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LEGAL HYPOTHECS OF CONSTRUCTION GET PRIORITY OVER A SUPER PRIORITY GRANTED BY THE COURTS FOR DIP FINANCING IN RESPECT OF CERTAIN ASSETS OF THE BANKRUPTED PARTY¹

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THE FACTS

- ▶ Maison Marcoux Inc. ("**Maisons Marcoux**") holds real estate in Boisbriand and elsewhere;
- ▶ The Caisse populaire du Centre Nouvelle-Beauce (hereafter the "**Caisse**") provided financing for the properties owned by Maisons Marcoux for an amount of \$3,633,621 and also provided an additional \$400,000 for those properties situated in Boisbriand;
- ▶ Twenty-eight creditors (the "**Creditors**") have registered legal hypothecs for construction on the properties in Boisbriand on which they were involved in erecting buildings;
- ▶ On March 20, 2008, an initial order for Maisons Marcoux was rendered;
- ▶ On April 8, 2008, a bridge financing agreement granting a loan of \$2,150,000 was signed between Maisons Marcoux and the Caisse; under the initial order, this financing was guaranteed by a super priority granted by Maisons Marcoux in favour of the Caisse over all assets of Maisons Marcoux;
- ▶ \$878,975 of this bridge loan was used for the Boisbriand project;

- ▶ Maisons Marcoux made an assignment in bankruptcy on July 18, 2009;
- ▶ The net realizable value of the assets of the bankrupt was \$5,097,653, which included an amount of \$1,200,000 from the proceeds of sale of the immovables related to the Boisbriand project;
- ▶ The trustee in bankruptcy wished to remit \$895,808 to the Caisse as a result of its super priority over the legal hypothecs of construction of the Creditors.

THE PROCEEDING

The Creditors petitioned the Court in order to have it amend the order of priority for payment determined by the trustee, so that their claims have priority over the super priority of the Caisse, but strictly in respect of the assets of Maisons Marcoux in Boisbriand.

THE DECISION

The Court concluded that the Creditors do not have prior rank over the Caisse because the Caisse had a super priority as a result of the initial order. In fact, the Court stressed that before the amendments to the *Company Creditors Arrangement Act*² (hereafter the "**CCAA**") in 2009, "Canadian Courts recognized that they had the jurisdiction to grant super priorities under the law, even if these were granted priority over already established claims under provincial laws".³

In fact, the Court considered that it had the power to modify the order of priorities established by the trustee under the CCAA and the clause at paragraph 4 of the initial order.

However, the Court was of the view that the Creditors must benefit from equitable protection and that their rights cannot be completely decimated by the super priority of the Caisse for the following reasons:

1. The amount owing under the bridge financing was \$2,000,000 on the date of the bankruptcy; the sale of the assets of Maisons Marcoux having brought in \$5,000,000, the claim of the Caisse under the bridge financing was not in peril;
2. By imputing the proceeds of sale of the Boisbriand lands (i.e. \$1,200,000) to the reimbursement of the bridge loan, the trustee was causing irreparable harm to the Creditors who would in effect lose all of their rights as a result thereof;
3. Both Maisons Marcoux and the Caisse demonstrated that they were open to ensuring that the Creditors not lose all of their rights, all the while focusing on ensuring that Maisons Marcoux maintained enough flexibility to emerge from its precarious financial situation;

¹ Maison Marcoux Inc. (Trustee of), 2010 QCCS 1806

² L.R.C. 1985, c. C-36

³ Ibid Par. 42, in-house translation

4. The Court could not modify its initial order, but it did provide a remedy ("redressment") to the Creditors by permitting them to receive part of the proceeds of realization of the assets. In order to do so, the super priority of the Caisse will be reimbursed from the proceeds of disposition of assets other than the Boisbriand lands:

"[68] To decide otherwise would be to privilege the pre-existing hypothecary claim of the Caisse to the detriment of the legal hypothecs of construction.

"[69] A super priority relating to debtor in possession financing ("DIP") is an extraordinary measure that must be limited to what is reasonably necessary to allow the Debtor to perform any of its obligations under the arrangement."⁴

COMMENTS

Certain points in this judgment are worthy of comment:

1. The judgment is rendered with the provision that the value of the actual claims under the legal hypothecs for construction must be established subsequently thereto;
2. The Court expressly notes that as a result of the net amount received from proceeds for the assets of Maisons Marcoux, the reimbursement of the super priority of the Caisse was not in peril. Would the conclusion of the Court have been different if the net realizable value of the assets was not enough to reimburse the Caisse after the reimbursement of the Creditors? In our opinion, the answer to this question is in the affirmative;

⁴ In-house translation

3. The reimbursement of other amounts owing to the Caisse, over and above the \$4,000,000, is not a concern for the Court, as these claims rank junior to the legal hypothecs of construction of the Creditors under the rules established under the Civil Code of Quebec;
4. Does the fact that the Court purports to base its reasoning on equity cause a problem in respect of the rights of the Caisse? We believe that this is so for the following reason. When the Caisse agreed to provide its bridge loan of \$2,150,000 to Maisons Marcoux, the assets of Maisons Marcoux were established at approximately \$6,000,000 and the total claims of the Caisse were just above \$4,000,000. By providing the bridge loan, the Caisse was assured that it would recover almost the totality of its claims thanks to its super priority. However, by limiting the scope of the charge of the super priority of the Caisse, the Court effectively limited the amount that the Caisse could recover. If it had known this outcome at the outset, the Caisse may have wished to diminish the amount of the bridge loan provided by at least the value of the claims for legal hypothecs of construction by the Creditors.
5. The Court seems to make a distinction between amending the order of priorities under the initial order and the remedy ("redressement") that it provides the Creditors. However, the remedy which orders that the super priority be reimbursed with the proceeds of assets of Maisons Marcoux other than those relating to the lands in Boisbriand, when the initial order stated that the super priority charged all assets of Maisons Marcoux, seems to us to be none other than an amendment of the initial order.

At first glance, it may be prudent to consider this judgment as one that relates solely to its facts. With deference to the reasoning of the Court, which seems to have its weaknesses, if this were a decision in an area other than bankruptcy and insolvency, we could argue that it is a judgment in equity. However, we cannot forget that in matters of insolvency, "equity" (between the parties) is in fact a guiding principle in the decision making process. Finally, while all decisions are based on the facts presented before the Court, there is little doubt that this judgment can be used as a precedent for future or similar cases.

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