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The Legal and Social Implications of Insolvent Cross-Border Real Estate Developers

Edward T. Canuel

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The Legal and Social Implications of Insolvent Cross-Border Real Estate Developers: Reviewing the U.S. and Canadian Commercial Real Estate Markets

*Edward T. Canuel**

ABSTRACT

This article analyzes the phenomena associated with cyclical real estate markets, discussing the theoretical and market influences which motivate developers during this cycle. Fluctuating commercial real estate markets necessitate a focus on market upswings and downswings, and consideration of the roles and motivations of a wide array of actors, ranging from industry analysts and developers to lenders. Legal considerations, particularly during real estate downturns, or busts, include a variety of issues, particularly if the commercial real estate developers in question conducted business internationally. This Article details the theoretical and economic conditions found during real estate market cycles, with special emphasis on cross-border real estate developers. Relevant legal considerations faced by such developers confronting insolvency are also considered. Finally, the Article notes possible measures which may mitigate the many pitfalls confronting the insolvent developer.

* The Author is a graduate of Boston College, Boston College Law School, and Osgoode Hall Law School, where he received his LLM in Business Law. Currently, Mr. Canuel is a Ph.D candidate in Law at the University of Oslo. Formerly with the international law firm of McDermott, Will & Emery, where his practice included government affairs, all aspects of commercial real estate, corporate finance law, and complex cross-border transactions, the Author is now a diplomat with the U.S. Foreign Service.

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I. INTRODUCTION

Real estate development forms a crucial aspect of the closely-linked economies of Canada and the United States.[1] During the late twentieth century, real estate markets suffered a variety of market rises and crashes. For example, in the U.S. real estate market bust of 1990, a resulting financial drain gripped the United States: The

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1. The strategic commercial relationship between both nations is clearly evidenced by a significant volume of trade. The traffic of cross-border imports and exports amounts to over $1 billion per day. *See* U.S. CUSTOMS AND BORDER PROTECTION BULLETIN 04-03 (citing U.S. CENSUS BUREAU OFFICIAL STATISTICS (Note: unless specified otherwise, all referenced currencies are in U.S. dollars)); U.S. Customs & Border Prot., *U.S., Canada Partner with Trade Community to Coordinate Emergency Response,* Aug. 18, 2006, *available at* http://www.cbp.gov/xp/cgov/newsroom/news_releases/archives/2006_news_releases/082006/08182006.xml; EMBASSY OF CAN., UNITED STATES-CANADA: THE WORLD'S LARGEST TRADING RELATIONSHIP (2001), *available at* http://geo.international.gc.ca/can-am/washington/trade_and_ investment/wltr2001-en.pdf.

bankruptcy of thousands of savings and loan institutions carried a debt of $600 billion, and the government-owned Resolution Trust Corporation held 40,000 foreclosed properties.[2] The Canadian markets during the most recent real estate bust were also in turmoil; the drop in market value of the shares of the five largest Canadian developers in the first quarter of 1991 amounted to $1,935 million (CDN).[3]

Business cycles in the real estate development market are characterized by certain identifiable phases: stagnation, recovery, credit-based expansion, speculative fever, and crash.[4] Each phase elicits different behavioral responses from the business community, as "booms" lead to crises and depressions.[5] During the market

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2. JIM C. WHITEHEAD, THE MIDAS SYNDROME: AN INVESTIGATION INTO PROPERTY BOOMS AND BUSTS 1, 83 (1996). The savings and loan crisis erupted in the early 1980s when lenders, taking advantage of governmental deregulation, financed hundreds of questionable office projects. Mark McCain, *Despite High Vacancy Rates, Buildings Keep Going Up*, N.Y. TIMES, Aug. 13, 1989 at 17. "[I]n the 1982 downturn, 60% of U.S. homebuilders went out of business and over 2 million housing-related jobs were lost." WHITEHEAD, *supra*, at 77.

The aftermath of the bust was stark: In 1989, the national vacancy rate of commercial real estate space was 18.6%. McCain, *supra*. Cumulatively, the banks and savings and loan institutions lost $75 billion on bad U.S. property loans between 1982 and 1989. WHITEHEAD, *supra*, at 84 (citing *The Property Crumble*, ECONOMIST, Nov. 3, 1990, at 19–20). "With the collapse of the real estate market in 1984 came a corresponding increase in the number of savings and loan institutions that faced financial difficulty or closure." Leif M. Clark, *Chapter 11—Does One Size Fit All?* 4 AM. BANKR. INST. L. REV. 167, 179 (1996) (citing STATISTICAL ABSTRACTS OF THE UNITED STATES tbl. 795 (113th ed. 1993)). "In the years following the collapse, approximately 5,000 savings and loans were in financial difficulty and 500 more closed." *Id.* The bursting of the speculative real estate bubble (and the availability of a ready device with which to blunt the worst effects of the collapse) led to the massive surge of thousands of single asset real estate filings. *Id.* (citing Brian S. Katz, *Single-Asset Real Estate Cases and the Good Faith Requirement: Why Reluctance to Ask Whether a Case Belongs in Bankruptcy May Lead to the Incorrect Result*, 9 BANKR. DEV. J. 77, 77 n.1 (1992)). Subsequent Code amendments in 1994 attempted to protect real estate lenders and constrain the number of single asset filings. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 218, 108 Stat. 4128.

3. WHITEHEAD, *supra* note 2, at 83. Real estate developers faced enormous losses prior to the commercial real estate crash of the early 1990s in other market downturns. For example, Canadian developers "Carma, Daon and NuWest continued to show losses in 1982–1983 of the order of $1 billion dollars (CDN)." *Id.* at 111. Carma's internal attempts to retool its operations and markets, including its acquisition of the Allarco company, have been analyzed by commentators. *See id.* at 117.

4. *Id.* at 24.

5. *Id.* at 37. A depression is "a normal process of reabsorption and liquidation characterized by outbreaks of crisis—panic, breakdown of the credit system, an epidemic of bankruptcies and its further consequences—and the abnormal process of liquidation." *Id.* (quoting J.A. SCHUMPETER, THE THEORY OF ECONOMIC DEVELOPMENT (1959)). A financial depression has also been defined as "a severe and prolonged recession characterized by inefficient economic productivity, high unemployment, and falling price levels." TheFreeDictionary: Depression, http://financial-dictionary.thefreedictionary.com/Depression (last visited April 21, 2007). Liquidation is defined

downslide, credit becomes scarce as banks and entrepreneurs seek liquidity, although very few borrowers exist to replace the lost loans.[6] The developers' responses have direct effects on the real estate markets, particularly evident in periods of dramatic over-building.[7] Real estate development has been characterized as a series of stages, building upon initial real estate market recovery and ending with a crash, leading to economic stagnation.[8]

Recently, the tide of real estate market investment has again surged. Large-scale developers in major North American metropolitan centers such as Miami[9] have developed substantial real estate projects. Lenders, once hesitant to finance mid-size or small-market real estate ventures, have become aggressive;[10] financiers are

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as "[a]ny transaction that offsets or closes out a long or short position." TheFreeDictionary: Liquidation, http://financial-dictionary.thefreedictionary.com/ liquidation (last visited Apr. 21, 2007). Liquidation is viewed as creating "a spiral contraction of prices, credit and demand," which "penetrates the entire economic system." WHITEHEAD, *supra* note 2, at 37 (quoting SCHUMPETER, *supra*).

6. WHITEHEAD, *supra* note 2, at 37.

7. "In times of economic turbulence, as occurred in the 1970s and 1980s, the amplitude of the business cycle dramatically increases, the period shortens, and uncertainty grows." *Id.* at 36. Following the high technology crash in 2001, office space need decreased, with "32.1 million sq. ft. of negative absorption recorded in the top [fifty] metropolitan markets . . . ." Ben Johnson, *Ouch! Double-digit Vacancies Hit Office Market*, NAT'L REAL EST. INVESTOR, Sept. 1, 2001, *available at* http://nreionline.com/ mag/real_estate_ouch_ doubledigit_vacancies/index.html. Additionally, the "national office vacancy rate . . . reached 10%, the highest level since year-end 1997." *Id.*

8. WHITEHEAD, *supra* note 2, at 36. Theorists propose that distressed companies ultimately have three options: (i) refinance (raising additional funds, perhaps involving an overhaul of the debt side of the balance sheet, or the company finding funds from a term lender, a venture capitalist, or a provincial or federal agency); (ii) reorganization ("in the form of a merger or an acquisition by a compatible company [that] can provide the technical, operational, and financial support that a distressed company needs to achieve its full potential, a process which could be lengthy and complex"); and (iii) restructuring. Bernard R. Wilson, *The Creditors' and Debtors' Guide to Survival and Success*, 28 CBR-ART 25, 63–65 (1995).

9. Following the downward track of high technology stocks, investors shifted their money to real estate, with developers planning several residential tower condominiums. Kirk Nielsen, *It's a Mad Mad Mad Loft World*, MIAMI NEW TIMES, Sept. 4, 2003, *available at http://www.miaminewtimes.com/2003-09-04/news/it-s-a-mad-mad-mad-loft-world*. In 2003, "40 new high-rise condominium and rental apartment projects, mostly luxury, were under construction or planned in downtown Miami." *Id.* By the year 2010, Miami-Dade county anticipates that the number of downtown residents will increase by 9,347 to 106,650, requiring an additional 4,700 units over existing capacity. *Id.* Accordingly, "when the high-rise residential projects currently planned or under construction are completed in 2006 there will be an expected surplus of about 15,000 units." *Id.* If Miami-Dade "county's conservative census-based projections remain valid," this surplus will address the number "needed by the year 2020, when the downtown population reaches 136,000." *Id.*

10. Mid-sized banks, such as Corus Bankshares in Chicago (with eleven local branches), have successfully concentrated on construction and mortgage lending. Kirk Shinkle, *Small Bank Has Big Reputation as Commercial Lender*, INVESTOR'S BUS. DAILY, INC., Sept. 23, 2004, at A07. The projects are riskier and larger in size than that traditionally handled by community banks, with "[r]ecent deals includ[ing] a $57

again looking at the leverage ratios of certain clients with guarded optimism.[11] As the development market cautiously grows, concerns are raised as to what will occur when (or if) the market drops. The current expansionist market has once again triggered theorists to analyze real estate market trends. Theorists contend that the boom of a business cycle predicts an increased volume of real estate inventory hitting the market in a relatively short timeframe.[12] Alternatively, the market bust signals that there are no longer any purchasers, and business cycles end with over-supply, business failures, and financial crises.[13]

Part II of this Article explores the cyclical commercial real estate industry, addressing the causes of real estate development market swings. Issues analyzed include: (i) the interrelationship between developers and lenders and the general concept of real estate cycles; (ii) the insolvency of well-known Canadian developers, most notably Olympia & York and its vast cross-border holdings; and (iii) the idiosyncrasies of real estate developers, with a focus on the personal attributes that precipitated their businesses' demise. Part III reviews legal issues faced during the cross-border insolvencies of developers, including: (i) substantive consolidation; (ii) debtor-in-possession (DIP) financing; (iii) the extension of the stay of proceedings, particularly when a landlord "goes dark"; (iv) executory contracts; and (v) cram-down provisions. The Article concludes by noting what safeguards can be instituted to either slow the economic slide of a developer or cushion its fall into insolvency.

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million loan to build condos in Fort Myers [Florida], and an $81 million loan for a Washington, D.C., office building." *Id.* "Corus specializes almost exclusively in big projects," lending close to its legal limit. *Id.* "The firm's 76 largest loans, between $20 million and $75 million, make up more than 80% of its commitments," with its current loan pipeline at $4 billion. *Id.* Corus' strength has been loft/condo conversions which make up 61% of its portfolio. *Id.* Although mortgage rates may increase with continuing upswings in interest rates, Corus has a substantial cash position: The size and strength of Corus' capital allows it to take possession of, and maintain, non-performing properties, until market conditions improve. *Id.*; *see also* Matt Maile, *Means Forsees Continued Growth*, J. REC., Jan. 17, 2003, at 1 (stating that "[n]et valuations of property in Oklahoma county have risen from $2.178 billion in 1992 to $3.558 billion in 2002," with real estate valuations growing over $1 billion).

11. "Leverage" is defined as "a high ratio of debt to equity, which exposes a company to even small changes in the property market. In a financially leveraged company the effects of small market changes are amplified." WHITEHEAD, *supra* note 2, at 9.

12. *Id.* at 20.

13. *Id.*

II. ANALYZING REAL ESTATE MARKETS, THE DOWNFALL OF DEVELOPERS, AND THE "TYPICAL" REAL ESTATE ENTREPRENEUR

Jim Whitehead's comprehensive analysis of the cyclical commercial real estate market, *The Midas System*, remains the most authoritative scholarship contending with the social, legal, and economic implications of international commercial real estate downturns and upswings. Accordingly, the Author acknowledges the sizeable contribution which Whitehead's important study has made to this piece.

A. *Real Estate Markets: Noting Upswings and Downturns*

Theorists have widely analyzed the concept of booms and busts in the commercial real estate market, proposing that the property development industry has suffered three recent and distinctive boom periods: 1973-1974, 1978-1981, and 1987-1989. [14] During these periods, Canadian developers with extensive cross-border holdings, such as Bramlea, Campeau, Carma Developers, Olympia & York, and Trizec, all became insolvent (their liabilities exceeded assets).[15] In the 1991 real estate development collapse, the office markets in many North American cities were overbuilt.[16] While favorable interest rates encouraged real estate investors, one expert argues that developers followed a "natural tendency" to "get carried away" until the real estate cycle ended.[17] In addition, developers, financiers, and government officials blamed each other on a variety of issues, including interest rate increases (arguably decreasing capital flows to projects), [18] overly optimistic developer forecasts, and blaming generous funding.[19] Other theorists, specifically pointing to the U.S.

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14. *Id.* at 11.

15. *Id.* The most well-known U.S. real estate developer, Donald Trump, had his empire crumble in the 1980s. *See id.* at 45–47; *see also* Allen R. Myerson, *More Than a Chip Off the Building Block*, N.Y. TIMES, Dec. 1, 1996, at C1 (discussing U.S. developer Trammel Crow's decline in the 1980s).

16. WHITEHEAD, *supra* note 2, at 13.

17. *See* Nielsen, *supra* note 9; *see also* Tracy Barbour, *Alaska's Urban Real Estate Markets: Housing Market Brisk, Commercial Market Brings in New Names*, ALASKA BUS. MONTHLY, June 1, 2006, *available at* http://www.allbusiness.com/north-america/united-states-alaska/1180387-1.html (stating that the robust Alaskan commercial real estate market may face obstacles if interest rates increase).

18. WHITEHEAD, *supra* note 2, at 13. It has been suggested that "higher interest rates will not only discourage future development, but . . . could also pressure rents before the economic expansion, which is uncertain at best, can absorb them." Gil Sandler, *The"Bubble Effect" on Real Estate Values: A Commentary*, REAL EST. FIN., Aug. 1, 2005, at 3 (discussing how to create a more gentle real estate bubble meltdown).

19. WHITEHEAD, *supra* note 2, at 14. During boom cycles, governments, in particular, often contradict themselves; on one hand, governments continue to follow unalterable review controls, while a government's promotional arm encourages real

savings and loan crash in the 1980s, take note of financial institutions investing in development projects that promised high return rates (while these institutions took full advantage of then-existing tax subsidies).[20]

Although historically the initial stimulus of a boom real estate economy varies dramatically (e.g., oil price increases and gluts of petrodollars seeking investments and the deregulation of the financial industry), extremely favorable economic conditions generally precede each property boom.[21] Whitehead aptly noted the hidden dangers that are ignored or unnoticed during a boom:

> First, the shortfall between the supply and the demand is not as large as first perceived. Profit-making opportunities are created for those developers who deliver their products to the market early in the cycle. Second, the magnitude of the property boom is not directly related to the level of economic activity. Rather, the size of the property boom and its intensity seem to be related to the availability of credit, the developer's perceptions of growth potential, and the ability to gauge the actions of competitors.
>
> . . . The weak correlation between the actual demand for new construction, the builders' perceptions of new housing opportunities, and new construction itself gives rise to decision errors leading either to over-building or under-building. [22]

In an economy moving towards the apex of a boom, several themes emerge: (i) developers become reckless and aggressive, given previous successes; (ii) a developer's business associates and bankers often follow the developer blindly and abandon independent thought; (iii) incorrect development forecasts lead developers astray; and (iv) the boldest real property purchases are often made at the market bottom's peak.[23] "The debt accumulated during the boom years

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estate developers by providing positive growth forecasts and offering a "financing infrastructure." *Id.* at 36.

20. *See* Daniel S. Goldberg, *Tax Subsidies: One-time vs. Periodic An Economic Analysis of the Tax Policy Alternatives*, 49 TAX. L. REV. 305, 339–40, 344 (1994).

21. WHITEHEAD, *supra* note 2, at 24. "The coming together of energizing forces in the real estate market, the buoyant financial climate, and the development industry's positioning fuels a surge of activity in property development." *Id.* at 24–25.

22. *Id.* at 40 (citing R.U. RADCLIFFE, REAL ESTATE ANALYSIS (1961), W. SMITH, URBAN DEVELOPMENT: THE PROCESS AND THE PROBLEMS (1975), and W.G. GRIGSBY, HOUSING MARKETS AND PUBLIC POLICY (1967)).

23. *Id.* at 45. When reviewing the fluctuation of prices during cycles, certain theorists assert that real property prices are intrinsically inefficient as compared to most traded assets (such as foreign exchange, equities, or bonds), creating immense, basic valuation issues. *Hot Property*, ECONOMIST, Oct. 2, 1999, at 86. Specifically, real property, unlike stock shares in a highly liquid market, is an illiquid asset in a market where buying and selling is occasional, resulting in fewer opportunities for prices to reflect real estate product information. *Id.*; *see also* Thomas A. Motta et al., *The Future of the Valuation Profession: Diagnostic Tools and Prescriptive Practices for Real Estate Markets*, APPRAISAL J., Oct. 1, 2003, at 345 (discussing various diverse methods of real estate valuation).

reflects both the inflation of real estate values and the leveraging of those values by debt."[24] Under booms, the first developers enter markets characterized by a great unsatisfied demand, and they often make windfall profits; gains encourage increased development, which saturates the market and forces expansion into other markets.[25] Some developers are successful, and the frenzy of buying and selling in hot real estate markets inflates land prices, as developers actually create their own boom.[26] Land Banking, the purchasing and maintaining of real estate inventory, overtakes land development as real property values surpass the costs of keeping inventory.[27] As such, developers commit to massive borrowing, using land as collateral to purchase additional land.[28] "Some of the larger joint-stock companies raising capital use the inflationary increase in land value as a measure of their real equity . . . [which] permits the raising of additional capital through corporate debentures and share offerings to purchase even more land."[29] In such a situation, some companies become so financially leveraged that they are vulnerable to interest rate fluctuations and to slight changes in supply and demand of real estate.[30] As a market boom progresses, developers often become reckless; when the real property market drops, developers whose strategies are predicated on continuing inflation, ever-increasing market share, and financial leverage often fail.[31] The decisionmaking process during expansionist real estate cycles often creates hasty, poorly executed decisions which affect the urban

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24. WHITEHEAD, *supra* note 2, at 48–49.

25. *Id.* at 15.

26. *Id.*

27. *Id.* In land banking, property values were artificially raised (for example, in Calgary, potentially developable urban land values were inflated "up to sixty times" that of agricultural land near the city's limits, and up to five times the values of agricultural property several miles outside the city). *Id.* at 127–28. Calgary would have had to grow by 4 million in the 1980s to absorb all the land on which the developers and others were speculating. *Id.* at 128. Developers predicted that interest rates would inflate less than land values. *Id.* Land banking essentially allowed developers to use unlimited debt to purchase land, which, in times of needed liquidity, could be sold. *Id.*

28. *Id.* at 15.

29. *Id.* at 15–16.

30. *Id.*

31. *Id.* Investors who overestimated the present value of what a specific property could accumulate in rent over its lifetime, deducting costs, incorrectly believed that constructing new real estate projects would result in profits. *Hot Property*, *supra* note 23, at 86. Richard Herring and Susan Wachter of the Wharton School conducted a study of property price cycles in the United States, Sweden, Thailand, and Japan, and found that real estate bubbles in these countries tended to share common causes. *Id.* They found that as it took months (or years) to complete the buildings, a substantial amount of time passed before the developers, and those banks who had lent to them, discovered their mistake. *Id.* Lenders realized their errors only after enormous amounts of "money had been wasted, a large number of unprofitable new buildings had reached the market—and the market bubble had burst." *Id.*

growth process in significant ways,[32] such as the creation of inefficiencies by ignoring vacant land, while the end product sacrifices quality of design, materials, and workmanship.[33]

Real estate market busts follow the development upswings, as the following industrial collapse adversely impacts the regional economy.[34] "Given the magnitude of the callable loans, interest payments, and outstanding principal repayments, even the strongest companies take drastic action."[35] One aftershock of a real estate bust is a marked increase in local unemployment rates and lost jobs.[36] At the close of the boom in 1982, as most real estate developers faced insolvency and many confronted bankruptcy, the collapse of the development companies helped precipitate the bankruptcy of contractors, subcontractors, and investors, also triggering mergers among financial institutions.[37] Theorists contend that several reasons for a bust exist, including: (i) over-supply (which can only be cured by an upturn in the economy) and (ii) debtor firms persuading banks to enter into long-term loan modification and debt restructuring before the market improves, giving the developers a chance to ride up the next cycle without the threat of bankruptcy.[38]

B. *Cross-Border Real Estate Developers*

The experiences of Canadian developers in the 1980s illustrate the plight of developers through booms and busts. As they began to compete for contracts to develop real estate in the United States,

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32. WHITEHEAD, *supra* note 2, at 17.

33. In the 1980s race to build during a boom (as particularly evidenced in Calgary), incompatible office uses in urban planning, typified by a lack of aesthetic coherence, was the norm. *Id.* at 97. Accordingly, in the middle of the 1980s boom, Calgary lost its zoning bylaw. *Id.* Questions of environmental quality arose, in addition to the unfinished look of partially developed, premature subdivisions, which have been described as the "physical manifestations of hasty and ill-conceived decisions." *Id.* at 100; *see also* Edward T. Canuel, *Supporting Smart Growth Legislation and Audits: An Analysis of U.S. and Canadian Land Planning Theories and Tools*, 13 MICH. ST. J. INT'L L. 309, 310–11 (discussing the negative connotations of "sprawl"). An additional example of a developer land banking and ignoring development potential, much to a municipality's chagrin, may be found in Boston. That city, acting with support from the Boston Redevelopment Authority, has now threatened to pull certain permits of a major real estate developer, Frank McCourt. Thomas C. Palmer, *City Presses McCourt to Develop South Boston Site*, BOSTON GLOBE, Jan. 11, 2006, at D.4. The city is angered by McCourt's pace in developing twenty-four acres of South Boston land. *Id.*

34. WHITEHEAD, *supra* note 2, at 25.

35. *Id.* at 76.

36. In Calgary, the local economy spiraled downward: The unemployment rate went from 5.7% (1982) to 15% (1983); 44,000 jobs were lost in the period. *Id.* at 87.

37. WHITEHEAD, *supra* note 2, at 107.

38. *Id.* at 77. Many firms, technically bankrupt, must rest their very survival upon the decisions of their creditors. *Id.*

Canadian developers (with financial backing from the so-called "Big Five" institutional lenders of the 1980s) out-maneuvered local rivals who were obliged to cobble together their financing for each project from a variety of lenders in the then-fragmented U.S. banking industry.[39] Charles and Edgar Bronfman's[40] Cadillac Fairview Corp. Ltd., developer of the Toronto-Dominion Centre and the Eaton Centre, and Richard Schiff's Bramalea Ltd., whose namesake residential subdivision west of Toronto laid the foundation for a North American empire of commercial, retail, and hotel projects, were among those leading Canadian developers.[41]

In the late 1980s, all of the major Canadian banks had written down their real estate loans by hundreds of millions of dollars, with many of western Canada's banks wiped out by non-performing real estate loans.[42] Oil capitals (such as Calgary and Edmonton) fared poorly after the collapse of oil prices after 1980.[43] In 1982, the office market crash hit Calgary, with tenants leasing 3,970,000 square feet less than the previous year, resulting in a six million square-foot surplus of unoccupied, newly constructed office space.[44] Banks faced enormous write-offs, as they suffered the consequences of being overly generous in lending to real estate development companies during the boom.[45] For example, the Chemical Banking Corporation had 15% of its total loans in commercial real estate, Citibank had 14%, and the Toronto Dominion Bank had 3% (with non-performing loans in its U.S. portfolio amounting to $230 million).[46] The bust following the 1978-1981 real estate boom resulted in the bankruptcy of Canadian Commercial Bank of Edmonton, while weaker Canadian banks merged with stronger ones (e.g., Mercantile Bank merged with National Bank).[47]

The most telling example of a cross-border real estate developer's decline is illustrated in the saga of Olympia & York Developments

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39. David Olive, *Growing Up; Toronto Flexes Its Muscle in the Business World, Powered by a New Generation Willing to Take Risks*, TORONTO STAR, Nov. 10, 2002, at F01.

40. The Bronfmans gained control of an old conglomerate known as Brascan, and then proceeded to acquire several companies in the 1980s, including "real-estate developers Bramalea and Trizec Corp. Ltd. (owner of Yorkdale Shopping Centre and Montreal's landmark Place Ville Marie)." *Id.*

41. *Id.* These Toronto-based firms, financed by Toronto banks, created major development projects in several U.S. cities, including Boston and Houston. The real estate bust precipitated the bankruptcies of several major real estate developers, including Bramalea and Cadillac Fairview. *Id.*

42. WHITEHEAD, *supra* note 2, at 20. Several Canadian trust companies (e.g., Royal trust, Central Guaranty Trust, and Financial Trustco) and insurance companies (e.g., Sovereign Life) were wound down by receivers or merged. *Id.* at 21.

43. *Id.* at 80.

44. *Id.*

45. *Id.* at 78.

46. *Id.*

47. *Id.* at 82.

Ltd. (OYD), the parent of a family of companies (collectively, O&Y), operating primarily in the United States, Canada, and the United Kingdom.[48] OYD held the marquee office towers throughout Canada (e.g., First Canadian Place and Scotia Plaza in Toronto)[49] and a vast series of U.S. holdings, as evidenced by once being the largest commercial landlord in New York).[50] O&Y's troubles stemmed from: (i) over-expansion during inflationary years, (ii) the money-draining $6 billion development of London's Canary Wharf,[51] (iii) bankrupt tenants,[52] and (iv) the decision from certain lenders to reduce desperately needed financing by $150 million (requiring a security interest on O&Y's remaining unencumbered Canadian real estate interests, effectively prohibiting future financings).[53] At its apex, the company held $20 billion in real estate assets and, at its low point in 1993, owed $6.7 billion on its Canadian office towers alone.[54]

The complex, multi-tiered corporate structure of O&Y created numerous court proceedings,[55] while centralizing the assets (and loan draw-downs) of the revenues and loans for all of the O&Y companies to meet the obligations of all the companies (with the exception of its U.S. real estate assets held by a U.S. subsidiary).[56] At the time of its 1992 filing, the O&Y bankruptcy applicants incurred $13.5 (CDN) billion in debt.[57] The debtor sought (and obtained) the benefit of Chapter 11's automatic stay of proceedings by filing concurrently in Canada and the United States.[58] OYD owned approximately 80% of

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48. *See generally* Edward T. Canuel, *U.S. - Canadian Insolvencies: Reviewing Conflicting Legal Mechanisms, Challenges and Opportunities for Cross-Border Cooperation*, 4 J. INT'L BUS. & L. 8 (2005).

49. First Canadian Place Scotia Plaza and the Exchange Tower alone contained 5.3 million square feet of rentable space and had combined debts of $1.3 billion. *See id.* at 18 n.77 (citing Clyde H. Farnsworth, *Olympia May Yield Real Estate*, N.Y. TIMES, Nov. 20, 1992, at D1).

50. Kenneth N. Gilpin, *Developer and Creditor Bid for Olympia & York U.S.A.*, N.Y. TIMES, July 14, 1995, at D2.

51. Clyde H. Farnsworth, *Olympia & York Liquidation Plan Advances*, N.Y. TIMES, Jan. 26, 1993, at D6.

52. Mervyn Rothstein, *Commercial Real Estate; Dividing an Office Tower to Get the Most From It*, N.Y. TIMES, Apr. 7, 1999, at B8.

53. *See* Canuel, *supra* note 48, at 19 (citing Yoine Goldstein et al., *Olympia & York: Navigating Uncharted Waters*, *in* CASE STUDIES IN RECENT CANADIAN INSOLVENCY REORGANIZATIONS 150, 151 (Jacob S. Ziegel ed., 1997)).

54. Farnsworth, *supra* note 51, at D6.

55. Canuel, *supra* note 48, at 19.

56. *Id.*

57. *Id.*

58. Note that the parties did not attempt to seek recognition of the Canadian proceedings under § 304 of the U.S. Bankruptcy Code, under which, as will be discussed subsequently, a "foreign representative" may commence ancillary proceedings; that provision requires appointment of a monitor (which the Canadian applicants did not intend) and the existence of a trustee (which does not exist under a Companies' Creditors Arrangement Act (CCAA) filing). *Id.* at 20 n.91 (citing Goldstein, *supra* note 53, at 156).

the five U.S. insolvency applicants, which were all indirect owners of the U.S. assets.[59] The issued stay placed the Canadian parent out of the U.S. creditors' collective grasp, while also protecting the U.S. restructuring process from being immediately controlled by the Canadian creditors.[60]

Another significant Canadian real estate development enterprise, the Campeau Corporation, restructured its assets in the 1980s following huge losses suffered by its U.S. subsidiaries—the Federated Department Stores, Inc. and Allied Store Corporation.[61] Robert Campeau was a former Ottawa house builder whose Harbour Castle Hotel, along with O&Y's Toronto Star building, pioneered large-scale development on Toronto's waterfront in the 1970s.[62] Robert Campeau acquired Allied Stores Corporation for $3.5 billion in 1986 and Federated Department Stores for $6.6 billion in 1988.[63] At one point, Campeau's debt exceeded $10 billion.[64] During the 1990 insolvency proceedings, Campeau's successor in interest, Camdev, only succeeded its financially troubled parent after extensive, lengthy, and costly restructuring proceedings.[65] Campeau had neither the interest nor experience in running the department stores.[66] Despite his vision that the purchase of the stores would facilitate a planned shopping center expansion in the United States, he soon realized that the cash flow from operations and asset sales would not cover repayment of acquisition loans.[67] He lost his personal fortune (estimated at near $500 million) and control of the company to the Reichmanns (who lost $136 million of their $560 million investment in Campeau Corporation).[68]

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59. Canuel, *supra* note 48, at 19.

60. *Id.* (citing Goldstein, *supra* note 53, at 155).

61. Kevin McElcheran, *The Restructuring of Campeau Corporation*, *in* CASE STUDIES IN RECENT CANADIAN INSOLVENCY REORGANIZATIONS, *supra* note 53, at 75–76; *see also* Campeau v. Olympia & York Developments Ltd., [1992] 14 C.B.R. (3d) 303 (Can.).

62. Olive, *supra* note 39.

63. WHITEHEAD, *supra* note 2, at 44.

64. *See* McElcheran, *supra* note 61, at 75–76; *see also* Carol B. Swanson, *The Turn In Takeovers: A Study in Public Appeasement and Unstoppable Capitalism*, 30 GA. L. REV. 943, 982 n.164 (1996); Steven N. Kaplan, *Federated's Acquisition and Bankruptcy: Lessons and Implications*, 72 WASH. U. L.Q. 1103, 1105–06 (1994) (discussing valuation of buy-outs under bankruptcy regimes, with emphasis upon Campeau).

65. *See* McElcheran, *supra* note 61.

66. WHITEHEAD, *supra* note 2, at 44.

67. *Id.*

68. *Id.* at 45. Another case of an insolvent developer that would have benefited from the innovations of the O&Y cases was Northland Properties, a major western Canadian developer heavily involved in large-scale development projects, primarily in the U.S. and Canadian Pacific Northwest. At the height of its success, Northland employed over 1,000 employees and subsequently became indebted to over 2,100 creditors. In 1988, Northland claimed insolvency, following a period of interest rates exceeding 20% and negative equity approaching $100 million (CDN). Ralph D. McRae,

Development failures, particularly in Canada, were often a "result of an unmanageable growth rate, land banking, and a fascination with appraisal surplus, as well as a singular reliance on one-time sales and an uncritical view of success."[69] With respect to unmanageable growth rates, developers quickly accumulated assets, where high growth rates became difficult to manage.[70] Near the peak of the boom, developers: (i) overpaid for new properties and tendered contracts that locked costs at unmanageably high levels (and, thereafter, land and construction prices tumbled); (ii) bought overpriced lots in inadequate locations; and (iii) became embroiled in class-action law suits with condominium buyers related to the poor construction of large-scale residential real estate projects.[71]

C. *Real Estate Entrepreneurs: Idiosyncratic Factors*

Several factors of the individual developers contributed to investment mistakes, including their perceptions of the business environment.[72] Under the so-called "Midas Syndrome" shared by developers, real estate development industry leaders (generally at the forefront of innovation, discovery, and action) become overly confident and aggressive during property booms; accordingly, their followers display "groupthink," a herd instinct spreading and amplifying the original strategic errors made by their leading developers.[73] During

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Northland Properties, *in* CASE STUDIES IN RECENT CANADIAN INSOLVENCY REORGANIZATIONS, *supra* note 53, at 101.

69. WHITEHEAD, *supra* note 2, at 123.

70. *Id.* at 124.

71. *Id.* at 127. Assets purchased at the beginning of a boom are of a good value, but assets purchased near the peak of a business cycle typically are overpriced and too large for the market to digest, given the approaching glut. *Id.* at 136. A number of factors account for the change in results, including overworked markets, companies dumping unwanted assets, acquisitions made on "the greater fool theory" (if the acquisition does not turn out right, there is always someone else willing to buy it), and larger projects becoming unstable, posing a threat to the developer's survival. *Id.* Carma Development suffered several development project nightmares in western Canada, particularly due to planning goals (and expectations), which fell short of projections. Canuel, *supra* note 33, at 336 n.163. For example, Calgary's McKenzie Towne project, which incorporated high-density growth principles and public transit into its mixed use community, faced several difficulties, including high vacancy rates, stagnant sales, and the failure for the light rail system to be included. *Id.* The developer ultimately abandoned several of its development goals. *Id.*

72. WHITEHEAD, *supra* note 2, at 15.

73. *Id.* Strong, charismatic leaders often precipitate groupthink. *Id.* at 175. The group herd mentality and enticement of gains caused concern. As one developer noted, the allure of high profits caused people (particularly forthcoming retirees) to abandon their conservative investment policies, lose their entire investment portfolio in three or four years, and then be forced into working during their retirement years. *Id.* at 178–79. Managers without knowledge of the property development business were hired. *Id.* at 182. "Finance departments considered themselves to be profit

these booms, "developers make repeated strategic decision errors related to growth, diversification, and financing."[74] The dynamism of the developer essentially dominates the development enterprise.

Whitehead proposes that the more talented (and cunning) entrepreneurs move on early in the business cycle; inferior leadership remains in the market, leading to lower quality products or services produced at higher costs, thereby contributing to a further lowering of profit margins.[75] Real estate entrepreneurs possess qualities such as rationality (collecting data about products, markets, and competitors), a sense of preparing for market strategy, and high public profile and stature (often using the media).[76] For example, Australian developer Alan Bond was characterized by an unmatched audacity, an inordinate fondness for other people's money, and a willingness "to bend the rules until out of shape."[77] In addition, he placated enraged creditors by sprinkling small payments among them (promising more later, daring them to make him go bust); he staved off the judgment of the market by dodging taxes and making friends with politicians.[78]

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centers and took on lives of their own, independent of their original function." *Id.* at 184.

74. *Id.* at 15.

75. *Id.* at 42. The nature of the decision environment predicated on a centralized, strong-willed developer surrounded by placating employees leads to disastrous results. The ill-effects of a domineering developer (and the resulting work environment) include: (i) overconfident and inflated views of the relevant local economy; (ii) believing economic successes are attributed to the developer, rather than business conditions; (iii) failing to innovate and deviate from existing, previously successful business strategies, while ignoring different new challenges; (iv) failure to understand fully the local business climate; (v) misinterpreting or overvaluing business forecasts; and (vi) hoping that previous successes will somehow overcome present or future obstacles. *Id.* at 189–90.

76. *Id.* at 42.

77. *Id.* at 43–44.

78. *Id.* at 44. The recently deceased U.S. developer/contractor Lelio "Les" Marino epitomizes the rags to riches story and personal dynamism personifying certain developers and contractors. *See* Stephanie Ebbert, *Construction Firm Founder Dies; Company Worked on the Big Dig; Company Faced Ban in Stalled Rte. 3 Work*, BOSTON GLOBE, Nov. 13, 2004, at B1. Marino built a $1.3 billion empire consisting of a conglomerate of construction, real estate, restaurant, and farm interests, arriving in the United States as an Italian immigrant with only $30. *Id.* "In 1967, he launched Modern Continental with a single $4,000 sidewalk repair contract." *Id.* Modern Continental grew into a billion-dollar enterprise, with 4,000 employees, offices in New York and California, and international and national projects. Lane Lambert, *Lelio Marino, Downfall of One Man's Legacy; Tragedy Reflects the Faded Glory of Modern Continental*, PATRIOT LEDGER, July 12, 2006, at 6. Evidencing his personal dynamism (and eccentricities), he woke up between 3:00 and 4:00 a.m. each day, worked out two hours daily, never took vacations or days off from work, and dedicated himself to a strict dietary regimen. Ebbert, *supra*. He was attributed as stating, "I want to see if we can become the biggest company in the world. . . . The only person that can stop it is me." *Id.* "Observers said it was Mr. Marino's ambition that caused his business to suffer, as he spread himself thinner and his enterprise became unwieldy." *Id.* For example, Modern Continental reportedly lost millions in 2002 on a waterfront real

III. CROSS-BORDER REAL ESTATE DEVELOPMENT AND INSOLVENCIES: LEGAL CONCEPTS AND STRATEGIES

Cross-border real estate developer insolvencies[79] involve the laws of all countries involved, which often vary dramatically in the protections afforded.[80] The statutory frameworks of the Canadian and U.S. legal regimes provide a perfect example. With respect to real estate developer insolvencies, the relevant Canadian statutes are the Bankruptcy and Insolvency Act (BIA) and the Companies' Creditors Arrangement Act (CCAA).[81] Alternatively, Chapter 11 of the U.S. Bankruptcy Code must be reviewed when considering U.S.

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estate deal. Lambert, *supra*. In 2004, "the Massachusetts Highway Department was levying daily fines for the firm's delays in Route 3 roadwork north of Boston." *Id.* Recent controversies include Modern Continental's work on the multi-billion dollar Massachusetts Central Artery Tunnel Project, following the well-publicized discovery of several hundred leaks in the tunnel. Ebbert, *supra*.

79. The insolvency of real estate developers arguably draws upon issues and obstacles recently confronted by telecommunications companies. The Author's personal experiences as a practitioner attest to this. Similar to the dissolution of real estate developers of the 1980s and 1990s, telecom companies often involve the disposition of a substantive real estate portfolio (including sites for antenna communications, site towers, and communication "hotels") and, like the developers of the 1980s, many received generous financing from lenders hoping to cash in on the high tech wave. As profits decreased and debts mounted, real estate portfolios became a target to capture needed cash. For example, the telecommunications giant "Deutsche Telekom . . . cut the value of its real estate portfolio, . . . raising the likelihood that it would miss its debt-reduction target." Bertrand Benoit, *Companies & Finance Europe: D Telekom Cuts Value of Real Estate Portfolio*, FIN. TIMES, Feb. 22, 2001, at 26.

80. General scholarship *specifically* concerning real estate matters under U.S. insolvency law is admittedly sparse. Many commentators concentrate on fraudulent conveyances and minimum benchmarks for foreclosure sales. *See, e.g.*, Cynthia L. DeReamer, *Upsetting the Law of Transfer: Mortgage Foreclosures as Fraudulent Conveyances Under the Bankruptcy Code*, 63 AM. BANKR. L.J. 321 (1989) (citing Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), which established a 70% benchmark by which to avoid a mortgage foreclosure as a fraudulent conveyance under the Code). *But see* Ruebeck v. Attleboro Sav. Bank (*In re* Ruebeck), 55 B.R. 163 (Bankr. D. Mass. 1985) (discussing the reasonably prudent person standard in the conduct of a sale); Adwar v. Cargo Leasing Corp. (*In re* Adwar), 55 B.R. 111 (Bankr. E.D.N.Y. 1985) (holding that the foreclosure market itself, and not the 70% "rule," should determine the standard for reasonably equivalent value). There is significant scholarship concentrating on title matters created by insolvencies filed under the Bankruptcy and Insolvency Act (BIA). *See* Dwight Shipley, *Real Property Titles as Affected by Proceedings Under the Federal Bankruptcy Act*, 14 CBR-ART 105 (1971) (Carswell) (describing title matters with respect to real estate bankruptcy filings); *see also* John S. Kelly, *Tracing of Property Co-Mingled or Converted by Fiduciaries – A Discussion of the Principles and Rules Relating Thereto or How to Get It Back When It Seems to Be Gone*, 46 CBR-ART 189 (1983) (Carswell) (stating that under the Bankruptcy Act, the "trustee of the bankrupt is only entitled to take *the property of the bankrupt* subject to the rights and equities which affect the bankrupt").

81. Bankruptcy and Insolvency Act (BIA) (R.S.C., ch. B-3 (1985), amended by R.S.C., ch. 27, § 2 (1992), further amended by R.S.C., ch. B-3, § 269 (2004)) (Can.) (hereinafter BIA); Companies' Creditors Arrangement Act (CCAA) (R.S.C. ch. C-36 (1985), amended by, ch. C-36, § 18.6 (2004)) (Can.).

insolvencies.[82] Legal concepts applicable under both U.S. and Canadian insolvency law include: substantive consolidation, debtor-in-possession financing, extension of the stay of proceedings, executory contracts, and cram-down provisions. However, these concepts have often markedly different implications under the U.S. and Canadian legal systems.

A. *Statutes and Protocols in Canada and the United States*

Canada's bankruptcy act, amended in 1992 and now known as the BIA, is viewed as an alternative to the CCAA.[83] The BIA services small and mid-sized corporate debtors who cannot meet the $5 million (CDN) threshold required by the CCAA.[84] The CCAA, enacted in the 1930s to allow corporate reorganizations,[85] arguably filled gaps in the BIA. For example, corporate liquidations had resulted from corporate insolvencies, as the outstanding bonds of Canadian corporations did not contain contractual provisions for allowing amendments to the bond's terms in dire financial situations.[86] The CCAA addressed this issue, allowing corporations to restructure their debt.[87] Courts resurrected the CCAA in the 1980s as an equivalent to Chapter 11 of the U.S. Bankruptcy Code[88] to rescue financially troubled corporations through allowing "instant" bonds and trust deeds to be created, interpreting § 11 of the CCAA to allow courts sole discretion to issue stays or orders restraining secured and unsecured creditors, and recognizing the CCAA's implied power to rescue distressed companies.[89]

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82. Bankruptcy Code, 11 U.S.C. §§ 101–1531 (2006).

83. *See* Jacob S. Ziegel, *The Modernization of Canada's Bankruptcy Law in a Comparative Context*, 33 TEX. INT'L L.J. 1, 8 (1998); *see also* R.S.C., ch. B-3, § 269 (2004).

84. R.S.C., ch. B-3, § 269; *see* Ziegel, *supra* note 83, at 9. For a detailed description of the BIA with emphasis on sales, see David J. Griff, *Working Notes on Methods of Realization of Bankruptcy Assets*, 19 CBR-ART 111 (1975). The BIA does "not supplant the CCAA as a means of facilitating rehabilitation for large corporations. . . ." Sean Dargan, *The Emergence of Mechanisms for Cross-Border Insolvencies in Canadian Law*, 17 CONN. J. INT'L L. 107, 113 (2001); *see also* R. Gordon Marantz & Rupert H. Chartrand, *Bankruptcy and Insolvency Law Reform Continues: The 1996-1997 Amendments*, 13 B.F.L.R. 107, 110 (1998).

85. Companies' Creditors Arrangement Act, 1933, 1932-1933 S.C., ch. 36 (Can.); Dargan, *supra* note 84, at 111.

86. Dargan, *supra* note 84, at 111.

87. 1932-1933 S.C., ch. 36. *See generally* STUDY COMM. ON BANKR. & INSOLVENCY LEGISLATION, REPORT OF THE STUDY COMMITTEE ON BANKRUPTCY AND INSOLVENCY LEGISLATION (1970); Dargan, *supra* note 84, at 111.

88. Dargan, *supra* note 84, at 111.

89. 1932-1933 S.C., ch. 36; Dargan, *supra* note 84, at 111; *see also* Ziegel,, *supra* note 83, at 7 (citing Elan Corp. v. Comiskey (1991), 1 C.B.R. (3d) 101, 116-23 (Ont. CA)).

The U.S. Bankruptcy Code was enacted to offer a consistent series of rules for reorganizations.[90] Once a firm files a Chapter 11 petition, a corporation's "[m]anagement enjoys powerful legal tools, including the ability to obtain additional financing by offering new investors high priority claims, such as super-priority liens on encumbered assets."[91] Management also has the exclusive ability to propose a reorganization plan during the 120 days immediately following the Chapter 11 filing.[92] Moreover, throughout the bankruptcy process, secured creditors may request that their interests be "adequately protected."[93]

Several similarities[94] exist among the North American regimes. For example, Canadian and U.S. creditors have voting powers under both, and the BIA and Chapter 11 include the ability to force modifications upon unwilling parties.[95] However, there are numerous differences, among the insolvency statutes.[96] One major distinction

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90. Pub. L. No. 91–354, 84 Stat. 468 (1978). The Commission was formed by congressional act on July 24, 1970, and consisted of nine members. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES (THE COMMISSION), H.R. Doc. No. 93-137, pt. I (1973) [hereinafter REPORT ON BANKRUPTCY LAWS], *reprinted in* COLLIER ON BANKRUPTCY (Lawrence P. King ed., 15th ed. 1995). The Commission began hearings in June 1971, deliberated for a total of forty-four days, and submitted its report on July 30, 1973. *Id.* at pt. V. For a thorough description of the underlying theories supporting the creation of Chapter 11 and its development, *see* Clark, *supra* note 2, at 170.

91. Omer Tene, *Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganizations*, 19 BANKR. DEV. J. 287, 296 (2003) (citing 11 U.S.C. § 364 (2006)).

92. *Id.* (citing § 1121).

93. *Id.* (citing §§ 361–62).

94. The U.S. bankruptcy regime is labeled as "debtor-oriented," while the Canadian regime is characterizes as "creditor-oriented." Janis Sarra, *Debtor in Possession Financing: The Jurisdiction of Canadian Courts to Grant Super-Priority Financing in CCAA Applications*, 23 DALHOUSIE L.J. 337, 374 (2000). "The BIA grants powerful rights to secured creditors at the point of bankruptcy in order to aid debt collection and create certainty in lending decisions." *Id.* "The CCAA tempers for a very limited time period the powerful remedies of secured creditors, by taking into account the interests of all stakeholders in the restructuring process." *Id.* "The U.S. bankruptcy scheme tempers the powerful remedies of the debtor corporation during the prolonged period that it can remain in Chapter 11, by better balancing creditors' interests during this period." *Id.* at 374–75.

95. *See* Dargan, *supra* note 84, at 114–15 (citing Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 CARDOZO L. REV. 1495, 1496 (1993)).

96. The timeframe pertains to single-asset real estate under Chapter 11. *See* Scott Carlisle, *Single Asset Real Estate in Chapter 11: Secured Creditors' Perspective and the Need for Reform*, 1 AM. BANKR. INST. L. REV. 133 (1993). Timelines vary widely among the statutory regimes. Debtors have ninety days to submit a plan under Chapter 11, which secured and unsecured lenders must then separately vote on. Dargan, *supra* note 84, at 114. "Under the BIA, a mandatory creditors' meeting is held within twenty-one days of a commercial reorganization plan's filing." *Id.* If, during this meeting, the unsecured creditors reject the plan through a vote, the business is deemed bankrupt. *Id.*

between the BIA and the Bankruptcy Code is that the Code does not require that the filer make a showing of insolvency for admission to bankruptcy, which the Canadian equivalent does.[97] In Canada, "[a] Canadian corporation is declared insolvent when its financial status no longer allows it to pay its debts as they become due, or its liabilities exceed its assets."[98] Only when a corporation reaches this level, as opposed to the U.S. strategy of anticipating insolvency, it is able to initiate BIA proceedings.[99] Additionally, unlike Chapter 11, the CCAA mandates that "[t]he applicant bear[] the burden of showing that there is some likelihood of success."[100] The Chapter 11 debtor may initiate an action only by "delivering a petition, a list of names and addresses of creditors, and the filing fee to the court," which must be accepted by the court clerk.[101] Additionally, the CCAA requires that the applicant file an application for a stay, while Chapter 11 provides for an automatic stay.[102] Finally, it has been argued that the CCAA is much more flexible than Chapter 11, allowing Canadian judges wide discretion and latitude, [103]

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97. BIA, R.S.C., ch. B-3, § 50.41 (1985) (Can.); Bankruptcy Code, 11 U.S.C. §§ 109, 301, 302(a), 303(a) (2006); *see also* Theresa Beiner, et al., *Take What You Can, Give Nothing Back,: Judicial Estoppel, Employment Discrimination, Bankruptcy and Piracy in the Courts*, 60 U. MIAMI L. REV. 1, 32 n.226 (2005); Nathalie Martin, *Common Law Bankruptcy System's Similarities and Differences*, 28 B.C. INT'L & COMP. L. REV 1 (2003); Jay Lawrence Westbrook, *Creating International Insolvency Law*, 70 AM. BANKR. L.J. 563, 568 (1996) (describing various regimes recognizing foreign insolvency orders); Jacob S. Ziegel, *Corporate Groups and Canada-U.S. Crossborder Insolvencies: Contrasting Judicial Visions*, 35 CAN. BUS. L.J. 459, 462 (2001) (stating that the U.S. Bankruptcy Code § 362 automatically imposes a stay of proceedings against the debtor upon filing of Chapter 11 petition); Roundtable Discussion, *Religious Organizations Filing for Bankruptcy*, 13 AM. BANKR. INST. L. REV. 25, 30 ("Insolvency obviously isn't a requirement for filing for Chapter 11."); Bruce Leonard & Justice J.M. Farley, Lecture, Osgoode Hall Professional Development Centre Business Law LL.M. Program: Insolvency Reorganization Practice and Procedure in Canada, (Feb. 10, 2004) (hereinafter Insolvency Lecture).

98. Dargan, *supra* note 84, at 114–15 (citing Daryl E. Clark, *U.S. Asset-based Lenders: Accessing the Canadian Market*, SECURED LENDER, June 1, 1999, at 38).

99. *See* R.S.C., ch. B-3, § 2 (1985) (defining "insolvent person").

100. Steven G. Golick, What, How, Where and When to File: Considerations and Implications in Cross-border Insolvency Proceedings 6 (Feb. 24, 2003) (unpublished paper presented at the Fourth Symposium on American/Canadian Insolvency Law, on file with author).

101. Chapter 11 (11 U.S.C. §§ 301, 302(a), 303(a) (2006)); CCAA (R.S.C., ch. B-3, § 269 (2004)); *see also* Golick, *supra* note 100, at 5.

102. Chapter 11 (11 U.S.C. §§ 362 (2006)); CCAA (R.S.C., ch. B-3, § 11(1)-(6) (2004)); *see also* Golick, *supra* note 100, at 6.

103. The CCAA does not set forth any specific criteria as to when a stay should be awarded, or guidelines for reviewing whether an existing stay should be either extended or terminated. Golick, *supra* note 100, at 6. For example, "[n]o criteria are set out under the CCAA for when a stay should be granted or what considerations should be evaluated when determining whether [] a stay of proceedings should either be terminated or extended." *Id.*

particularly with respect to granting a judicial stay.[104] In sanctioning a plan under the CCAA, the court balances equities, noting the prejudices that would flow from granting or refusing the requested relief.[105] Similarly, noted Canadian insolvency expert Justice Blair held that a court reviewing a CCAA matter must act reasonably, meaning that the court must exercise "its discretion so that justice is done to all concerned parties. . . ."[106] Fairness, flexibility, and reasonableness are viewed as the crucial components of the CCAA.[107] Despite such guidelines, however, theorists and judges also note that the arguably liberal intent of the CCAA has limitations.[108]

Cross-border real estate developers navigating insolvency rules in Canada and the United States will pursue various strategies, often instituting bankruptcies in both countries. For example, cross-border insolvencies invariably involve "either a full debtor application under the CCAA or an ancillary proceeding pursuant to [§] 18.6 of the CCAA (which specifically deals with international insolvencies),

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104. Under CCAA § 11, a court has broad powers to stay all present and prospective proceedings involving an insolvent business, whereby "proceedings" has been relied on by courts to model a Chapter 11-styled approach. Golick, *supra* note 100. "In Meridian Developments v. Toronto-Dominion Bank, [[1984] 52 C.B.R. 109 (Q.B.)] J. Wachowich stated that the purpose of the stay power in [§] 11 of the CCAA was to maintain the status quo, to give the debtor company breathing space to develop its restructuring plan, and to prevent creditors from trying to obtain an advantage over other creditors." Douglas S. Nishimura, *The Companies' Creditors Arrangement Act and the Petroleum Industry: The Blue Range Resource Corporation Proceedings*, 39 ALBERTA. L. REV. 35, 43 (2001).

105. Canuel, *supra* note 48, at 12 (citing *Re* Olympia & York Developments, [1995] 34 C.B.R. (3d) 93, 500 (Can.)). Justice Blair stated that "'[f]airness' and 'reasonableness' are . . . the two keynote concepts underscoring the philosophy and workings of [the CCAA] . . . . If a debtor company, in financial difficulties, has a reasonable chance of staving off a liquidator by negotiating a compromise arrangement with its creditors, 'fairness' to its creditors as a whole, and to its shareholders, prescribes that it should be allowed an opportunity to do so, consistent with not 'unfairly' or 'unreasonably' depriving creditors of their rights under their security. . . ." *Re Olympia & York Developments*, 34 C.B.R. (3d) at 508–09 (Can.).

106. Olympia & York Developments Ltd., [1995] 38 C.B.R. (3d) 54, 62 (Can.).

107. Canuel, *supra* note 48, at 6.

108. For example, the "court may deny access to a debtor if it is demonstrated that the debtor will not be viable once restructured." Golick, *supra* note 100, at 3 (citing *Bargain Harold's* case, *Bargain Harold's Discount Ltd.* v. *Paribas Bank of Canada* (1992), 7 O.R. (3d) 362, 370–71 (Ont. Gen. Div.), where J. Austin, in dismissing the debtor's application, commented: "[T]he applicant still does not know the precise nature of the problem which brought about its financial circumstances. According to its own auditors, the cause or causes may never be known. . . . [T]he applicant has no specific idea how its operation can be salvaged, other than to suggest "downsizing". There is no reason to believe that downsizing can be done any more efficiently by the applicant than by a receiver. . . . [There is a] complete loss of confidence in management of the company. To this is added the failure of the applicant to suggest who the new management might be."); *see also* Jacob S. Ziegel, *Corporate Groups and Canada-U.S. Crossborder Insolvencies: Contrasting Visions*, 35 CAN. BUS. L.J. 459, 463 (2001).

coupled with their respective U.S. counterparts: a full Chapter 11 case or an ancillary proceeding pursuant to [§] 304 of the U.S. Bankruptcy Code."[109] Accordingly, real estate developers face a number of considerations when a choice is made to file for insolvency.[110] With respect to cross-border jurisprudential cooperation, the BIA and the CCAA contain specific provisions allowing Canadian courts broad powers to make orders, render relief, and make arrangements that result in coordination with foreign proceedings.[111] Similarly, § 304 of the U.S. Bankruptcy Code, also known as the ancillary proceeding section, allows full cooperation with foreign proceedings.[112] Despite controversies,[113] most Canadian and U.S. courts recognize foreign insolvency proceedings[114] and the

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109. Golick, *supra* note 100, at 1–2.

110. Insolvent companies must confront many strategic decisions when determining exactly how to structure their claim, particularly when considering a hybrid of filing in both Canada, the United States, or both. These considerations should include the location of the debtor (and its assets and creditors), whether debtor in possession financing will be sought, protections sought by the debtor's management, and the desired speed (and cost) of the insolvency proceedings.

Id. at 2.

111. *See* CCAA, R.S.C., ch. C-36, §§ 18.6(2), 18.6(3), 18.6(6) (2004).

112. 11 U.S.C. § 304 (2006); Golick, *supra* note 100, at 19; *see also* Bruce E. Leonard, *International Insolvency Proceedings: Current International Initiatives and the Proposed Canadian Model*, *in*THE CANADIAN BAR ASS'N - ONTARIO, INSOLVENCY REFORM: THE NEXT GENERATION 36 (1996).

113. *See* Singer Sewing Machine Co. of Canada, Ltd., [2000] 18 C.B.R. (4th) 127 (Can.) (refusing to recognize proceedings in New York against the Canadian subsidiary as part of a group filing); *see also In re* Toga Manufacturing Limited, 28 B.R. 165 (Bankr. E.D. Mich. 1983) (denying a Canadian bankruptcy trustee's request for injunction against a U.S. creditor under 11 U.S.C. § 304, holding that it was the court's duty to "protect United States citizens' claims against foreign judgments inconsistent with this country's well-defined and accepted policies."); Holt Cargo Systems Inc. v. ABC Containerline N.V., [2001] 30 C.B.R. (4th) 6, 14 (Can.) (holding that the Canadian judicial adherence to the so-called "grab rule" "in which each national court takes charge of assets in its own jurisdiction for the benefit of creditors who win the race to the courthouse is to be destructive of international order and effectiveness, and that, under the territoriality principle, the court in each jurisdiction where the debtor has assets distributes the assets located in that jurisdiction pursuant to local rules").

114. Recent Canadian cases generally demonstrate a willingness of courts to order a stay of proceedings with respect to a solvent Canadian subsidiary of a debtor that has filed for protection under Chapter 11; ordering such a stay involves recognition of the U.S. proceedings. *See* J.M. Farley, et al., Cooperation and Coordination in Cross-Border Insolvency Cases 18–25 (Feb. 6, 2004) (unpublished paper presented at the Univ. of British Columbia Faculty of Law: First Annual Insolvency Review Conference, on file with author). "If the question of obtaining a stay of proceedings against a Canadian subsidiary is an issue, a concurrent Canadian proceeding can be commenced under the CCAA." Golick, *supra* note 100, at 13. In *Babcock,* Justice Farley extended recognition in Ontario to a stay of proceedings order issued in Louisiana, which was issued in response to Babcock & Wilcox (BW), Canada's U.S. parent company and U.S. based affiliates, even though BW Canada, a Canadian incorporated (and solvent) entity, was not party to U.S. proceedings (and not involved

protections of assets of foreign estates,[115] particularly through the development of protocols. These protocols are "solutions on a case-by-case basis,"[116] and generally involve cases where simultaneous debtor filings occur under Chapter 11 and the CCAA.[117]

B. *Legal Strategies*

1. Substantive Consolidation: Real Estate

In contending with solvent companies existing within corporate groups, it has been argued that a corporate group should not be divided into units, but rather treated as a singular corporate entity, which effectively translates under the law into an "administrative consolidation or a modified form of substantive consolidation."[118] It is possible for a U.S. Chapter 11 debtor's solvent affiliate to obtain a stay under the CCAA's § 18.6 as an ancillary proceeding to the Chapter 11 filing.[119] The "substantive consolidation" doctrine essentially dilutes creditors' interests, as courts are permitted to consolidate the assets of several debtor companies to create a common

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in any Canadian bankruptcy proceedings). Babcock & Wilcox Canada Ltd., [2000] 18 C.B.R. 9 (4th) 137 (Can.). U.S. courts have also demonstrated a trend of recognizing foreign judgments. For example, in *Maxwell Communication Corporation*, the U.S. Bankruptcy Court for the Southern District of New York and the English Court of Appeal, based on the concept of comity, created the first cross-border insolvency protocol. Maxwell Commc'n Corp. v. Barclays Bank (*In re* Maxwell Communication Corp.), 170 B.R. 800 (Bankr. S.D.N.Y. 1994), *aff'd*, 186 B.R. 807 (S.D.N.Y. 1995), *aff'd*, 93 F.3d 1036 (2d Cir. 1996) (citing Hilton v. Guyot, 159 U.S. 113, 163–64 (1895)); *see also In re* Drake, 1998 Bankr. Lexis 2030 (Bankr. W.D. Wa.) (issuing stay of Chapter 11 proceedings and granting a far-reaching petition under § 304 in respect of the CCAA proceedings); *In re* Culmer, 25 B.R. 621 (Bankr. S.D.N.Y. 1982) (holding that Bahamian law related to liquidation proceedings was in substantial conformity with U.S. law; the U.S. judge rejected the proposition that any minor differences between Bahamian and U.S. bankruptcy laws should favor the adoption of U.S. bankruptcy laws).

115. Courts seeking guidance when addressing reorganizations and developing so-called "protocols," have reviewed the International Bar Association Concordat, the American Law Institute's Transnational Insolvency Project, and United Nations Commission on International Trade Law (UNCITRAL)'s Model Act. For a description of such guidance, see Farley, *supra* note 114, at 1–5; Anne Nielson et al., *The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies*, 70 AM. BANKR. L.J. 533, 534–35 (1996). *See generally* TRANSNATIONAL INSOLVENCY PROJECT, PRINCIPLES OF COOPERATION IN TRANSNATIONAL INSOLVENCY CASES AMONG THE MEMBERS OF THE NORTH AMERICAN FREE TRADE AGREEMENT (2003), *cited in* Ziegel, *supra* note 97, at 462.

116. Dargan, *supra* note 84, at 119.

117. *Id.* at 120. Additionally, protocols contend with several issues, including the coordination of hearings and procedures (such as asset sales) in multiple jurisdictions, in addition to ensuring the equal treatment of unsecured creditors. Farley, *supra* note 114, at 9.

118. Golick, *supra* note 100, at 13.

119. *Id.* at 14.

fund accessible by the companies' creditors [120] in addition to consolidating the relevant creditors (specifically for "purposes of voting on the plan").[121] Canadian courts exercise this power under the broad judicial discretion allowed through the CCAA.[122]

The CCAA's case law concerning substantive consolidation focuses upon insolvent estates' integration and how such integration may prejudice the estates' creditors. [123] A noted case involving substantive consolidation is Northland Properties,[124] which suggests that Canada utilize a two-step test for substantive consolidation applications. Specifically, the consolidation proponent must demonstrate a consolidation need, while equities must favor the consolidation over the alternative of a separated debtor.[125]

Cross-border real estate developers exhibit many of the characteristics that Canadian courts deem necessary for a permitted consolidation. For example, the real estate developer's subsidiaries are often heavily intertwined within the operations of the parent. The O&Y insolvency provides a telling example: the assets (and loan draw-downs) of the revenues and loans for all of the twenty-nine O&Y companies were centralized to account for all of the companies' financial obligations (with the exception of the family's U.S. real estate assets).[126] The business affairs of real estate developers (and their foreign subsidiaries) are heavily interrelated, based on the presence of multiple instances of inter-corporate debt, cross default

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120. *Id.*

121. *Id.*

122. *Id.* (citing Ellen L. Hayes, *Substantive Consolidation Under the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act*, 23 CAN. BUS. L.J. 445 (1994)); *see* Joy E. Mason, *The Impact of Substantive Consolidation in Bankruptcy*, 27 L.A. LAWYER, Sept. 2004, at 18 (noting that "the standards for invoking the remedy of substantive consolidation have evolved through case law as opposed to legislation"). With respect to how the CCAA allows Canadian justices broad powers, see Ziegel, *supra* note 83, at 6–10. One commentator implicitly questions the powers afforded Canadian justices under the CCAA, at least in the interests of comity with respect to enforcing U.S. judgments. *See* Ziegel, *supra* note 97, at 461–69.

123. Golick, *supra* note 100, at 15 (citing Lyndon A.J. Barnes & Shelley W. Obal, *Priorities in Insolvency Litigation: When Judges Make The Rules*, Vol. 1, No.13, FIN. INTELLIGENCE 3, 7 (1996)).

124. *Id.* (citing Northland Properties Ltd., [1988] 73 C.B.R. 146 (B.C.S.C.), *aff'd*, [1989] 73 C.B.R. 195 (B.C.C.A.)). Northland Properties is a major western Canadian developer that once owned nineteen hotels, several major office buildings, and prime vacant land in Vancouver, Calgary, Oregon, and California. Canuel, *supra* note 48, at 22–23. At the height of its success, Northland employed over 1,000 employees and subsequently became indebted to over 2,100 creditors. *Id.* In 1988, Northland claimed insolvency, following a period of interest rates exceeding 20% and negative equity approaching $100 million (CDN). *Id.*

125. Golick, *supra* note 100, at 16 (citing Hayes, *supra* note 122, at 448). In the United States, the Eleventh Circuit proposed a specific (and similar) substantive consolidation test, as articulated in Eastgroup Properties v. Southern Motel Ass'n Ltd., 935 F. 2d 245 (11th Cir. 1991).

126. Canuel, *supra* note 48, at 20.

provisions and guarantees, and operation of centralized cash management system.[127] These factors have been considered by courts to be crucial in approving a consolidation.[128]

2. Debtor-in-Possession Financing

Under DIP financing, debtor corporations are provided an opportunity to continue operations pending a workout, as interim financing is granted during the stay and negotiation period.[129] This financing is often granted in the real estate development proceedings, given the vast number of employees, properties, and property management costs.[130]

Chapter 11 provides that new lenders in certain circumstances can obtain priority over pre-filing unsecured creditors. During restructuring, companies often need additional financing to continue business operations.[131] Workouts are facilitated under Canadian insolvency laws, given the rationale that insolvent corporations may

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127. The O&Y group of companies maintained a centralized cash management system; creditors who held security on specific assets were denied the ability to segregate revenues to ensure that such rents would not be pooled to pay the expenses for other buildings. *See* Canuel, *supra* note 48 at 21 (citing Goldstein, *supra* note 53, at 162–63).

128. *See generally* PSINet Ltd., [2002] 33 C.B.R. (4th) 284, 287 (Ont. S.C.J.) (allowing four Canadian PSINet companies to file a consolidated plan on the basis that such plan avoids complex litigation concerning the allocation of proceeds from sale of the PSINet companies' assets to TELUS Corp).

129. Sarra, *supra* note 94, at 339. Under the CCAA, DIP financing is geared toward allowing the debtor to continue its operations while negotiations with creditors occur. *Id.* at 341. The underlying policy rationale is that if the business continues to operate, customer and supplier goodwill is preserved, while experienced employees stay on and assist the company as it attempts to turn the corner. *Id.* Insolvent businesses are often more highly valued than a going concern, which could hopefully be restructured or sold, rather than having it dissected, with all of its assets sold to potentially different purchasers. *Id.*

130. A few CCAA cases also refer to general, administrative, and restructuring (GAR) funding. These terms are in part interchangeable, although arguably DIP financing is a more inclusive term because it relates to financing beyond that required to actually restructure. GAR funding is specifically discussed in *In Re Olympia & York Developments*, [1996] 38 C.B.R. (3d) 309 (Ont. Gen. Div.); *Re Bramalea Inc.* (Mar. 1 1995), Toronto RE5055/95 (Ont. Gen. Div.). To address how general administrative and restructuring costs would be paid, the courts decided to: (i) apply cash flow from secured assets, such as rentals from real property and dividends from securities, to cover the costs of managing the encumbered asset and to pay a management fee to cover all GAR costs; (ii) approve the sale of unencumbered assets to generate further revenues to fund GAR costs; and (iii) the Canadian court imposed a security interest on the unencumbered assets running in favor of the secured creditors who overfunded the GAR costs. Canuel, *supra* note 48, at 18.

131. 11 U.S.C. §§ 364, 507 (2006); *see also* David C. Hillman & Mathew L. Caras, *When the Bank Wants its Borrower in Bankruptcy: Benefits of Bankruptcy for Lenders and Lender Liability Dependants*, 40 ME L. REV. 375, 388 n.37; Golick, *supra* note 100, at 24–25.

actually be beneficial to creditors if a negotiated workout would ultimately enhance value.[132] Canadian courts are not granted power under legislation to grant super-priority status to loans effected after insolvency proceedings commence.[133] Conversely, Chapter 11 grants priority to creditors who lent during the restructuring process, with mechanisms established to control the extension of credit.[134] However, "Section 364(b) states that if the extension [of credit] is outside the ordinary course [of business], the priority must be authorized by the court before the extension is made."[135] If the reorganization fails, § 726(a) and (b) of the U.S. Bankruptcy Code still provides that "post-filing debts will retain priority over unsecured pre-filing debts in the ensuing liquidation."[136] "[I]f priority over pre-petition unsecured claims is insufficient to induce the provision of needed credit, sections 364(c) and (d) [of the Bankruptcy Code], allow the court to authorize the debtor to grant security interests to post-petition lenders, even if they prime already existing interests."[137] Accordingly, "a post-filing secured lender bears minimal risk of loss, even if the reorganization fails."[138]

Commentators have suggested that the CCAA and the BIA, as different statutes with separate legislative objectives and schemes for achieving those objectives, create differing methods for contending with DIP financing.[139] For example, the BIA contends with enforcing claims during bankruptcy and receivership, and includes provisions for individual and commercial insolvency workouts.[140] The BIA "does not address the priorities of claims in the period of an interim stay under either its own proposal provisions or the provisions of the

132. Sarra, *supra* note 94, at 339. The courts have interpreted their equitable or inherent jurisdiction as including the ability to order DIP financing to allow corporations to continue operating during the stay period under the CCAA. *Id.* (citing United Used Auto & Truck Parts [2000] S.C.C.A. 142.). Canadian courts have stated that they will not be bound to certain DIP tests prevalent in the United States, such as the requirement to provide adequate protection.

133. Golick, *supra* note 100, at 25 (emphasis added). Disputes have arisen regarding the scope and process of granting DIP financing during the workout period, given the dearth of legislative direction concerning the issues of priority and such DIP financing. Sarra, *supra* note 94, at 352. Under Canadian case law, "five principles currently operat[e] in the courts' consideration of applications for DIP financing: adequate notice, sufficient disclosure, timeliness of the request, balancing the prejudice, and the principle of granting priority financing as an extraordinary remedy." *Id.* at 375

134. Golick, *supra* note 100, at 25. For example, "[§] 364(a) of the U.S. Bankruptcy Code [provides] that if the extension of credit is in the ordinary course of business, the priority is automatic." *Id.*

135. *Id.*

136. *Id.*

137. *Id.*; 11 U.S.C. § 364 (c)-(d) (2006).

138. Golick, *supra* note 100, at 25.

139. Sarra, *supra* note 94, at 340.

140. *Id.*

CCAA."[141] Commentators point out that as the Canadian Parliament intended the CCAA and BIA as complementary statutes, courts should not be viewed as having "compromised the rights of senior creditors by the granting of proportionately small priority financing to facilitate the aims of the CCAA."[142] The CCAA focuses upon allowing the corporation to continue under a credible business plan and generate income, whereby creditors and the public generally may receive greater potential value.[143] Commentators questioned whether a court reviewing a CCAA filing has the appropriate jurisdiction "to order priority payment and DIP financing without the debtor obtaining the consent of creditors, in order to facilitate the restructuring objectives of the CCAA, given the creditors' priorities enshrined in the Bankruptcy and Insolvency Act."[144]

In either scenario, DIP financing seeks to create new funding potential.

> At the point of insolvency, credit is a much riskier proposition than when a corporation is solvent, and thus lenders of DIP financing are able to extract a premium i.e., priority financing in exchange for advancing the money . . . . [W]here all of the corporation's assets are already subject to secured creditors' claims, such new private financing will not be available.[145]

Critics argue that when the court orders DIP financing, one major concern is why additional risk should be assumed by existing secured creditors when they do not have a veto, or even a vote, as to acquiring such additional risk.[146]

Reasonable fees of the court-appointed monitor in the CCAA application raise another type of priority charge. Generally, this includes the legal and professional fees of the monitor.[147] A Canadian court following the CCAA appoints a monitor, whose role resembles that of a trustee under the BIA's proposal provisions.[148] The monitor is crucial in the context of a real estate developer's insolvency, as the monitor may act as an intermediary with creditors (including facilitating negotiations) and provide expertise as to

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141. *Id.*

142. *Id.* Advocates challenge the contention that creditors are prejudiced by the monitor's administration charges and DIP financing, noting that the CCAA's objectives "are to facilitate a workout" and protect creditors (including consumers, employees, and landlords. *Id.*

143. *Id.*

144. *Id.* at 339.

145. *Id.* at 342.

146. *Id.* (emphasis added).

147. *Id.*

148. *Id.* The courts also grant DIP financing under BIA proposal provisions. Courts have determined that they have jurisdiction to order administration charges to facilitate the objectives of the CCAA, specifically a monitor's legal and professional fees to carry out its statutory duties and to assist in the negotiation of a plan of arrangement or compromise. *Id.* at 343.

whether the revised business plan's requirements can be followed by the debtor corporation.[149]

Case law reiterates that Canadian courts maintain authority to provide court officers (including a receiver) with super-priority to protect property under their control, in addition to protecting the fees of court appointed receivers and their counsel.[150] One commentator found that the court rendered the "most extreme example" of super-priority DIP financing orders in the celebrated Algoma case.[151] The commentator noted that there was no evidence in *Algoma* that the noteholders had adequate protection and that the noteholders were, in fact, undersecured.[152] The court nevertheless approved the requested priming charge without notice to the noteholders.[153] Accordingly, the Algoma court's decision runs against the DIP financing provisions of Bankruptcy Code § 364 under which, among other things, the debtor must demonstrate its inability to obtain non-priming financing.[154] The process of DIP financing becomes less arduous depending on several factors, including the availability of unencumbered assets with which to satisfy existing secured creditors, funds, or both.[155] In such instances, the debtor effectively borrows money "on the strength of new security granted, with no attempt to shift priorities."[156]

3. Extending the Stay of Proceedings

As real estate developers face insolvency, courts weigh the implication of their financial distress, particularly in the context of leasing. Courts will carefully consider the extension of a stay of bankruptcy proceedings, noting the implications to tenants. The CCAA's extended stay of proceedings are under Chapter 11. Canadian courts, acting under their inherent jurisdiction, can stay persons from proceeding against non-parties to the reorganization filing.[157] One specific example involves Eaton's, a now defunct Canadian department store chain which acted as an anchor tenant in several Canadian shopping malls. The majority of these shopping mall tenants had leases which provided that the tenants could

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149. *Id.* at 342 (citing R. Gordon Marantz, *The Reorganization of a Complex Corporate Entity: The Bramalea Story*, *in* CASE STUDIES IN RECENT CANADIAN INSOLVENCY REORGANIZATIONS, *supra* note 53, at 1, 16).

150. Golick, *supra* note 100, at 25–26.

151. *Id.* at 31 (discussing *Re* Algoma Steel Inc., [2001] 25 C.B.R. 4th 194 (Can.)).

152. Golick, *supra* note 100, at 31.

153. *Id.*

154. *Id.* at 32–33. For an interesting discussion as to when DIP financing leads to unpredictable (or unforeseen) results, see Kaplan, *supra* note 64, at 1120–26.

155. Golick, *supra* note 100, at 33.

156. *Id.*

157. *Id.* at 8.

renegotiate their leases or abandon their leashold estate should the anchor tenant "go dark."[158] Following Eaton's bankruptcy filing under the CCAA, an order was requested under which shopping center tenants would be stayed from exercising their leasehold rights to go dark (subsequent to the closure of an Eaton's anchor store).[159] Landlords believed the court order would bring stability and prevent disruption at the shopping malls.[160] The court, considering the needs of the various landlords, approved the stay.[161]

4. "Executory" Real Estate Contracts—Termination of Interests

Chapter 11 of the U.S. Bankruptcy Code contends with the termination or affirmation of executory contracts.[162] One of the principal purposes of a bankruptcy proceeding is to maximize the cash available for distribution to general unsecured creditors of the debtor; if the debtor owns real estate and the real estate is encumbered by restrictive covenants or executory interests such as reversions, the amount of cash a trustee realizes from a sale of real

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158. *Id.* at 9. *See generally* Patrick A. Randolph, Jr., *Going Dark Aggressively*, http://dirt.umkc.edu/files/dark.htm (last visited May 20, 2007) (discussing the concept of "going dark").

159. Golick, *supra* note 100, at 9.

160. *Id.* (citing *Re* T. Eaton Co. Ltd. RE7483/97, [1997] O.J. 6388 QUICKLAW (O.C.J. May 8, 1997) (Can.)).

161. The stay gave "landlords sufficient time to replace Eaton's with another anchor tenant in those centres where Eaton's had disclaimed its lease obligations, without having to worry about tenants fleeing the premises." Golick, *supra* note 100, at 10.

162. 11 U.S.C. § 365 (2006). The term "executory contract" is not defined in the Bankruptcy Code, although it has been proposed that an executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Gregory Hesse, *Impact of Bankruptcy on Deed Restrictions and Executory Interests*, 14 AM. BANKR. INST. J. 20, 20 (1995) (quoting Vern Countryman, *Executory Contracts in Bankruptcy*, 57 MINN. L. REV. 439, 460 (1973)). Other theorists propose that "a contract that has been fully performed on either side is not executory." Madlyn Gleich Primoff & Erica G. Weinberger, *E-Commerce and Dot Com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts Including Intellectual Property Agreements and Related Issues Under Sections 365(c), 365(e) and 365(n) of the Bankruptcy Code*, 8 AM. BANKR. INST. L. REV. 307, 310 (2000) (citing 3 COLLIER ON BANKRUPTCY ¶ 365.02[1] (Lawrence P. King et al. eds., 2000)). "Some courts have held that a contract must be substantially unperformed on both sides to be executory." Primoff & Weinberger, *supra*, at 310 (citing *In re* C & S Grain Co., 47 F.3d 233, 237 (7th Cir. 1995); *In re* Adler, Coleman Clearing Corp., 247 B.R. 51 (Bankr. S.D.N.Y. 1999); *In re* Street & Beard Farm Partnership, 882 F.2d 233, 235 (7th Cir. 1989)). "In determining whether an agreement is an executory contract, courts will typically examine the unperformed duties and obligations of each party." Primoff & Weinberger, *supra*, at 310 (citing *In re* Qintex Entertainment, Inc., 950 F.2d 1492, 1495 (9th Cir. 1991)).

estate may be reduced.[163] Under Chapter 11, the trustee could realize a higher cash value from the sale of the real estate if it could reject the restrictive deed covenants [164] or executory interests pursuant to 11 USC § 365,[165] or sell the property free and clear of the restrictive deed covenants or executory interests pursuant to 11 USC § 363. Extensive scholarship also has been devoted to the classification (and termination) of leases as "executory contracts" under the Code.[166]

Real estate developers, seeking to control and protect the longevity of certain development rights, have rediscovered tools such as Reciprocal Easement Agreements (REAs).[167] It has been proposed

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163. Hesse, *supra* note 162, at 20.

164. It has been proposed that courts have concluded that a "restrictive covenant is an interest in property that cannot be rejected" and that "trustees will be unable to enhance the value of property by rejecting restrictive covenants or executory interests that impair the marketability of the property, pursuant to 11 U.S.C. § 365." *Id.* at 26.

165. When a debtor files for bankruptcy, 11 U.S.C. § 365 provides that the trustee has the authority to assume or reject any executory contract or unexpired lease. The purpose of 11 U.S.C. § 365(a) is to enable a trustee in bankruptcy to reject an executory contract or unexpired lease that does not provide an appropriate economic benefit to the debtor or imposes a burdensome liabilities on the debtor. Hesse, *supra* note 162, at 20.

166. For a discussion of acceptance and rejection of leases by a bankruptcy trustee (including the obligations a debtor must undertake), see Bruce H. White, Wiliam L. Medford & John C Murray, *Practice & Procedure: Recharacterization of Synthetic Leases: How a Lease Becomes a Secured Claim*, 18 AM. BANKR. INST. J. 20 (1999). The authors propose that a synthetic lease, which allows a lessee/corporate real estate user to book real estate payments as landlord expenses without identifying these expenses as balance sheet debts runs the risk of being characterized as an unsecured claim in a bankruptcy. *Id.* Courts closely examine synthetic leasing transactions to determine whether a lease is actually a financing transaction and if a lessee is actually a beneficial owner, following § 502(b)(6) of the Code. *Id.* at 21. Courts review a variety of factors, including whether: (i) rental payments actually were used as investment returns rather than compensation for the tenants' use of the leasehold estate, (ii) the purchase price was related to fair market value of the property or was actually intended to finance the deal, (iii) tax advantages shaped how the transaction was structured, and (iv) whether the lessee assumed obligations tied to the financing. *Id.* Accordingly, to assist in preventing recharacterization as a security agreement, synthetic lease documents "should include typical mortgage provisions to protect the synthetic lessor's interests." *Id.*

167. An REA is "an agreement that applies to multiple parcels of land that are generally part of a single, joint development project or development scheme." George W. *Further Misinterpretation of Bankruptcy Code Section 363(f): Elevating In Rem Interests and Promoting the Use of Property Law to Bankruptcy-Proof Real Estate Developments*, 76 AM. BANKR. L.J. 289, 315 (2002). An REA "is recorded in state or county real estate records along with deeds and other grants and conveyances of record." *Id.* (citing Marvin Garfinkel, *May All or Portions of a Recorded Shopping Center Reciprocal Easement Agreement Be Rejected as an Executory Contract Under Section 365 of the Bankruptcy Code?*, 28 REAL PROP. PROB. & TR. J. 83, 94 (1983)). "Reciprocal easement agreements commonly contain affirmative and restrictive covenants and negative and affirmative easements including cross-easement arrangements; easements to construct, use, or maintain improvements on another

that characterizing certain real estate property rights to create a present in rem property interest that runs with the land, such as REAs, residential community covenants, codes, and restrictions and conservation or environmental easements, will insulate those rights from certain sections of the Code.[168] One commentator proposes that REAs will insulate real estate development projects from bankruptcy risk, as partnership agreements and "traditional" contractual methods will likely be construed as executory contracts and, in the buyer's subsequent bankruptcy case, these contracts will be subject to rejection under § 365, the result of which would leave the seller with a pre-petition claim of unknown security.[169] "A non-severable REA . . . will not be stripped off the property absent consent or a bona fide dispute in a subsequent bankruptcy proceeding."[170]

The 1992 amendments to the BIA created provisions which effected the termination of executory contracts, as the amendments provided that a debtor making a proposal could terminate certain commercial real estate leases if the debtor demonstrated that the lease termination was essential to the proposal's success.[171] Disclaiming contracts with executory provisions to be undertaken by the debtor are not addressed under the BIA, and the CCAA does not include any provisions regarding executory contracts.[172] Courts, following the broad inherent jurisdiction under the CCAA, have made "orders allowing debtors to terminate and breach contracts, which then forces the non-defaulting party to claim as an unsecured creditor for its damages in the CCAA proceedings."[173] Courts may terminate leases and thereby alter landlord rights, similar to sanctioning CCAA plans which alter secured creditors rights.[174]

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parcel; [and] easements pertaining to improvements on the parcel itself such as lateral support, encroachment, party wall, and access arrangements . . . ." Kuney, *supra*, at 315–16 (citing Garfinkel, *supra*, at 95–99). "Individual lease and operating agreements and the rights of mortgagees may be respectively subordinated to the rights conferred in an REA." Kuney, *supra*, at 317 (citing Denise L. Savage, *Reciprocal Easement Agreements: Assumption and Rejection in Bankruptcy*, 19 REAL EST. L.J. 99, 100 n.4 (1990)).

168. Section 363(f)(1) or Section 363(f)(5) of the Code should permit a sale free and clear of all encumbrances. Kuney, *supra* note 167, at 312.

169. *Id.* at 313–14.

170. *Id.* at 314–15. The REA will continue to encumber the real property despite bankruptcy proceedings. *See id.*

171. R.S.C., ch. 27, § 2 (1992); Golick, *supra* note 100, at 37.

172. Golick, *supra* note 100, at 37.

173. *Id.* (citing *Re* Blue Range Resources Corp., [2000] 20 C.B.R. (4th) 187 (Can.)).

174. Golick, *supra* note 100, at 38 (citing *Re* Armbro Enterprises Inc., [1993] 22 C.B.R. (2d) 80 (Can.)).

5. Cram Down Provisions

Following the satisfaction of certain requirements,[175] a debtor is allowed under Chapter 11 to impose a plan of organization on opposing impaired creditors.[176] With respect to extinguishing of real property interests through a cramdown, there is no direct case law.[177] Commentators note that U.S. courts have allowed substantial modification of lien-holders' rights through cramdown.[178] In the United States, courts may confirm plans that allow debtors to extinguish due-on-sale clauses; modify notes to include a thirty-day cure period for monetary defaults; and limit or eliminate nonmonetary defaults unrelated to collateral to eliminate prepayment penalties, default interest, late payment charges, and reporting requirements.[179] A cramdown requires providing either the present value of a claim or less than that value (with no junior class distributions) to interest holders.[180] Coupled with § 1141(c) of the

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175. These requirements include: (i) confirmation of all standards under § 1129(a) and (ii) the plan's "fair and equitable treatment" of the impaired classes (holding both secured and unsecured claims). *See* J. Robert Stoll & Amy S. Korte, *Cross-Border Insolvency Proceedings Involving Assets Located in the United States of America*, 20 NAT'L INSOLVENCY REV. 53, 19 (2003).

176. Golick, *supra* note 100, at 49. "Cramdown" is defined by one commentator "as a means to obtain approval of plans over the objections of dissenting creditors," which "requires the court to engage in costly and time-consuming valuation proceedings before approving a plan." Sarra, *supra* note 94, at 373. "Under the cram down rule, shareholders as the most junior claimants, do not receive any value in the reorganized corporation unless creditors consent or all claims are paid in full." *Id.*; *see also* Kuney, *supra* note 167, at 322 n.154 ("Cramdown is the colloquial expression for confirming a plan that has not been accepted by all classes of creditors as required for consensual confirmation under § 1129(a) [of the Code]. A nonexclusive list of the standards for cramdown is found in § 1129(b).").

177. *See* Kuney, *supra* note 167, at 322.

178. *See id.*

179. *Id.*

180. *Id.* at 325. Further:

> Cram down under alternative (i)—by providing the holder of an *in rem* interest with the present value of that interest—is simply a matter of providing just compensation for what may be viewed as the government's taking of that interest through the bankruptcy reorganization process, a public use. But cramdown under alternative (ii)—payment of less than the full present value of the claim and providing no distribution to junior classes—runs smack into the Constitutional prohibition on takings without just compensation. If cram down is to be accomplished by giving the holder of an *in rem* interest less than the present value of that interest, a taking without just compensation is what is being proposed, and the fact that junior classes of interest holders receive nothing under the absolute priority rule is no salve for this uncompensated injury. There are two alternatives in such a circumstance: either confirmation must be denied by the bankruptcy court upon objection by the interest holder, or the interest holder may proceed in the appropriate court with a 'takings' claim against the United States.

Id.

Code, which provides for post-confirmation vesting of property pursuant to the plan free and clear of "all claims and interests of creditors, equity security holders, and of general partners in the debtor,"[181] cramdown may provide an avenue for stripping off in rem interests in a Chapter 11 case.

A cramdown is unavailable under the CCAA or the BIA.[182] Theorists assert that the application of U.S. law undermines contingent claimants from influencing the plan.[183] Under the CCAA, "a secured creditor can effectively be crammed down only if it is included in a class of creditors where it does not have a veto, that class approves the plan despite the creditor's negative vote and the court sanctions the plan at the hearing required to approve the plan following its acceptance by the required majority of creditors."[184] In the Canadian real estate development context, cramdown issues arise in the context of creditors holding specific mortgages against various properties owned by different companies that were placed in one class.[185]

Several other concepts, formalized under the U.S. statutory insolvency regime, are at least implicitly recognized through Canadian case law (despite the absence of any corresponding statute). Equitable subordination,[186] for example, has been accepted by Canadian courts.[187] Additionally, unlike the U.S. bankruptcy laws, the CCAA contains no statutory prohibition against using cash

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181. 11 U.S.C. § 1141(c) (2006).

182. Pamela L.J. Huff & Lisa S. Corne, *Recent Developments in Cross-Border Insolvencies: Application of the Proper Law in the Sale of Assets and the Claims Process*, 2000 C.N.I.R. LEXIS 19, 28 (2000).

183. *Id.*

184. Jeffrey B. Gollob & Lisa Kerbel Caplan, *Overview of Insolvency Proceedings in Canada*, 2000 C.C.I.R. LEXIS 4, 21 (2000); *see* Jacob S. Ziegel & Rajvinder S. Sahni, *An Empirical Investigation of Corporate Division 1 Proposals in the Toronto Bankruptcy Region (c)*, 41 OSGOODE HALL L.J. 665, 680 (2003) (stating that under the CCAA, Canadian courts may give "debtors much flexibility in structuring classes of creditors for voting purposes to enable a debtor to forge an alliance of favourable votes"). One commentator notes that some courts have taken a "relaxed approach to evaluating the classifications of secured claims in an attempt to give the debtor a means of binding a disruptive secured creditor to a fair and equitable plan that will allow for the survival of the debtor company." Golick, *supra* note 100, at 50.

185. Northland Properties Ltd., [1988] 73 C.B.R. 146 (B.C.S.C.), *aff'd*, [1989] 73 C.B.R. 195 (B.C.C.A.).

186. Equitable subordination "permits a court exercising equitable jurisdiction to postpone 'the otherwise valid claims of one creditor to those of other creditors where that creditor has engaged in some kind of inequitable conduct that has secured for it an unfair advantage or that has resulted in injury either to the other creditors or to the debtor.'" Golick, *supra* note 100, at 52-53 (quoting Lyndon A.J. Barnes & Shelley W. Obal, *Priorities in Insolvency Litigation: When Judges Make The Rules*, 13 FIN. INTELLIGENCE 3, 8 (1996)).

187. *Id.* (citing Canadian Deposit Insurance Corp v. Canadian Commercial Bank [1992] 16 C.B.R. (3d) 154, 190–93 (Can.)).

collateral to assist in funding the restructuring process.[188] As commentators continue to explore and review the concept of cross-border insolvencies in the context of real estate developers, new issues will emerge for study and comment.[189]

IV. REVIEWING OPTIONS: CLIMBING OUT OF THE WELL

Despite the issues that overlap in both the U.S. and Canadian portions of a cross-border insolvency and the apparent trend to promote judicial cooperation in proceedings spanning both countries, bankruptcy must be viewed as the last resort to real estate developers. Even once cross-border bankruptcy proceedings commence, the stated policy goal (and hopeful goal of all parties to the insolvency) is to salvage a viable business, ensuring continued employment, payment of contracts, and honoring the financial obligations due lenders. To best avoid bankruptcies in the real estate development context, the following actions should be taken: (i) pursuing the smart diversification of real estate investments; (ii) supporting a strong, centralized manager willing to entertain competent investment advice (and recognizing when the manager has become a liability, rather than an asset); (iii) ensuring that financial

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188. Golick, *supra* note 100, at 47.

189. For example, real estate mortgage investment conduit trusts (REMICs) are now involved in advanced bankruptcy law analysis. *See* C. Wade Cooper, *Commercial Real Estate Securitization: A New Generation of Secured Creditors?*, 13 AM. BANKR. INST. J. 20 (1994). The Tax Reform Act of 1986 produced REMICs, given that the Act allows single-level taxation for a qualifying entities that hold a fixed mortgage pool, including owner's trust or fixed investment trust corporations. *Id.* at 23 (citing KENNETH G. LORE, MORTGAGE-BACKED SECURITIES: DEVELOPMENTS AND TRENDS IN THE SECONDARY MARKET 6–3 (1994)). "[I]nvestors receive an undivided interest in the underlying mortgage loans, a status similar in nature to a loan participant." Cooper, *supra*, at 28. In a structured, multi-class REMIC, different classes may elect to participate in loan treatment negotiations or also appear before the court, which presents the opportunity for conflicting interests among various class members. *Id.* at 30. Different classes at various ends of the priority structure may view loan treatment negotiations very differently. *Id.* at 31. Additionally, conflict within the same class is possible. *See id.* Despite potential issues, commentators urge relying less on bank debt to finance construction, and more on equity. Wall Street's scrutiny of real estate investment trusts, in particular, have purportedly decreased speculative development while increasing the disbursement of timely, appropriate information to investors. *Hot Property*, *supra* note 23. The expansion of real estate investment trusts is well-established: between 1992 and 2004, the U.S. real estate investment trust (REIT) industry grew from $6 billion to $310 billion, driven by commercial real estate lenders exiting the market. *Reits are an American Dream That May Come True in Europe*, EUROPROPERTY, July 1, 2004, at 23. This boom also reflects the recognized need for strong, professional management. *Id.* For a comprehensive discussion tracing the history of REITs, in addition to the tax and fiduciary implications of such entities, see Chadwick M. Cornell, *REITS and UREITS: Pushing the Corporate Law Envelope*, 145 U. PA. L. REV. 1565 (1997).

information indicating troubled investments is adequately reviewed; and (iv) encouraging lenders to lend in a measured, far-sighted fashion, without being swept up in the fervor of an "upswing" market.

Real estate developers should attempt to create a methodical, smart investment approach, rather than advocate an aggressive market focus oblivious to impending market shifts, resulting in overbuilding and fueling a declining economic atmosphere.[190] With respect to targeting and maintaining investment resources, a developer's mix of its real estate portfolio must be logical and diversified.[191] During the real property busts discussed in Part II, *infra*, new and unfamiliar businesses were acquired, and Canadian companies "committed to new geographic markets 'without adequate reconnaissance and market analysis.'"[192] Many companies during the downturn of the 1980s realized that spreading risk to investors through broad diversification and routinely approving contractual obligations to honor guarantees to investors forced these developers into bankruptcy.[193]

In reacting to a forecast of the real estate market of 1990-2000, a Canadian theorist proposed that there would be tensions in the Canadian market, which demanded resolute, effective property mangers to contend with the following competing factors: (i) an increased demand by purchasers, such as life insurance companies and pension funds; (ii) a decreased demand by users such as tenants; and (iii) downward pressure on real estate returns.[194] The manager must manage the portfolio with the "prudent man rule," managing the portfolio as if the manager were the owner.[195] The successful manager must thus have a micro approach (in which he is aware of the ongoing performance of individual properties in a portfolio while recognizing the role of the property manager)[196] and a macro approach (in which he makes decisions of selling/maintaining

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190. Developers often only address short-term market concerns and fail to recognize real estate inflation (and its impacts). WHITEHEAD, *supra* note 2, at 14–15. Overbuilding can create devaluation and financial upheaval, which stymies urban development and results in the negative consequences of commercial real estate inactivity, including unemployment. *Id.*

191. The 1982 Canadian real estate crash demonstrated that geographic diversification of development projects does not necessarily produce stability. *Id.* at 139.

192. *Id.* at 138.

193. *Id.* at 140.

194. Stephen B. Demmings, *Roles and Responsibilities of the Asset Manager in the 1990s*, *in* MANAGING REAL ESTATE ASSETS FOR PROFITABILITY AND GROWTH 4 (1989). The Vancouver market has surged again, with an estimated $62 billion in real estate projects lined up through 2015. Derrick Penner, *Building Boom Shows No Signs of Leveling Off*, VANCOUVER SUN, Apr. 27, 2005, at C3.

195. Demmings, *supra* note 194, at 5.

196. Micro considerations include analyzing and comparing property performance on a regular basis and forecasting performance on properties. *Id.* at 8.

individual properties in their relationship to an entire portfolio).[197] The manager should frequently monitor the property portfolio,[198] while developing an acceptable baseline for a portfolio's life held under a particular investor's ownership (the so-called life cycle).[199] Finally, the manager should not be swept away in the excitement to develop as quickly as possible and capitalize on an up market without seriously weighing all consequences.[200] The ultimate decisionmaker must hold managers accountable for their strategic decisions, while recognizing strong, independent leaders from thoughtless risk-takers.[201]

Lack of up-to-date, accurate financial information (or failure to actually study such information) are symptoms of impending problems. Such information reveals that the company is maintaining a steady cash flow.[202] Undercapitalization and a history of continued losses also indicate troubled businesses. For example, Canadian company Algoma Steel's 1991 insolvency was attributed in part to an enormous long-term debt load, estimated at $700 million in 1991.[203] Rising out of insolvency, the company became insolvent once again during 2001, having accumulated debt greater than $560 million.[204]

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197. *Id.* at 6. The macro portfolio skills of the manager require "defined real estate investment strategies for desired portfolio mix." *Id.* The "idealized" asset manger of the twenty-first century must be cognizant of various macro considerations, with an ability to: (i) conduct regular external appraisal reviews; (ii) present "value enhancement opportunities" (e.g., re-tenanting, rehabilitation, refinancing, or remerchandising); and (iii) be aware of alternative investment options (e.g., stocks, bonds, and money markets). *Id.* at 6–7.

198. Property management monitoring should include the monthly assessment of various indicators, including expense variances, arrears assessment, and analysis and vacancy statistics. *Id.* at 8.

199. The concept of a property's life cycle (meaning the period in a property's life that is held under a particular investor's ownership, and not its physical life) has been reviewed. *Id.* at 14. During the 1980s, a property's holding period ranged between three and ten years; the advent of investors from the Pacific Rim (particularly in Vancouver and Toronto), who are usually willing to hold onto properties for generations to secure returns, greatly elongated the life cycle. *Id.*

200. Examples of reducing risk in land development projects include purchasing "reasonably–priced" land, minimizing overhead and administration costs, focusing on "diversified urban centers," and resisting the temptation to become over-extended. WHITEHEAD, *supra* note 2, at 206–07.

201. Bad management exists where managers do not effectively combine industry knowledge, entrepreneurial intuition, and technical management skills. Wilson, *supra* note 8, at 26. The factors indicating a tip-off to bad managers include "high turnover rates among employees," "inadequate financial planning and controls," "mismatch between managerial skills and the economic age of [the] business," and a "gut feeling" about the managers of a business. *Id.* at 26–27.

202. *Id.*

203. JANIS SARRA, CREDITOR RIGHTS AND THE PUBLIC INTEREST: RESTRUCTURING INSOLVENT CORPORATIONS 158 (2003).

204. *Id.* at 164. Experts warn that successful commercial real estate lenders "never completely take [their eyes] off the loan recovery." James R. Stillman, *Loan Recovery: The Real Estate Secured Lender's Assessment of Value, Commercial Real*

One recent commentator warns that today's market also bears similarities to the bubble of the 1980s, including the arrival of real estate speculators, the "gold rush frenzy to avoid missing the market," and the seeming belief that real estate investments are "invulnerable" and may "resist cyclical [market] fluctuations."[205]

Lenders seem to have learned their lessons, diversifying portfolios and curtailing open-ended loans.[206] To combat a downturn, measured, sensible lending policies must be maintained.[207] Financial institutions, extending loans in a carefully controlled manner with sensible debt ratios and well thought out underwriting (and loan documents) will hopefully avoid many of the traps confronted during the previous real estate development busts.[208] "Liberal lending policies and 'no-strings-attached' corporate loans were at the root of previous financial crises."[209] Real estate development companies

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Estate Defaults, Workouts, and Reorganizations, ABA SPRING 2002 SYMPOSIA, Apr. 25, 2002, at 2, *available at* http://www.abanet.org/rppt/meetings_cle/2002/2002spring/RealProperty/Thursday/JerkingTheLenderAround/Stillman.pdf. The lender should carefully consider resale factors such as real property impairments and transaction costs associated with resale in addition to the contested foreclosure adjustment, which relates to costs and uncertainties associated with seizing the property from the borrower, including litigation expenses. *See id.*

205. Sandler, *supra* note 18, at 6.

206. Some developers survived the crashes, through financial restructuring and loan modifications. WHITEHEAD, *supra* note 2, at 156. The result was that banks and other financial institutions had to bear the financial burden of insolvent firms. The availability of credit and its role refueled the property boom. It has been theorized that many factors, including inexperience, questionable judgment, greed, and losing optimistic returns to competitors, motivated lenders to loan money carelessly to certain real estate developers. *Id.* at 156–57. Bankers during the boom/bust years "became wound up in a never-ending cycle of inflation" and "were competing with each other." *Id.* at 157. In addition, some real estate lenders did not have substantial commercial real estate experience or topical knowledge. *Id.* at 158. Experts were overworked, and many developers dealt with local developers who were, in the view of one theorist, gullible and not specialized. *Id.*

207. The ratio of non-performing assets to total assets in 1990, 2.94%, rose to 3.02% the next year. Kenneth N. Gilpin, *Why Banks Can Avoid a Hard Landing*, N.Y. TIMES, Dec. 24, 2000, at BU6. Savings and loans institutions had a non-performance ratio of 3.96% in 1991. *Id.*

208. One popular method of raising funds which could be used rather liberally by real estate developer borrowers was through debentures. WHITEHEAD, *supra* note 2, at 152. Lenders did not attempt to follow how the funds were spent. With such seeming disinterest and lack of scrutiny, such sums could (and did) end up as equity in real estate acquisitions. As debentures provided the initial equity, developers could stack loans until the existing credit became exhausted. *See id.*

209. *Id.* at 154–55. In the boom years, property was largely financed with debt; borrowers had an incentive to exploit their creditors by increasing the riskiness of their projects. *Hot Property*, *supra* note 23, at 86. When conditions soured, the lenders would bear most losses, and thus the developers did not have the incentive to invest their own funds and stabilize the darkening situation. *Id.* Additionally, bank employees sought to reap financial rewards by maximizing the number of approved loans, with the employees expecting to leave their positions when the loans defaulted. Banks moved slowly hoping that either a government would bail them out or that the

often are short-sighted, selling more valuable real estate inventory at year-end simply to meet stock market expectations, despite the fact that holding the inventory longer would possibly reap greater profit.[210] Uncontrollable debt service ratios must be reigned in, and generous extensions of credit must be forestalled. For example, some development companies in the early 1980s increased their credit and cash lines "to shore up the cash flow from operations" as companies sensed a weakening economy.[211] As the anticipated recovery did not occur, developers evaporated their assets while the recession continued and worsened.[212] The close and careful scrutiny of developers by wary financiers should occur, and the real value of the firm must be recognized.[213]

Although it has been suggested that "capitalism without bankruptcy is like Christianity without hell,"[214] few real estate developers or their creditors willingly seek to endure the flames of a bankruptcy's inferno or the resulting implications. While the bankruptcy of real estate developers must continue to be discouraged (particularly considering the disastrous implications stemming from the real estate downturns of the late twentieth century), practitioners and legal theorists must recognize the practical realties that a cross-border real estate developer file bankruptcy and live without the resulting benefits and burdens.[215]

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market would improve. *Id.* Conversely, as of 2001, pension funds and real estate investment trusts owned roughly 75% of institutional, quality commercial real estate nationally; these institutional owners have a reputation for measured growth and investment. Johnson, *supra* note 7, at 68.

210. WHITEHEAD, *supra* note 2, at 146. Based upon the Author's experience as a practitioner, carefully crafted loan documents with negative covenants could control asset sales.

211. *Id.* at 155.

212. *Id.* For example, "a test for the issuance of a bond has to be the assurance that a company has the ability to maintain an income stream over the life of the bond. Bankers should also pay more attention to the markets, the industry's nature, to project feasibility, and to their impact on both the company and the bank." *Id.* In short, "corporate decision makers must focus on the organization's survival rather than on individual projects or grand strategies." *Id.*

213. Real estate investors have moved beyond sophisticated, large-scale REITs, insurance companies, and pension funds. It has been asserted that the "new real estate speculator" (derided as either a do-it-yourself investor garnering its knowledge from "*Dummies* books on building a real estate empire" or individuals sucked into the "gold rush mentality") arguably influences the current real estate bubble. Sandler, *supra* note 18, at 4.

214. *Quotes of the Day*, CHI. TRIB., July 18, 1996, at 2.

215. A "successful" asset liquidation must necessarily involve a tactical approach by all involved parties, such that each party acts: (i) "based on an expert understanding of [the] ultimate legal and business consequences"; (ii) to "protect[ ] or improve[ ] the asset value of the loan recovery or, from the borrower's point of view, moves the equity valuation in the positive direction"; (iii) to "minimize[ ] transaction costs . . . [that] are not cost-effective"; and (iv) to "promot[e] finality of result." Stillman, *supra* note 204, at 11.