

Focus BANKRUPTCY & INSOLVENCY

Use explicit language with notice to enforce security

Entitlement to early termination fee may depend on whether or not lender sought loan repayment



Lisa Corne

Early termination fees, or make whole payments, as they are sometimes called, are common features in commercial lending arrangements. They serve to compensate lenders for the financial loss arising from early repayment of a loan and provide lenders with the certainty of a specified rate of return in the event that the loan is repaid before maturity.

They also provide a means by which lenders may recoup upfront costs incurred in conducting due diligence investigations prior to extending a financing commitment. As such, they are an integral part of the overall economic arrangement negotiated by lenders.

Therefore, lawyers advising secured lenders on strategies for recovery of their indebtedness should be aware that certain seemingly innocuous actions may jeopardize a lender's entitlement to recover an early termination fee.

In *Re Gasfrac Energy Services Inc. (Gasfrac)*, [2015] ABQB 1501/00396, Justice Jo'Anne Streckaf considered whether the issuance of a Notice of Intention to Enforce a Security (NOI) pursuant to s. 244 of the *Bankruptcy and Insolvency Act* had deprived the lender of its entitlement to an early termination fee.

In that case, Ernst & Young Inc., in its capacity as court-appointed monitor in the proceedings by Gasfrac under the *Companies' Creditors Arrangement Act* (CCAA), took the pos-



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ition that PNC Bank Canada branch (PNC) was not entitled to an early termination fee in the amount of \$1.2 million because PNC had delivered an NOI, and thereby triggered Gasfrac's equitable right to redeem.

PNC, like most secured lenders asked to forbear from enforcing their security, sought to ensure that upon termination of the forbearance period, it would be in a position to enforce its security immediately, without having to give 10

days' prior notice as required pursuant to s. 244 of the *BIA*. Because the *BIA* prohibits a creditor from obtaining a waiver of the 10-day notice period prior to sending the NOI, PNC issued the NOI in order to ensure the effectiveness of any waiver by Gasfrac.

Justice Streckaf emphasized that the NOI was sent by PNC in the context of negotiating a forbearance agreement and was accompanied by an e-mail explicitly explaining that the NOI should not be viewed in an

adversarial manner as it was sent strictly in order to comply with the technical requirement for delivery of the notice in advance of obtaining the waiver of the 10-day notice period. Justice Streckaf therefore concluded that the issuance of the NOI by PNC did not constitute a demand for repayment or the enforcement of security that would trigger a right of redemption, so as to deny the bank's right to enforce payment of the early termination fee.

Justice Streckaf agreed with the reasoning of Justice James Farley in *Prudential Assurance Co. v. 90 Eglinton Ltd.* 1994 O.J. No. 868, in which he concluded that an NOI does not automatically trigger a right to redeem. Justice Streckaf also followed the view of the majority of the New Brunswick Court of Appeal in *Leby Properties Ltd. v. Manufacturers Life Insurance Co.* 2006 NBCA 14, in which the court held that the issuance of the NOI does not constitute a demand for repay-

ment or the enforcement of security, but rather simply alerts a debtor to the possibility that, with the passage of time, a secured creditor will be in a position to compel payment by enforcing its security.

In *Dondeb Inc. (Re)* 2013 ONSC 2832, a group of companies owning a large real estate portfolio sought relief under the *CCAA*. Empire Life Insurance Company (Empire), a mortgagee of one of the debtor's properties, together with several other mortgagees of various properties owned by the debtors, opposed the debtors' application for relief under the *CCAA*, and supported an application by certain mortgagees for the appointment of a receiver. Justice Frank Newbould held that by supporting the application to appoint a receiver over the debtors' properties, Empire had taken steps to realize on its security, and was therefore not entitled to collect any amounts claimed on the basis of repayment prior to the maturity of its loan.

Whether a lender will be entitled to payment of an early termination fee will depend upon the specific facts and circumstances of each case and whether the lender has unequivocally sought repayment of its indebtedness by enforcing its security. Lenders who send an NOI but wish to preserve entitlement to recover an early termination fee should be sure to convey, in explicit language, that no demand is being made for payment of the loan.

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Assets: In family law a spouse's debt can preclude payout of a settlement

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at any time without penalty. Bankruptcy, on the other hand, assigns the debtor's assets to the Licensed Insolvency Trustee (LIT), who distributes it to creditors. The debtor then makes a payment monthly to the LIT until discharged from the bankruptcy, which in simple situations can be as soon as nine months.

These definitions are highly simplified, and there are variations based on the quantum of

debt, whether the debtor is a corporation or an individual, whether this is a first time insolvency, and more.

Only a LIT can invoke the protection of the *Bankruptcy and Insolvency Act* (BIA) to stop creditor action against unsecured debts, relieve wage and bank garnishments and Canada Revenue Agency (CRA) garnishments and negotiate a legally binding settlement of debt for pennies on the dollar. Since the BIA exists to

assist honest but unfortunate debtors make a fresh financial start, it makes good sense for legal counsel to consider consulting with a LIT when it's clear that a client needs debt relief.

There are many ways in which client debt can become a stumbling block in the course of client representation. A family law matter can be derailed when one spouse's debt precludes payout of a settlement, or even encumbers the other

spouse's equity in the matrimonial home or other property.

Tax owing to the CRA may be secured with a lien on a home, presenting a big hiccup to the real estate lawyer trying to close a simple home sale, especially when the tax liability exceeds the proceeds of the sale.

Settlement of a tort may be impacted by the losing party's debt load. Whenever money or property is involved, debt can become a roadblock.

Whatever your area of practice, when a client's debt load becomes a problem, even if it's not material to your representation, consider referring them to a Licensed Insolvency Trustee for a review of their situation.

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