MORTGAGE REMEDIES FOLLOWING DEFAULT: CHOOSING BETWEEN FORBEARANCE AND ENFORCEMENT

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by Grant B. Moffat [1]

INTRODUCTION

Following default, the first and most important choice that a mortgagee must make is between forbearance and enforcement. The key to that choice is a clear understanding of the remedies available to the mortgagee under its security, especially if the debtor carries on an operating business from the mortgaged premises. Mortgage remedies are often only one part of the puzzle. A debtor which operates a business upon real property mortgaged to a secured lender will usually also grant personal property security to that lender, usually in the form of a general security agreement, charging all of its assets, property and undertaking. This paper examines the remedies available to a lender holding both real property and personal property security from a debtor carrying on an operating business.

FORBEARANCE AND RESTRUCTURING

When a lender is dissatisfied with the performance of its debtor, there are a number of steps it can take prior to enforcing all of its rights and remedies. Where the debtor has committed a default or defaults under its agreements with the lender, the lender can waive the default, tolerate the default or require remediation of the default. A "tolerance letter" notifies the debtor of the default and confirms the default will be tolerated for a specified period of time. A "letter of dissatisfaction" notifies the debtor of the default but confirms that the default must be remedied

[1] Partner, ThorntonGroutFinnigan LLP. The author wishes to gratefully acknowledge the assistance of Mahesh Uttamchandani.

by a specific date. A letter of dissatisfaction is not a demand for payment and as such does not trigger the repayment obligations of the debtor.

(A) <u>FORBEARANCE AGREEMENTS</u>

A forbearance agreement is not a court document but a contract which binds the signatories thereto in the same way as a security document. It describes the unsatisfactory situation and requires the debtor to acknowledge and correct the situation on specified terms. It also typically preserves the rights of the lender arising from the debtor's defaults during the forbearance period. In addition to the lender and the debtor, the parties to a Forbearance Agreement should include those parties who have some type of relationship with the lender arising out of the primary debt such as guarantors. If the subject loan has been insured by Canada Mortgage and Housing Corporation ("CMHC"), CMHC should be put on notice of the terms of the Forbearance Agreement. CMHC's consent to the forbearance terms may be required, and in certain circumstances, such as a fundamental restructuring of credit terms, a new certificate of insurance may be required to be issued by CMHC.

Similarly, a lender to a regulated business may need to involve the regulatory authority in forbearance discussions. For example, private hospitals are licenced in Ontario by the Ministry of Health pursuant to the *Private Hospitals Act*. Any sale or transfer of a licence to operate a private hospital may only be made with the Ministry's approval. A retirement care residence, which is not licenced in Ontario, would require no such approval.

1. When should I use a Forbearance Agreement?

Forbearance Agreements are most commonly used in the following circumstances:

(a) when the lender feels that "take out" financing for the debtor is imminent and the lender wishes to keep the debtor on a "tight leash" during the intervening period;

(b) when the lender has identified problems with its security which the debtor has agreed to remedy in exchange for the lender's continuing forbearance; and

(c) when the lender genuinely thinks that the debtor is going through a particularly bad business period and, given a little more time, can turn its fortunes around.

A forbearance agreement can be employed both before and after the debtor is in default. Often, the debtor will request some form of concession from its lender and this may be an opportune time for the lender to request an amendment to the underlying credit facilities, by way of a forbearance agreement, to terms more favourable to the lender. A forbearance agreement is also useful after default and can include, among other things, a waiver by the debtor of all notice periods including those under the *Bankruptcy and Insolvency Act* (Canada)[2] (as discussed below).

A Forbearance Agreement will generally try to achieve same or all of the following:

(a) remedy the debtor's reporting defaults or increase the level or frequency of reporting;

(b) amend the existing terms of the credit facilities as required by the situation, including the imposition of new or revised margining requirements and events of default;

(c) remedy the lender's existing security in the event that such security may be invalid or unenforceable;

[2] *Bankruptcy and Insolvency Act*,1992,c.27,s.2 [hereinafter, the "BIA"].

(d) obtain certain collateral benefits such as the execution by the debtor and any guarantors of a consent to the appointment of a receiver or receiver/manger and/or a consent to judgement;

(e) ensure third parties, including guarantors of the obligations of the debtor, confirm and ratify any prior amendments to the credit facilities which were not properly consented to by such third parties;

(f) address the appointment of a consultant or monitor of the lender's choosing to allow the lender a better opportunity to oversee the affairs of the debtor;

(g) apply pressure on the debtor's search for replacement financing through the use of fees, increased interest rates, reduced credit availability, stricter reporting requirements and the potential imposition of a monitor or consultant;

(h) assist the lender in keeping its "finger on the trigger" at all times to ensure that it can immediately enforce its rights and remedies against the debtor in the event of a material adverse change in the affairs of the debtor or any increased jeopardy to the lender's security position;

(i) allow temporary market conditions to pass which would negatively affect the realization by the lender on the collateral subject to its security; and

(j) convert a term loan to a demand loan.

It should be noted that a forbearance agreement is often used as an opportunity for the lender to take "fresh security" for the reasons described above. Lenders should be wary, however, of taking new security from a debtor which may be on the eve of insolvency. Sections 95(1) and

96[3] of the BIA allow a Trustee in Bankruptcy to review transactions made, even with arm's length parties, in the three months proceeding the date of bankruptcy and to potentially void those transactions. Consideration must be given by the lender to the debtor for such fresh security. Such consideration may include additional advances and, arguably, the lender's forbearance.

2. What terms should my Forbearance Agreement contain?

Recitals

- the recitals should reference the credit facility letter and any amendments or renewals thereto, the events of default that have occurred (if applicable), the issuance of demands and notices by the lender (if applicable) and the purpose(s) of the Forbearance Agreement (i.e. the debtor needs time to repay its indebtedness to the lender; the debtor requires time to complete an equity investment; etc.).

Acknowledgements

- the debtor should acknowledge its indebtedness to the lender, the occurrence of any defaults under the credit facilities and, if applicable, that the lender has made proper demand for repayment and that the debtor is not able to satisfy the demand for repayment at this time; if demand has not yet been made, the debtor should

[3] 95(1) **Avoidance of preference in certain cases** – Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy.

acknowledge that the lender is in a position to demand payment and that the debtor would not be able to repay its obligations to the lender upon demand.

- each guarantor should acknowledge the execution of its respective guarantee and, if applicable, the issuance of demands for payment under the guarantee and the inability of the respective guarantor to satisfy a demand for repayment at this time.

- each debtor and guarantor should release the lender from all claims that such parties may have against the lender for all matters including, without limitation, any steps taken by the lender against the debtor or the guarantors to date.

- each guarantor should specifically acknowledge and consent to the terms of the lender's forbearance and acknowledge that it has no defences or counterclaims which might be brought under its respective guarantee or any security granted to the lender.

Fees

- the debtor will usually pay the lender a forbearance fee as consideration for the lender's forbearance and other accommodations under the Forbearance Agreement.

- all of the lender's costs associated with its loan to the debtor including, without limitation, its legal fees and disbursements on a solicitor and client basis and all costs and disbursements of the lender's monitor, shall be paid by the borrower.

- a Forbearance Agreement may also include a monitoring fee which reflects the increased administration costs of the lender associated with the more detailed and/or more frequent reporting obligations imposed on the debtor.

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96 **Extended period** – Where the conveyance, transfer, charge, payout, obligation or judicial proceeding mentioned in section 95 is in favour of a person related to the insolvent person, the period referred to in subsection 95(1) shall be one year instead of three months.

Conditions Precedent

- the agreement should not be effective until certain conditions precedent have been met including the lender receiving any necessary internal approvals, the lender receiving duly authorized, executed and delivered copies of the Forbearance Agreement signed by all necessary parties thereto, the lender receiving duly executed consents by the debtor and any guarantors to the appointment of a consultant/monitor and the lender receiving any other documents or payments required under the Forbearance Agreement.

Additional Reporting Requirements

- the lender may wish to appoint a consultant/monitor to assess its security position and monitor the ongoing affairs of the debtor; the debtor and each of the guarantors should consent to the appointment of such monitor and execute a separate monitor engagement letter whereby all parties agree that such appointment is not an act of enforcement by the lender and that the monitor shall have no managerial responsibilities with respect to the debtor.
- the lender may wish to impose stricter reporting requirements on the debtor as the situation warrants.

Amendments to the Credit Facility

- if necessary, the lender may wish to amend the current credit facility agreement to impose restrictions on credit availability if the debtor's credit facilities revolve or have not been fully advanced if non-revolving.

Forbearance Deadline

- depending upon the objective of the Forbearance Agreement (i.e. to allow the debtor time to obtain take-out financing or obtain a new equity investment), the lender will wish to set a firm deadline for the repayment of all or a portion of the debtor's indebtedness to the lender with any forbearance automatically terminating on such deadline (the "Forbearance Deadline"), subject to earlier termination upon the occurrence of a "Forbearance Terminating Event" (discussed below).

- a Forbearance Agreement should be seen as a temporary situation and rarely should it initially extend beyond three months in duration; a Forbearance Agreement should not be seen as a replacement to the existing credit facility with annual reviews thereof.

Representations and Warranties

- the lender may wish to have any representations or warranties set out in the original credit facility agreement and/or any existing security held by the lender re-confirmed or obtain new representations and warranties which were not obtained in the initial security package.

  standard representations and warranties in a Forbearance Agreement include:

  (i) that the debtor will continue to conduct its business in the ordinary course in its own name and for the account of the debtor;

  (ii) that the debtor has not sold or encumbered any of its assets and that all of the assets secured by the lender's security are in existence;

(iii) that the lender's loan and security documents are valid and enforceable in accordance with their terms;

(iv) that during the course of the Forbearance Agreement the position of the borrower's unsecured creditors will not be adversely affected;

(v) that the debtor will pay all prior claims such as employee source deductions; and

(v) that any existing breaches of covenants will not worsen during the term of the Forbearance Agreement.

Non-Waiver

- the Forbearance Agreement should expressly state that none of the lender's existing rights and remedies and none of the existing defaults of the debtor are waived but that all of such rights and remedies and defaults are specifically reserved and preserved. In appropriate cases, the lender may also wish to reserve the right to take any further step it deems necessary, in its sole discretion, to protect its security position, including the issuance of any notices required by any statutes governing the enforcement of the lender's security.

Forbearance and Termination of Forbearance

- in a typical Forbearance Agreement, the lender will agree not to take any enforcement steps prior to the Forbearance Deadline (discussed above) unless and until a specific event defined as a "Forbearance Terminating Event" has occurred.

- a Forbearance Agreement should also specify that demand loans remain payable upon demand being made at any time.

- typical Forbearance Terminating Events include:

  (i) any further event of default under the original credit facility agreement or any security held by the lender;

  (ii) any defaults under any other agreements between the debtor and the lender or default under any other agreements between the debtor and any third parties;

  (iii) the insolvency, bankruptcy or the appointment of a Receiver or Receiver-Manager over the assets of the debtor; and

  (iv) fairly discretionary defaults including the occurrence, in the sole opinion of the lender, of a material adverse change in the affairs of the debtor or with respect to the security position of the lender or if the lender at any time receives a report from its monitor which is unsatisfactory to the lender in its sole discretion,

- upon the occurrence of a "Forbearance Terminating Event", a Forbearance Agreement typically allows the lender to immediately terminate the debtor's facilities and accelerate all indebtedness owing by the debtor to the lender. If the lender has previously demanded payment and issued a notice of intention to enforce security pursuant to s. 244 of the BIA, the lender should be permitted to immediately enforce all of its rights and remedies as it sees fit without the need for any further demand or notice.

- the lender may also obtain specific concessions from the debtor which are triggered upon the occurrence of a "Forbearance Terminating Event" such as the consent of the debtor and each of the guarantors to the immediate appointment of a receiver, receiver and manger or agent of the lender's choosing.

Miscellaneous Provisions

- the lender may wish to add a clause allowing it to assign the indebtedness and security of the debtor notwithstanding any contrary terms in the credit confirmation letter or security held by the lender and to disclose to a potential assignee any information regarding the debtor in the lender's possession.

- the agreement should be binding on permitted successors and assigns; the debtor and guarantors should be prohibited from assigning any of their rights or obligations under the Forbearance Agreement without the prior written consent of the lender.

ENFORCEMENT

(A) DEMANDS AND NOTICES

If forbearance is not the appropriate response to a debtor's default, or if the lender simply wishes to recover payment of the subject facility, the lender should evaluate its enforcement options. Although the decision to enforce or forbear is always fact specific, a lender will often choose enforcement for the following reasons:

(i) the debtor has defaulted under the terms of its credit facilities and permitting the debtor time to remedy the default would prejudice the lender's security position;

(ii) the lender wishes to exit the relationship;

(iii) the debtor's business has clearly failed and there is no immediate prospect of a turnaround;

(iv) the debtor has provided false reporting or otherwise misled the lender;

(v) the value of the collateral subject to the lender's security is deteriorating and immediate realization will mitigate a larger loss later on;

(vi) the lender is exiting a particular part of its portfolio or is not comfortable with the risk associated with the debtor's particular business; and

(vii) the debtor has engaged in a transaction or behaviour unacceptable to the lender, such as repaying a shareholder loan without the lender's consent.

The enforcement process almost always begins with the giving of notice to the debtor that repayment of the subject debt must be made immediately. Notwithstanding anything that may be contained in a given mortgage or other security document, it is never advisable for a mortgagee to begin enforcement proceedings without providing written notice to the debtor. Certainly in the typical case, where real property security forms part of the larger security package, liability is virtually assured if the lender takes any enforcement steps without giving written notice to the debtor.

1. Can I demand the loan?

The first step to recovering payment is determining if the subject credit facility is a term loan or a demand loan. A "demand loan" is one that is payable at any time "on demand" by the lender without reference to any other event. A "term loan" is outstanding for a specified term and usually requires payments over that term (although not necessarily so). Payment of the unpaid balance of a term loan is due on the "maturity date" unless provisions are made for acceleration of the loan upon occurrence of certain events (usually events of default). Often, even if a term loan is in default, the debtor will have a "cure period" during which to rectify such default.

A court will look at all the relevant documents to determine if the parties truly intended the subject loans to be paid on demand. If the documents conflict, a negotiated agreement will often take precedence over a lender's standard forms.

There have been no reported cases in Ontario which have determined that a lender's decision to make demand has to, in and of itself, be reasonable. The lender may make a decision to require repayment for reasons internal to the lender, independent of any conduct or default on the part of the debtor. It is always, of course, prudent for the lender to act reasonably as any behaviour that can be characterised as "unreasonable" will certainly colour a court's view of the overall behaviour of the lender.

Unfortunately, draftsmanship in credit documents results, in some cases, in an agreement where a credit facility is described as a "term demand loan". It is generally the intention of the lender in such cases that the lender reserve the right to require full payment at any time, but also requires repayment of principal amounts on a scheduled basis. In actual fact, these are intended to be demand loans and should be referred to as such. Where the misnome, "term demand loan" is used, the lender may not be able to rely upon the right to demand as the rules governing construction of documents generally favour the party that did not draft the document.

2. How much notice do I have to give?

The common law has developed a doctrine that "reasonable notice" must be given to a debtor of the lender's requirement for repayment. Prior to the decision of the Supreme Court of Canada in

Lister v. Dunlop[4] a demand for repayment could be, and usually was, immediately followed by the appointment of a receiver or other enforcement step. In that era "on demand" meant immediately. The Supreme Court of Canada, however, in *Lister*, without legislative support, interpreted the phrase "on demand" as meaning "after a reasonable time". The Court then suggested that a "reasonable time" meant "reasonable in all the circumstances" with regard to such factors as how long the debtor had a relationship with the lender and the prospects of the debtor finding re-financing. Subsequent case law has determined that, in rare cases, an immediate enforcement would be acceptable and that an outside limit of what a reasonable time might be is 30 days[5]. This position that notice must be reasonable in all the circumstances is inconsistent with the state of the law in most other commonwealth jurisdictions.

3. What other types of notices do I have to give?

Section 244 of the BIA requires that a secured creditor may not enforce security against the inventory, accounts receivable or "other property of an insolvent person" in relation to a business unless it gives notice[6] under this section of its intention to enforce its security and waits ten days after the giving of such notice, unless the debtor consents to an earlier enforcement. Although the issue has not yet been settled, the ten day BIA notice period likely does not replace the common law notice, which means that some debtors may be entitled to more than ten days notice. Lenders taking action after ten days in such cases could be responsible for damages under the *Lister* theory of reasonable notice. Although, for constitutional reasons, the BIA only applies to "insolvent persons", most mortgagors would likely be considered "insolvent persons" under the BIA definition if their primary lender had demanded payment of all outstanding loans. It is therefore the prudent course to issue a BIA Notice. The only way of shortening or

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[4] *Lister v. Dunlop* [1982] 1 S.C.R. 726 [hereinafter, *Lister*].
[5] *Bank of Nova Scotia v. Dunthy Leasing Enterprises Ltd.* [1992] 1 W.W.R. 577 (Alberta Court of Appeal).

eliminating the BIA Notice period is if the debtor signs and delivers to the lender the statutory waiver of the BIA Notice period. It should be noted that this waiver can only be signed after the notice has been given, thereby preventing lenders from requiring such a waiver as part of the original financing package at the time the mortgage and personal property security are taken.

While the BIA only requires the issuance of a BIA Notice when the property being enforced against is "all or substantially all" of the debtor's property used in its business, it is rarely prudent for a lender to attempt to engage in an analysis of whether the property being enforced against is of sufficient value to meet this test. Rather, it is preferable to simply issue the BIA Notice and, if possible, wait out the notice period. As a practical matter, lenders will often make loans to an operating company ("Opco") and take personal property security from Opco. Opco will be operating on premises that are, however, owned by its parent or subsidiary ("Holdco") whose sole purpose is to hold real property. In this case, the lender will typically take a guarantee of the Opco indebtedness from Holdco, which guarantee will be secured by a mortgage over real property. In this example, when enforcing against Holdco, although there is no personal property being enforced against, Holdco's sole or principal property consists of real estate and, therefore, a BIA Notice should be issued before enforcing the mortgage.

In addition to the BIA Notice, mortgagees proceeding by way of power of sale must issue a Notice of Sale under the *Mortgages Act*.[7] This notice requires, among other things, that the subject mortgage be in default for at least fifteen days. It is not yet settled whether such a notice can be issued contemporaneously with a BIA Notice, to allow the two notice periods to run concurrently (assuming that the 15 day default period has elapsed before the BIA Notice is issued). However, it is certainly open to a Court to find that the issuance of a Notice of Sale

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[6] Hereinafter a "BIA Notice"
[7] *Mortgages Act* R.S.O. 1990, c. M.40. [hereinafter the "*Mortgages Act*"]

Under Mortgage is an "act of enforcement" and, therefore, something that should not be done within the ten day BIA Notice period.

4. What issues should I think about before demanding?

Demanding a loan from an operating business often involves issues not encountered with a conventional mortgage loan to a real property "holdco". As with all other aspects of its debtor's affairs, the lender must keep the existence of its demand confidential. Nevertheless, publicly traded companies may have to disclose demands for repayment from their lenders as material events which could affect their stock price. This could dramatically decrease a public company's share prices which, while it may not be directly relevant to the security position of the lender, may have the effect of foreclosing certain restructuring options. In addition, knowledge of a demand often spreads quickly among trade suppliers to the debtor. This usually has the effect of eliminating trade credit for the company with further sales being on a C.O.D. basis. In some cases, trade suppliers may even require additional payment of old accounts for future, critical supplies, commonly referred to as "hostage payments"[8]. In addition, critical agreements (such as supply agreements with customers or licencing or franchise agreements) may have an "insolvency clause" which could be triggered by the demand or BIA Notice. In such an event, the other contracting party is usually given a right to terminate the agreement in question. These contracts may have a material effect on the restructuring options available to the lender and it is therefore important that the lender and its counsel obtain and review copies of any critical agreements prior to making demand for payment.

It is generally acknowledged that, in the case of a troubled business, a lender's best chance for full recovery of its loans is through the sale of the business as a going concern. This would

[8] See, for example, the current restructuring of Cineplex Odeon Corporation where film distributors were able to, despite a CCAA stay, demand payment of past invoices before providing future films.

involve a sale of the assets (both real and personal) of the company to a third party who continues to operate the company's business. If the debtor is in the process of negotiating such a sale, the lender's demand can have a material adverse affect on such negotiations. Depending on the status of such negotiations, the debtor may be compelled or may feel morally obligated to disclose the fact of the lender's demand. Such disclosure often has the effect of terminating discussions regarding equity injections or en-bloc sales and may, at the very least, depress sale prices. Very often, third party potential buyers simply wait for a receivership to buy the assets, including the real property, at a discount.

(B) TAKING CONTROL OF THE DEBTOR'S PROPERTY

Once the relevant demand and notice periods have expired, the lender is left with the decision of how to best recover payment of the subject debt. The simplest enforcement step is to issue a Notice of Sale Under Mortgage and proceed to sell the subject real property under power of sale. Real life issues are often more complicated than that, however, as the lender's security rarely consists of just vacant land. As a result, the lender will usually want to consider other options to maximize its recovery. One of the most common options considered by lenders is the appointment of a Receiver or Receiver-Manager whether by way of a private appointment under a security instrument or by way of a court appointment. A Receiver has the power to exclude the debtor's management from the debtor's premises. Appointing a Receiver may be necessary to ensure the mortgagee selling under power of sale can deliver vacant possession. A Receiver can take immediate control of the premises of the debtor to secure both the personal and real property and prevent the debtor from dissipating the value of either or both. The Receiver can then make a determination as to how best maximize the value of the debtor's assets.

5. What is the difference between a Receiver and a Receiver-Manager?

As the name suggests, a Receiver is appointed by the lender for the purpose of "receiving" the assets of the debtor, whether through the collection of accounts receivable, the sale of assets or the sale the business itself. Such appointment does not include a duty to continue to manage the business of the debtor. A Receiver-Manager, however, possesses all of the attributes of a Receiver, but is also given the ability to "manage" (carry on) the business of the debtor for the purpose of selling the business as a going concern. A Receiver is generally used for the purpose of converting the security into cash while a Receiver-Manager can have the more complex function of running the business so it can be sold *en bloc*. Often, the value of real property will be dictated by the business operated by the debtor on that property. In such cases, appointing a Receiver-Manager may be necessary to preserve value.

6. Who Should be the Receiver or Receiver-Manager?

A mortgagee in possession of the debtor's real property may find itself a "Receiver" for the purposes of the BIA. Part 11 of the BIA includes in the definition of "Receiver" a mortgagee who has taken possession of or control of the subject property under the mortgage, if that property is all or substantially all of the debtor's real property in relationship to a business carried on by an insolvent debtor. The exception to this definition is where the mortgagee recovers possession as part of the process of acquiring title to the mortgaged property through foreclosure or a transfer from the mortgagor to the mortgagee. It is generally not advisable for the mortgagee to allow itself to become a Receiver or Receiver-Manager of an operating business unless the mortgagee has the necessary expertise to avoid the potential liabilities of running a business as a Receiver. The services of a professional accounting firm will usually be required.

7. How do I make a "private" appointment?

The private appointment of a Receiver is a contractual right and must be contained in the security documents executed by the debtor. The debtor still owns its assets (they do not "vest" in the Receiver), but the debtor no longer has the right to possession or control of them. While this right is typically contained in most personal property security agreements, lenders must ensure that the power to appoint a Receiver is contained in the mortgage document as well so that the Receiver can be appointed over both the debtor's personal property and real property.

While a privately appointed Receiver will have the powers enumerated in the mortgagee's security, it remains subject to statutory restraints. For example, while the security document may give the Receiver the power to sell the subject property, the general power of sale restrictions in the *Mortgages Act*, the *Land Titles Act*[9] and, where applicable, the *Farm Debt Mediation Act*[10] will apply.

8. What obligations or concerns are associated with a private appointment ?

The privately appointed Receiver owes its duties to the lender that appointed it, and not to creditors generally. It is, however, required to carry out its duties in a "commercially reasonable" manner. The lender has an interest in ensuring that this is done, in order to minimize the chance of subsequent secured creditors, guarantors or shareholders asserting that the Receiver appointed by the lender realized on the debtor's assets improvidently. As a practical

[9] *Land Titles Act* R.S.O. 1990, c. L.5
[10] *Farm Debt Mediation Act*, S.C. 1997, c.21

matter, the lender will typically guarantee the fees and expenses of its Receiver and will also indemnify the Receiver for any liabilities, other than those arising out of negligence or misconduct.

A private receiver is not supervised by the court and is thus usually much less expensive than a court-appointed receiver.

Nevertheless, when selling the mortgaged property, either in piecemeal fashion or as part of an *en bloc* sale, the Receiver is required to comply with the terms of the security under which it has been appointed, to conduct a fair and provident sale and to account for any surplus to all stakeholders.

9. When is a Court-appointed receiver appropriate?

It is not necessary for the lender to have a contractual right to appoint a Receiver under its security documents in order to apply for a court-appointed Receiver (this can be particularly useful for mortgagees who do not have the receivership appointment right in their mortgage documents). Section 101 of the *Courts of Justice Act* (Ontario)[11] allows anyone to apply for such an appointment where it can demonstrate to the court that it is "just and convenient" that such an appointment be made. Alternatively, section 47 of the BIA permits the court to appoint an "interim receiver"[12]

[11] *Courts of Justice Act*, R.S.O. 1990 c. C.43 [hereinafter the "*CJA*"] s. 101

[12] The only way of shortening the notice period required under s. 244 of the BIA is to obtain a consent to the waiver of the notice period, after the issuance of the BIA Notice itself. Where such waiver is not practical or forthcoming, and the case is one that requires swift action by the lender, the lender may wish to consider the appointment of an Interim Receiver under the BIA, a remedy of increasing use to mortgagees.
The appointment of an Interim Receiver is almost never done with the consent of the debtor. In many cases, the debtor is not even aware that the lender is applying for the appointment of an Interim Receiver as such application can be made on an *ex parte* basis (without notice to any other party). Interim Receiver appointments are usually a matter of great urgency and are appropriate where the lender has issued, or is about to issue a BIA Notice and is concerned that the assets (real, personal or both) of the debtor would dissipate during the ten day BIA Notice period.

The appointment of a Receiver by the court may be appropriate in the following circumstances:

(i) the debtor's business is highly regulated and the court's assistance may be required to ensure the necessary governmental licences or approvals are maintained;

(ii) there are a number of parties with competing interests in the debtor's business who may prevent a privately appointed Receiver from carrying out its mandate;

(iii) there are health or safety issues which may arise during the course of the receivership in respect of which the Receiver will obtain instructions from the court to insulate it or the lender from personal liability;

(iv) the debtor refuses access to a privately appointed Receiver or if the debtor is extremely litigious and the lender desires that the Receiver's actions be sanctioned by the court;

(v) achieving the highest sale price or even being able to conduct a sale of the debtor's assets will require the court's assistance, especially in circumstances in which the debtor vows to oppose any sale of its business.

It is also appropriate where the debtor has filed a Notice of Intention to Make a Proposal under the BIA (a voluntary restructuring mechanism) which has resulted in a stay of proceedings preventing the lender from taking steps to protect its security position, or when a petition for a receiving order (an order that will make the company bankrupt) has been issued by a creditor but has not yet been granted.

Traditionally, an Interim Receiver was of little use to mortgagees as it was appointed to take control of the receipts and disbursements of the debtor on an interim basis only, while allowing the debtor to otherwise carry on its business in the ordinary course. Accordingly, orders appointing Interim Receivers required the Interim Receiver to "preserve and protect" the debtor's assets but did not authorize the sale or other disposition of the assets.

Over the last few years, however, orders appointing Interim Receivers have included a much broader mandate, including the right to market and sell the assets of the debtor (including real property). This is accomplished by the broad language of the BIA which allows the court to include such terms of the order as the court considers advisable.

10. What are the main differences between a court appointment and a private one?

Unlike in a private receivership, a court-appointed Receiver owes its duties only to the court. It is an officer of the court (in much the same way that an Interim Receiver is) and does not act in the interests of any one creditor. The actions of the court-appointed Receiver are determined by the order appointing it and any subsequent orders made by the court. The court supervises all aspects of the receivership including the sale of assets, approval of the Receiver's actions and fees and distribution of any proceeds of sale. A court-appointed Receiver files written reports with the court. The Receiver is protected by its appointment order which usually provides that no action can be brought against it without an order of the court first being obtained. This type of protection provides insulation from liability to the Receiver and to the lender requesting its appointment. Since all of the Receiver's actions are undertaken pursuant to court order (as opposed to the instructions of the lender) any claim that the Receiver has acted improvidently will only succeed if the Receiver acts outside of its court sanctioned mandate. The order appointing a Receiver usually contains a stay of proceedings prohibiting any party from interfering with the Receiver's possession of the debtor's assets, or from taking any steps to enforce their rights and remedies against the debtor. This is effective "against the world", pending any further order being made by the court. This prevents third party creditors from taking enforcement steps against the debtor which might impede the lender's realization by way of a private appointment.

The order appointing the Receiver will usually provide that the fees and expenses of the Receiver form a first charge on the assets of the debtor, in priority to every other interest including any security interest, mortgage or charge. A court-appointed receivership is usually far more expensive than a private appointment, as all actions taken by the Receiver are subject to court approval which requires that the parties prepare material and attend in court frequently in the course of administering the estate. As a result, court-appointed receiverships are generally reserved for large and complex matters.

CONCLUSION

Choosing between forbearance and enforcement following default by the debtor requires a clear understanding of the secured lender's remedies. While the worlds of real property and personal property may seem to operate exclusively of one another, in enforcement scenarios, the relevant statutes and the common law mandate that they be considered together. The mortgagee that enforces its rights without considering the practical and tactical issues raised by "traditional" insolvency law does so at its own peril.