference between (i) a legal assignment and transfer of rights pursuant to a chattel mortgage, and (ii) the granting of a security interest pursuant to a GSA, and the distinctions drawn by the Ontario Courts to

date on the effect of these two types of instruments, as it relates to statutory restrictions on "transferability".

- If the lender's existing security is in the form of a chattel mortgage, consider obtaining a GSA that specifically includes reference to the licence, as well. (All of the usual considerations in respect of obtaining new security will apply, including the consideration to be given for the granting of new security.)

- Consider obtaining a separate agreement whereby the licensee's right (including with respect to the proceeds of any sale) arising from any additional rights attached to the underlying licence are assigned to the lender.

- If the security package does not already include these documents, attempt to obtain: (i) an acknowledgment and authorization from the debtor allowing the lender to communicate freely with the regulatory authority, and waiving any right of bank-customer confidentiality that may otherwise exist or, preferably, a tri-partite agreement among the debtor, the regulatory authority and the lender; and (ii) a surrender of the licence and a power of attorney in favour of the lender to execute and deliver the surrender, to allow a purchaser to obtain a re-issuance of the licence upon a sale of the business by the secured creditor.

- If the lender's security consists of a mortgage over real property and the lender has not obtained or registered an interest under the PPSA, ensure that it does so, as it will be in a better position than if it failed to do so. Confirm whether the licence is one that is issued in respect of a particular property, or if it is issued to an individual operator. If the operating lender is different than the lender holding

a mortgage over the real property, review any priority agreement or other agreement that may describe the collateral subject to the respective priorities. In many cases, the description of collateral in a priority agreement does not mirror the definitions contained in the PPSA, and therefore may specifically resolve a potential priority dispute as it relates to a licence.

- Review a current certified PPSA search and determine whether any other secured party has indicated that it claims an interest in the licence in question, or has registered an interest in priority to the lender. If necessary, make inquiries of all other secured parties pursuant to section 18 of the PPSA to obtain a description of the collateral secured by their PPSA registration.

- If a lender's security purports to include a security interest in a particular licence, in addition to any general registrations made under the PPSA (such as for a GSA), register a separate financing statement under the PPSA with a specific description of the licence in the "general collateral description"[26].

- Ensure that the statute governing the licence does not specifically prohibit the granting of a security interest in the licence (as, for example, under the *Independent Health Facilities Act*)[27], which could result in the entire transaction being void.

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[26] While the lower Court decision in *Bouckhuyt* confirmed that the PPSA overrules any equitable principles of actual notice, the Court of Appeal left open the issue as to whether the wording of the PPSA is sufficiently explicit to exclude the principle of actual notice as set out in *United Trust Co. v. Dominion Stores Ltd.* (1976), 71 D.L.R. (3d) 72 (S.C.C.).

[27] R.S.O. 1990, c.I. 3.

- At all times when advising secured creditors as to the collateral over which they hold security or their options for realization, ensure that appropriate qualifications are included as it relates to the enforceability of the lender's rights within the regulatory environment.

- Be aware of the *Personal Information Protection and Electronic Documents Act*[28] which will apply as of January 1, 2004 to all commercial transactions. As licences are often issued in regulated businesses involved in matters of health or safety (such as nursing homes), those businesses maintain confidential records such as files on individual residents that include personal information. While nursing homes are an obvious example, any type of commercial business will be subject to the Act, which could extend to information contained on individual records of employment.

Licences or quotas represent one more issue that a lender and its counsel must be aware of, in order to properly protect your client's interest. While a legislative amendment to the PPSA would be welcomed, the speed with which this issue may come before the legislators gives little comfort at this time. In the interim, the best way of ensuring that a lender obtains all that it bargained for and is able to realize the most value upon enforcement, is to review the regulatory framework very carefully prior to taking any steps of enforcement.

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[28] S.C. 2000, c.5.

Schedule "A"

British Columbia *Personal Property Security Act*, R.S.B.C. 1996, c. 359, s. 1

s.1(1)

"**intangible**" means

(a) personal property, but does not include goods, chattel paper, a document of title, an instrument, money or a security, and

(b) a licence;

…

"**licence**" means a right to harvest timber, or to grow and harvest Christmas trees, under an agreement referred to in section 12 of the *Forest Act*;

…

Saskatchewan *Personal Property Security Act*, S.S. 1993, c. P-6.2

s.2(1)

(w) "**intangible**" means personal property that is not goods, chattel paper, a document of title, an instrument, money or a security, and includes a licence;

…

(z) "**licence**" means a right, whether or not exclusive;

…

Northwest Territories and Nunavut *Personal Property and Security Act* S.N.W.T. 1994, c.8, s.1

s. 1(1)

"**intangible**" means personal property other than goods, chattel paper, a document of title, an instrument, money or a security and includes a licence;

…

"**licence**" means a right, whether or not exclusive, that is transferable by the grantee with or without restriction or the consent of the grantor

(a) to manufacture, produce, sell, transport or otherwise deal with personal property, or

(b) to provide services;

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