REVERSE VESTING ORDERS – WHEN IS THIS "EXTRAORDINARY MEASURE" APPROPRIATE?

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Reverse vesting orders (or "**RVOs**") have become an increasingly popular and useful tool for maximizing recovery in complex insolvencies in Canada, particularly in circumstances where traditional alternatives of asset sales or restructuring plans are not effective or practical. RVOs are very attractive to purchasers of distressed businesses because they can efficiently preserve the value of permits, tax losses and other assets which cannot be easily transferred to a purchaser through an asset transaction. Unlike a plan, court approval of a RVO does not require a creditor vote.

In our May 2021 bulletin, we reviewed two decisions, *Nemaska Lithium*[1] and *Quest University*[2], where Quebec and British Columbia appellate courts upheld the approval of RVOs in the face of stakeholder opposition.

However, the recent decision of the Ontario Superior Court of Justice (Commercial List) in *Harte Gold*[3], the Court issued a reminder that RVOs are an "unusual or extraordinary measure", not the new normal and are not justified merely because they are more convenient for the purchaser. The Court also identified the key factors that should be considered when seeking approval of a RVO.

Reverse Vesting Orders – An Unusual or Extraordinary Measure

In a traditional vesting order, the assets of the insolvent company are transferred to the purchaser, leaving behind any unwanted assets and liabilities. RVOs involve the transfer of the undesirable assets and liabilities from the insolvent company to another company, typically incorporated for this special purpose. The insolvent company is left with only those assets and liabilities sought by the purchaser. This allows the shares of the insolvent company to be sold, preserving valuable permits, contracts or tax losses while also, as discussed below, reducing the risk, delay and cost of more traditional insolvency transactions.

Despite the attractive benefits of RVOs, they are not specifically provided for in either the *Companies' Creditors Arrangement Act* (CCAA) or the *Bankruptcy and Insolvency Act*. The limited decisions approving RVOs have generally not provided substantial guidance on the positive and negative implications of RVOs. In light of this context, the Court in Harte Gold found that RVOs "should continue to be regarded as an unusual or

extraordinary measure, not an approach appropriate in any case merely because it ay be more convenient or beneficial to the purchaser."[4] Similarly, in *Quest University* the Court held RVOs should not be generally employed under the *CCAA* and debtors should not seek RVOs to rid themselves of a difficult creditor or to expedite their desired result without regard to the remedial objectives of the CCAA.[5]

Courts should be expected to closely scrutinize proposed RVO transactions and court-appointed monitors must diligently ensure the restructuring is fair and reasonable to all stakeholders, particularly where there is no significant party opposing the RVO transaction.[6]

Harte Gold

Harte Gold Corp. ("**Harte Gold**") is a publicly traded company that operates a gold mine located in northern Ontario. Its mining operation has 260 employees and requires over 30 different permits and licenses, as well as over 500 mineral tenures consisting of freehold properties, leasehold properties, mineral claims and additional tenures.[7]

The principal objective and benefit of the RVO transaction in Harte Gold was to preserve the numerous permits and licenses necessary to conduct the gold mining operation. In a traditional vesting order structure, the purchaser would have to apply to multiple agencies and regulators to either transfer existing permits and licenses or apply for new ones. The RVO structure avoids the inevitable risk, delay and cost of such a process in favour of the timely and efficient preservation of the exiting permits and licenses.[8]

The proposed RVO transaction in *Harte Gold* involved a share acquisition by one of Harte Gold's secured creditors by way of a credit bid that would see all secured debt satisfied in full as well as virtually all pre-filing trade payables. It also involved broad third-party releases in favour of Harte Gold's directors and officers, the Monitor, the Monitor's counsel, the purchaser and the purchaser's directors and officers.

Statutory Authority and Factors to Consider for RVOs

Previous decisions approving RVOs have relied on both the Court's specific authority to approve a sale of the debtor company's assets under section 36(1) of the CCAA and the broad jurisdiction conferred on the Court under section 11 of the CCAA to make any order appropriate in the circumstances.[9]

While questioning whether section 36(1) of the CCAA grants jurisdiction to approve RVOs, the Court in *Harte Gold* declined to resolve the issue as it found section 11 clearly permits the Court to approve RVOs in appropriate circumstances. Nonetheless, the factors enumerated in section 36(3) of the CCAA, based on the principles in *Soundair Corp.*,[10] governing approval of a sale or disposition of the insolvent company's assets are also applicable, with modifications, to a RVO transaction.[11]

When seeking approval of a RVO, the Court in *Harte Gold* held that the debtor, the purchaser and especially the court-appointed monitor must be prepared to answer questions such as:

(a) Why is the RVO necessary in this case?
(b) Does the RVO structure produce an economic result at least as favourable as any other viable alternative?
(c) Is any stakeholder worse off under the RVO structure than they would have been under any other viable alternative?
(d) Does the consideration being paid for the debtor's business reflect the importance and value of the licences and permits (or other intangible assets) being preserved under the RVO structure?[12]

The Court also considered the section 36(3) factors in the context of a RVO, including:

(a) Whether the process leading to the proposed RVO transaction was reasonable in the circumstances;
(b) Whether the RVO transaction resulted in better recovery for stakeholders than a bankruptcy proceeding;
(c) The degree of creditor consultation;
(d) The effect of the proposed RVO transaction on creditors and other stakeholders;
(e) The fairness of the consideration to be received for the assets; and
(f) Whether the monitor supported the RVO transaction.[13]

In particular, the Court noted that a bankruptcy proceeding would almost certainly result in lower recovery for stakeholders than the proposed RVO because of the risk, delay and cost involved in a traditional insolvency transaction.[14] The seven months of extensive solicitation efforts culminating competing credit bids made for a reasonable sale process.[15] The only stakeholders who did not stand to benefit were Harte Gold's existing shareholders who did not have any economic interest and therefore it was unnecessary to consider their views.[16] Ultimately, the Court found all of the relevant factors favoured approving the proposed RVO transaction.

The broad third-party releases sought as part of the RVO transaction were also found to be reasonable and appropriate in the circumstances when considering the factors outlined in *Lydian International Limited (Re)*.[17]

Conclusion

RVOs can be a powerful tool for maximizing recovery for stakeholders in appropriate circumstances, but they are not routine or normal transactions under the CCAA. When considering a RVO transaction, interested parties should consider whether they can answer the questions posed by the Court in *Harte Gold*. Parties seeking approval of a RVO transaction should be very careful to ensure the evidence before the Court satisfies the section 36(3) factors in the context of a RVO. They may be "unusual or extraordinary measures", but RVOs

still provide a valuable tool in complex insolvencies where traditional vesting orders cannot maximize recovery.

[1] Arrangement relatif à Nemaska Lithium Inc., 2020 QCCA 1488 (“Nemaska Lithium”).
[2] Southern Star Developments v. Quest University Canada, 2020 BCCA 364 (“Quest University”).
[3] Harte Gold Corp. (Re), 2022 ONSC 653 (“Harte Gold”).
[4] Harte Gold, at para. 38.
[5] Quest University Canada (Re), 2020 BCSC 1883, at para. 171.
[6] Harte Gold, at para. 38.
[7] Harte Gold, at para. 4.
[8] Harte Gold, at para. 71.
[9] Nemaska Lithium, at para. 19; Quest University, at para. 11.
[10] Royal Bank of Canada v. Soundair Corp., 1991 CanLII 2727 (ON CA); see also: Target Canada Co. (Re), 2015 ONSC 1487, at para. 14-17.
[11] Harte Gold, at para. 37.
[12] Harte Gold, at para. 38.
[13] Harte Gold, at paras. 40-77.
[14] Harte Gold, at paras. 48-49.
[15] Harte Gold, at para. 44.
[16] Harte Gold, at para. 56, 64; citing Sino-Forest Corporation (Re), 2012 ONSC 4377, at paras. 23-29 and Stelco Inc. (Re), 2006 CanLII 4500 (ON SC), at para. 11.
[17] Harte Gold, at paras. 80-86; citing Lydian International Limited (Re), 2020 ONSC 4006, at para. 54.

By Daniel Shouldice

A Cautionary Note