# Insolvency & Financial Restructuring

## RECENT DEVELOPMENTS OF IMPORTANCE

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### Introduction

Over the course of the recent economic downturn, insolvency professionals in Canada have had the unique opportunity to test the boundaries of recent amendments to Canada's restructuring laws. Large company reorganizations in Canada are primarily governed by the *Companies' Creditors Arrangement Act*[1] (the "*CCAA*"), Canada's equivalent of Chapter 11 of the *United States Bankruptcy Code*[2] (the "*Bankruptcy Code*"). On September 18, 2009, the Canadian parliament brought into force substantial amendments to the *CCAA*.

Many of the amendments codify forms of relief that were introduced into Canadian restructuring law by judges through the use of judicial discretion. These practices include a number developed from US principles including section 363-style asset sales. Although the amendments provide a somewhat broader statutory foundation for restructuring practices in Canada, much is still left to the exercise of judicial discretion and judicial interpretation.

One year after the coming into force of the amendments to the *CCAA*, one of the more interesting developments in Canada has been the use of formalized credit bidding in a number of recent restructuring cases.

### Background

A credit bid, as US practitioners will be familiar, is essentially an offer made by a secured creditor to acquire the assets to which its security attaches. The consideration for such an acquisition is the secured creditor's agreement to cancel the indebtedness of the debtor in the amount of the bid. Although not completely foreign to Canadian law, formal credit bidding has been a relatively uncommon strategy in Canada.

A number of factors have contributed to the recent popularity of credit bidding in Canada. From a business perspective, the hallmark of the recent economic crisis was the unprecedented constriction in the credit market. The lack of credit available to support refinancing plans or third-party purchasers significantly limited secured creditors' recovery options.

From a legal perspective, prior to the 2009 amendments, there had been lingering doubts as to whether a court had the authority to order a sale of assets out of the ordinary course during a restructuring over the objections of a secured creditor with blanket security over all the debtor's assets. The 2009 amendments now expressly authorize the debtor to sell or otherwise dispose of assets outside of the ordinary course of business with court authorization. Although not as comprehensive as section 363 of the *Bankruptcy Code*, new section 36 of the *CCAA* introduces a number of factors to be considered by the court when deciding how to exercise its discretion, including:

a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
b) whether the monitor (a court appointed officer who acts as the eyes and ears of the court) approved the process leading to the proposed sale or disposition;
c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition in a liquidation proceeding;
d) the extent to which the creditors were consulted;
e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Secured creditors are statutorily entitled to notice of the proposed sale or disposition, but there are no additional express protections. In particular, unlike the *Bankruptcy Code*, there is no statutory provision contemplating credit bids. Some practitioners have interpreted these new provisions as opening the door to the approval of sales processes over the objection of secured creditors.

### Strategic Considerations

In the face of severely restricted credit markets and the risk of having collateral subject to forced sales in a depressed market, it is no surprise that secured creditors in Canada began to seriously consider credit bidding as a defensive strategy.

The strategic considerations for making a credit bid in Canada are largely the same as those that a secured creditor would consider in the US. However, certain aspects of credit bidding in Canada and its implementation differ as a result of the absence of any statutory authority to support the practice.

As a defensive strategy for secured creditors, credit bids have a number of benefits. A credit bid can provide stability to a debtor's reorganization efforts by assuring a going-concern solution for the business. A going-concern option can alleviate some of the operational pressures on the debtor's business by promoting employee, customer and supplier confidence and limiting any decline in enterprise value. When coupled with a sales process, a credit bid can also provide secured creditors with some measure of protection for the value of their collateral by setting a floor on price through the credit bid. The resulting discipline on competing bidders would limit the success of deeply discounted bids.

A credit bid strategy can also mitigate the risk that secured creditors may be forced under the debtor's plan of arrangement to accept debt or equity on anomalous or off-market terms. Secured creditors offering a credit bid have control over the capital structure of the acquiror

("Newco"). Indeed, a credit bid option can be particularly useful when dealing with a large syndicate of secured lenders with differing views on acceptable recoveries. Some lenders may prefer to retain securities in the reorganized debtor and wait for a more favorable market in order to enhance their recovery. Other lenders may prefer a more immediate recovery from the proceeds of sale of the collateral (even at a discounted price). A well-structured credit bid could ensure that the shares of Newco issued to the syndicate are roughly equal to or greater than the current realizable value of the business. In this way some lenders could monetize their investment, while others could hold the shares (for possible future upside) with no loss to the group of lenders as a whole.

Secured creditors can also use credit bidding to execute on more proactive business strategies. For example, in *Planet Organic Health Corp.*,[3] the senior lender used a credit bid mechanism in order to execute a "loan to own" strategy. In *Trident Exploration Corporation*,[4] the lending syndicate found itself in a protracted *CCAA* proceeding with little influence over its outcome. By offering a credit bid acquisition to the Court as a competing proposal, the lending group was able to force the resolution of the case. The equity sponsors were required to complete a plan of arrangement in a relatively short period of time or risk losing their investment entirely.

From an implementation perspective, secured creditors have a number of options. Strictly speaking, a sales process may not always be necessary to implement a successful credit bid. In order to approve a credit bid, a court would need to be satisfied that the secured creditor has valid security in the collateral and that it is under-secured. Proving that the secured creditor is under-secured requires some form of valuation evidence or a sales process. In some cases the risk of a protracted valuation dispute will weigh in favor of running a sales process. In other cases it may be easy to prove that the secured creditors are under-secured without incurring the cost of a sales process. If a sales process is adopted, the secured creditor would also have the flexibility to submit its credit bid as a stalking-horse at the outset of the case, or to participate with the other bidders in an auction. The circumstances of each case will dictate the appropriate timing of the credit bid.

In addition, secured creditors also have the option of implementing the credit bid through a conventional acquisition transaction coupled with an order of the Court approving the transaction and vesting the transferred assets in Newco free and clear of all liens and encumbrances. Alternatively, the credit bid may be implemented through a plan of arrangement with a single voting class, being the secured creditors. The use of a plan is particularly advantageous where there may be a legal argument that unanimity is required under the terms of the credit agreement to fully implement the credit bid. If the requisite voting majorities (two-thirds in value and a simple majority in number) are achieved at the creditors meeting, then the whole syndicate will be bound under the *CCAA*.

## Credit Bidding in Canada

Unlike the *Bankruptcy Code*, Canadian courts do not have the express statutory authority under the *CCAA* or other insolvency legislation to approve credit bidding in restructuring proceedings. However, the concept of credit bidding is in many ways analogous to foreclosure remedies available to secured lenders under various provincial personal property security and mortgage legislation. In this context "foreclosure" means taking title to the collateral in satisfaction of the secured debt. Foreclosure has been used consistently in Canada as one of many secured creditor remedies, but has not traditionally been thought of as a big case strategy. The introduction of this remedy as part of a competitive bidding process in formal reorganization proceedings represents something of a renaissance in Canadian law.

Perhaps the highest profile case in which a credit bid was brought into play is that of *Canwest Limited Partnership*.[5] In January of 2010, Canwest Limited Partnership, along with its newspaper and digital media subsidiaries (the "Newspaper Debtors") applied for relief under the *CCAA* in the province of Ontario. As part of the first day relief requested, the Newspaper Debtors asked the Court to approve a sale and investor solicitation process (the "SISP"), back-stopped by a credit acquisition transaction (the "Credit Acquisition") put forward by the senior lenders to the Newspaper Debtors.

An *ad hoc* committee of senior subordinated noteholders objected to the relief sought by the Newspaper Debtors. In considering the appropriateness of the SISP and Credit Acquisition and the objection of the noteholders, the Court conducted a careful review of the terms of the SISP and the Credit Acquisition. The Court finally concluded that the Credit Acquisition and SISP ensured an enhanced likelihood of the continuation of going concern operations, the preservation of jobs and the maximization of value for stakeholders of the Newspaper Debtors.

In granting the relief requested by the Newspaper Debtors, the Court was cognizant that it was not being asked to approve the Credit Acquisition transaction, but merely to accept it as part of the SISP process. However, the Court did not find the fact that the Credit Acquisition transaction was to take the form of a credit bid troubling. Implicit in the Court's decision is the acceptance of credit bidding as a concept in Canadian restructuring law.

Although a superior alternative bid (which paid out the senior lenders in full) was ultimately accepted over the Credit Acquisition, in the subsequent *CCAA* proceedings in respect of *Planet Organic Health Corp.* the Court approved the implementation of a credit bid acquisition.

## Conclusion

In accepting credit bidding as a workable secured creditor remedy, courts in Canada have interpreted insolvency laws in a principled and flexible manner that responds to the needs of both a restructuring company and its creditors. Although the market conditions that led to the rise of credit bidding in Canada have changed over time, it is expected in light of the 2009 statutory amendments that credit bidding as a secured creditor strategy is likely here to stay. ■

1. R.S.C. 1985, c. C-36.
2. 11 U.S.C.
3. *Re Planet Organic Holding Corp. et al.* (Ontario Court File No. 10-8699-0CL), see the Monitor's website for further details: http://www.deloitte.com/ca/planet-organic.
4. *Re Trident Exploration Corp. et al.* (Alberta Action No. 0901-13483), see the Monitor's website for further details: http://cfcanada.fticonsulting.com/trident/.
5. *Re Canwest Publishing Inc.*, 2010 CarswellOnt 212 (Ont. S.C.J. (Commercial List)).

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