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# Reverse Vesting Orders – Developing Principles and Guardrails to Inform Judicial Decisions

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**Reverse Vesting Orders – Developing Principles and Guardrails to Inform Judicial Decisions**

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*Abstract*

Reverse vesting orders (RVO) are a new tool being used by insolvency practitioners in Canada's *Companies' Creditors Arrangement Act (CCAA)* and other insolvency proceedings, where the debtor is not required to propose a restructuring plan and creditors are not permitted a vote on the going-forward strategy. The article starts from the premise that the court has authority to approve an RVO pursuant to sections 11 and 36 of the *CCAA* and the court's general authority under the statute. However, it suggests that there must be exceptional circumstances for the court to be persuaded to bypass provisions of insolvency legislation aimed at giving both secured and unsecured creditors a meaningful voice/vote in the proceedings, as they are the residual claimants to the value of the debtor's assets during insolvency. It highlights some issues for consideration as the courts move forward in their deliberation of RVO and proposes questions the courts should be asking of their court-appointed monitors when considering such transactions.

## 1. Introduction

Reverse vesting orders (RVO) are a relatively new tool being used by insolvency practitioners in *Companies' Creditors Arrangement Act (CCAA)* and other insolvency proceedings.[1] RVO usually involve the sale of an insolvent debtor company's shares to a purchaser in a transaction where unwanted assets and liaiblities are excluded in the purchase transaction and are transferred, assigned and vested in a newly-incorporated company ('newco') as part of a pre-closing reorganization, allowing the debtor company to shed liabilities and retain the most valuable assets.

The result of an RVO is to expunge the existing corporate structure of the debtor company of anything the purchaser does not want. The newco is added to the insolvency proceeding and continues in that process while the debtor company exits the insolvency proceeding with broad liability releases; then the newco is liquidated or placed in bankruptcy to be liquidated. The transaction takes place outside of a negotiated and court-approved plan of arrangement or compromise.[2]

The benefits of such transactions accrue primarily to senior secured lenders and the purchaser, which may or may not be related parties. The purchaser acquires the existing debtor without many of the liabilities, ostensibly to allow the business to continue operating under new owners. This strategy can preserve non-transferable licenses, permits, intellectual property, and/or tax attributes such as tax losses, all of which provide value only if exercised by the debtor. The rationale is that the process can be efficient, particularly for debtor companies operating in a highly regulated environment, and going-concern value can be preserved. In several cannabis insolvencies, there have not been any secured creditors and the value has gone to creditors generally, often the founding owners that funded the start-up.

Weighed against these benefits is the concern that the RVO approach bypasses key components of the statutory framework that balances multiple creditor rights and interests, including the ability of creditors to vote on a plan. While one benefit of an RVO is often described as cost-savings if a plan vote is avoided, the cases reveal that RVO

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[1] *Companies' Creditors Arrangement Act,* RSC 1985, c C-36, as amended (*CCAA*). In French, an RVO is une ordonnance de dévolution inversée (ODI).

[2] There are two exceptions where the RVO has been approved as a plan of arrangement with a creditor vote: *Redrock Camps Inc et al*, Order of Neufeld J, (18 February 2021), Calgary File No 2001-06194 (Alta QB) Order-re-Plan-Sanction-February-18,-2021.pdf (bdo.ca); and *Re Tribalscale Inc,* Sanction Order of Kavanagh J, (11 January 2021), Toronto CV-20-00645116-00CL (Ont SCJ), (Ont SCJ), tribalscale-order-pt-1-jan-11-2021.pdf (mnpdebt.ca) and tribalscale-order-pt-2-jan-11-2021.pdf (mnpdebt.ca). This paper discusses the 20 cases where approval has taken place outside of a plan and creditor vote.

can be complex and costly to structure and implement. There is also a question of whether companies will be able to shed substantial environmental remediation and reclamation obligations under this new structure, leaving few assets to satisfy the obligations. In some instances, the RVO offers secured creditors a new "race to the assets" that the statutory stay provisions were originally designed to slow down to give a meaningful opportunity to negotiate with all creditors.[3]

To date, most of the RVO transactions have been approved by the courts without reasons, either because they have been uncontested, or where they have been contested, the focus has been on the court's statutory authority. Many judgments have relied on other judicial endorsements of RVO, with little or no discussion of the court's authority. In part, the absence of judicial reasons regarding RVO may be a function of the increasingly complex financial reasons for insolvencies and increasing pressures on the court to sanction strategies that speedily resolve the financial distress. It reflects a larger trend of parties placing voluminous material before the court without it giving adequate time to fully understand the transaction. Endorsements without any reasoning leave stakeholders, regulators, and other courts with uncertainty on the criteria that the courts are applying in departing from the general framework of the statute. In some cases, a going-concern business is the objective, but without some of the guardrail protections that the plan of arrangement process offers.

While there has been commentary on the positive features of such transactions,[4] there is a lacuna in the commentary on the prejudice that may be experienced by various creditors and other stakeholders given the nature of these transactions. A recent *Financial Post* article quotes Canadian insolvency practitioners as saying that there will be a significant diminution of *CCAA* plans of arrangement and that RVO will become the predominant transactional path to effectuate a restructuring in a distressed context.[5] In the space of two years, RVO have gone from being approved only in 'exceptional' circumstances,[6] to a push for being the norm. The building pressure to be the norm is troubling insofar as the RVO approach effectively uses the *CCAA* process, but bypasses the framework set out in the statute.

Why are RVO so popular? The *Financial Post* article notes that practitioners are selling RVO to potential clients on the basis that, among other factors, creditor votes are not required; the "purchaser does not have to offer employment to employees; nor do purchasers have to take on pensions and benefits plans; licenses and permit[s], even those purporting to be non-transferable can remain in place"; and execution risks are minimized.[7]

This brief paper highlights some issues for consideration as the courts move forward in their deliberation of RVO. It starts from the premise that the court has authority to approve an RVO pursuant to sections 11 and 36 of the *CCAA* and the court's general authority under the statute. However, it suggests that there must be exceptional circumstances for the court to be persuaded to bypass provisions of insolvency legislation aimed at giving both secured and unsecured creditors a meaningful voice/vote in the proceedings, as they are the residual claimants to the value of the debtor's assets during insolvency. Just as the provisions limiting initial stay periods under the *CCAA* are aimed at improving the participation of all stakeholders and encouraging parties to act in good faith,[8] the courts should ensure that their court-appointed officers are establishing guardrails that protect stakeholders and the integrity of the insolvency regime.

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[3] Janis Sarra, *Rescue! The Companies' Creditors Arrangement Act,* (2d ed) (Toronto, Carswell, 2013) at 12-17 (hereafter Sarra, *Rescue*); *Re Blue Range Resource Corp* (2000), 192 DLR (4th) 281, 20 CBR (4th) 187 (Alta CA).

[4] B Wiffen, "Reverse Vesting Transactions: An Innovative Approach to Restructuring", in J Corraini and the Honourable B Nixon eds, *Annual Review of Insolvency Law, 2020* (Toronto: Carswell, 2021) at 167-214; D Bish et al, "Reverse vesting order issued by Québec Superior Court after first contested hearing" Torys newsletter, (16 October 2020), Reverse vesting order issued by Québec Superior Court after first contested hearing | Insights | Torys LLP; D Ferland and N MacParland, "Canadian Insolvency Landscape During the Pandemic, (March 2021), Canadian Insolvency Landscape During the Pandemic | Davies (dwpv.com); Zena Olijnyk, "Use of the Reverse Vesting Order a significant feature of Canadian firm restructurings in 2020", *Canadian Lawyer,* (19 March 2021), Use of the Reverse Vesting Order a significant feature of Canadian firm restructurings in 2020 | Canadian Lawyer (canadianlawyermag.com).

[5] Julius Melnitzer, "New insolvency rules help energy companies carve out their environmentally-compromised assets", *Financial Post,* (26 May 2021) New insolvency rules help energy companies carve out their environmentally-compromised assets | Financial Post.

[6] *Re Quest University Canada* 2020 BCSC 1883 (BC SC), (hereafter *Quest University*), leave to appeal denied *Southern Star Developments Ltd v Quest University Canada*, 2020 BCCA 364 (BCCA) (hereafter *Quest University* Appeal). The *CCAA* judge held at para 171 that: "I do not consider that an RVO structure would be generally employed or approved in a *CCAA* restructuring to simply rid a debtor of a recalcitrant creditor who may seek to exert leverage through its vote on a plan while furthering its own interests."

[7] Melnitzer, *supra* note 5.

[8] *Re Lydian International Limited,* 2019 ONSC 7473, at paras 25, 26 and 30, decision of Chief Justice Morawetz, Ontario Superior Court of Justice, discussing s. 11.02(1) of the *CCAA.*

## 1. The Court's Authority to Approve an RVO

The Supreme Court of Canada (SCC) has consistently held that the remedial objectives of Canadian insolvency laws are to provide timely, efficient, and impartial resolution of a debtor's insolvency, preserve and maximize the value of a debtor's assets, ensure fair and equitable treatment of the claims against a debtor, protect the public interest, and balance the costs and benefits of restructuring or liquidating the debtor company, where possible avoiding the social and economic losses resulting from liquidation of an insolvent company by facilitating the reorganization and survival of the business as a going concern.[9] Considerable deference is typically given by appellate courts to the *CCAA* supervising judge, given the broad statutory authority of the *CCAA* and the extensive knowledge of the proceeding acquired by the judge.

Section 11 sets out the general authority of the court in *CCAA* proceedings. Specifically, in respect of a debtor company, "the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances."[10] This broad statutory authority allows the court to make determinations where there are gaps in the express provisions; however, the authority is qualified in that it must always be exercised within the framework of the statute, having careful regard to the objectives of the *CCAA*.[11]

The other source of authority for RVO that courts have relied on is s. 36 of the *CCAA,* which allows for the sale or disposition of assets outside the ordinary course of business if specified criteria are met. In exercising its authority pursuant to s. 36 to approve a sale, the court must be satisfied that notice has been given "to the secured creditors who are likely to be affected by the proposed sale or disposition."[12] The court is to consider, among other factors: "(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances; (b) whether the monitor 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 under a bankruptcy; (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."[13]

These factors involve the court weighing the evidence, including valuations of different options for dealing with the insolvency, and balancing the interests of diverse stakeholders. The language is quite specific in s. 36(1) that a "debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of <u>*assets*</u> outside the ordinary course of business unless authorized to do so by a court."[14] Certainly s. 36 has evolved since its enactment to encompass 'liquidating *CCAA*', but is it clear that an RVO of liabilities is included, and if it is, are the same considerations adequate?

Leaving aside this question, the combination of these statutory provisions and the caselaw suggest that there is a basis for approval of an RVO pursuant to the broad statutory authority of the court. The SCC has held that the exercise of judicial discretion has allowed the *CCAA* to adapt and evolve to meet contemporary business and social needs.[15] The important question is what factors the court should consider in approving an RVO, particularly in circumstances where the RVO approach does not form part of a plan of arrangement pursuant to the statute. A relevant issue is whether the RVO is being used to deliberately evade the plan process, including voting procedures, and have the proponents of the RVO justified evasion of these requirements?

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[9] *9354-9186 Québec inc c Callidus Capital Corp,* 2020 SCC 10 at paras 40, 41 (hereafter *Callidus*). See also *Century Services Inc v Canada (Attorney General),* 2010 SCC 60, [2010] 3 SCR 379 at para 70 (hereafter *Century Services*).
[10] *CCAA,* s. 11.
[11] *Canada v Canada North Group Inc*, 2021 SCC 30 at para 21.
[12] *CCAA,* s. 36(2).
[13] *CCAA,* s. 36(3).
[14] *CCAA,* s. 36(1). Emphasis added.
[15] *Century Services, supra* note 9 at para 21. For a discussion, see Sarra, *Rescue, supra* note 3 at 14.

The RVO resembles features of bank resolution proceedings adopted in Canada and internationally.[16] The rationale in bank resolution proceedings for overriding creditor voting rights, embedded in the statutory resolution framework, is that the protection of the financial system is a paramount consideration, including protection of deposit-holders' savings and policyholders' life annuities. Given the systemic risks of financial institution failure, extraordinary remedies for resolution are authorized over a very tight time frame, without a creditor vote, but with a resolution authority granted broad statutory powers.[17] None of these bank resolution proceeding features are present in the corporate insolvencies involving RVO. They do not involve protection of the financial system. In contrast to a bank resolution proceeding, the RVO transaction does not need to occur over a weekend or in a few days to prevent collapse of the financial system. There is no risk of a run on the financial system from a corporate insolvency. Given these distinctions, what principles should inform the court's decision to approve a transaction?

## 2. Genesis and Development of the RVO

It merits considering the first *CCAA* case that used an RVO outside of a plan of arrangement,[18] because it was approved on an exceptional basis. In that case, the court was persuaded that it had all the features of a plan of arrangement.[19] Plasco Energy was a 2015 *CCAA* proceeding before the Ontario Superior Court of Justice, in which the Court approved a sale transaction of certain equipment, a global settlement with commercial entities, and a settlement with government entities. Collectively, the settlements were aimed at selling the principal assets of the applicants, facilitating an orderly liquidation, and satisfying the debtor companies' decommissioning and environmental remediation obligations.

The Court's approval in Plasco Energy is a five-page handwritten decision by Justice Wilton-Siegel, who held that the court had jurisdiction to approve the sale transaction, applying the criteria in s. 36 of the *CCAA* and the *Royal Bank v Soundair Corp* tests,[20] and approving the settlement agreements pursuant to s. 11 of the *CCAA*.[21] Of note are the following findings of the court:

- There was an extensive sales process that failed to produce any bids for the business and there was no evidence of any unfairness in the sales process.
- There was extensive consultation with both secured and unsecured creditors and other stakeholders likely to be affected by the transaction; and the secured creditors and 95% of the unsecured creditors supported the transaction.
- The court's authority to approve settlement agreements pursuant to s. 11 must further the purposes of the *CCAA,* which, in this case, entailed an orderly wind-up of the business and a maximization of recoveries for its creditors and other stakeholders".
- "The test for approval requires demonstration that: (1) the settlement is fair and reasonable; (2) the settlement will be beneficial to the debtor and its stakeholders generally; and (3) that the settlement is consistent with the purpose and spirit of the *CCAA*."

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[16] Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (2014), Key Attributes of Effective Resolution Regimes for Financial Institutions (fsb.org); Janis Sarra, "A Bridge Over Troubled Waters - Resolving Bank Financial Distress in Canada", in J Sarra and the Honourable B Romaine, eds, *Annual Review of Insolvency Law, 2018* (Toronto: Carswell, 2019), "A Bridge Over Troubled Waters - Resolving Bank Financial Distress in C" by Janis P. Sarra (ubc.ca).

[17] *Canada Deposit Insurance Corporation Act,* RSC 1985, c C-3, as amended.

[18] Some commentators have suggested that the first RVO was *Re T Eaton Co*. However, in that proceeding, Farley J approved a motion to have creditors vote on a share purchase at a creditors' meeting pursuant to a proposed plan of arrangement and expressly declined to approve a transaction outside of a *CCAA* vote or bankruptcy proceeding if the vote failed: *Re T Eaton Co,* 1999 CanLII 15025 (Ont SCJ) (17 November 1999). The Court held: "[5]…one must be particularly concerned that there is a legitimate process which will be followed so that no matter what the result that is obtained from that process, the parties affected will, disappointed though they may be with the decision (and uncertain though they may be with the practical result that will obtain from that decision), say that at least the process was fair, reasonable and objective in the circumstances. The company was subsequently liquidated. [13] In the end result, I am of the view that, in these circumstances, it would be inappropriate to deal with the s.9 Sears deal at this time. I think it extremely desirable to appreciate that the bankruptcy regime with the roles and responsibilities laid out therein should not be ignored or pre-empted by a decision at this time. It is on this basis that I decline to give the requested order."

[19] *Re Plasco Energy Group Inc et al*, Endorsement of Wilton-Siegel J, (17 July 2015), Toronto Court File No CV-15-10869-00CL ((Ont SCJ [Comm List]), Further-Endorsement-Stay-Extension-july-17.

[20] *Royal Bank v Soundair Corp* (1991), 4 OR (3d) 1 at 6, 1991 Canlii 2727, 7 CBR (3d) 1 (Ont CA); the criteria are whether the party conducting the sale made sufficient efforts to obtain the best price and did not act improvidently; the interests of all parties; the efficacy and integrity of the process by which offers were obtained; and, whether there has been any unfairness in the sales process.

[21] *Re Plasco Energy Group Inc et al*, *supra* note 19 at paras 1 to 5.

- A key feature was that it allowed for the decommissioning of a facility in a cost-effective way that satisfied the fairness and reasonableness requirements consistent with the purpose of the *CCAA*.
- The settlement was analogous to a *CCAA* plan "in the context of these particular proceedings".[22]

In the past two years, RVO have been approved for debtors in at least 20 cases outside of a plan of arrangement and sidestepping creditor voting, including a debtor developing lithium deposits,[23] to preserve cannabis licenses,[24] proposal proceedings,[25] construction projects,[26] and companies in the entertainment,[27] retail,[28] energy,[29] grain,[30] and mining sectors.[31] Terms being used include 'newco', 'residualco', and 'excludedco' to refer to the separation of the debtor as an entity from its liaiblities under new corporate structures that are added to the insolvency proceeding, with the original debtor exiting without its prefiling liabilities and obligations.

Often the proceedings involve complex arrangements in respect of leases,[32] relief due to the COVID 19 pandemic,[33] disclaimer of supply and other contracts,[34] and vesting off of contractual rights in a sale process.[35] In some cases, the transaction is altered from a proposed plan process late in the proceeding to proposing an RVO transaction, at the point that the court is presented with untenable alternatives. More recently, use of RVO has expanded to receivership.[36] Another court noted from the records that the transaction value in that case was only sufficient to repay the interim lender and perhaps some amount for the first secured creditor.[37] One RVO transaction was approved on the basis that it was unopposed and supported by the monitor, the transaction satisfied s. 36(3) of the *CCAA* and the *Royal Bank v Soundair Corp* tests, and the court was advised that the proposed transaction was economically superior to an estimated liquidation value.[38] Another case dismissed objections to RVO where the objecting creditor failed to establish it did not receive notice, without analyzing considerations that court should

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[22] *Ibid* at paras 2-5. See also *Re Plasco Energy Group Inc et al,* Settlement Approval Order (17 July 2015), Toronto CV-15-10869-00CL (Ont SCJ [Comm List]).

[23] *Arrangement relatif à Nemaska Lithium inc.,* 2020 QCCS 3218 (Cs Que) at para 6 (hereafter *Nemaska Lithium* (Que SC)), leave to appeal dismissed; *Arrangement relatif à Nemaska Lithium inc,* 2020 QCCA 1488 (Que CA) (hereafter *Nemaska Lithium* (Que CA)); application for leave to appeal from the judgment of the Court of Appeal of Québec dismissed, *Victor Cantore v. Nemaska Lithium Inc. (Formerly Nemaska Lithium Inc., Nemaska Lithium Whabouchi Mine Inc, Nemaska Lithium Shawinigan Transformation Inc, Nemaska Lithium P1p Inc and Nemaska Lithium Innovation Inc), et al,* (29 April 2021) *Brian Shenker v Nemaska Lithium Inc, et al,* 2021 CanLII 35003 (SCC), Supreme Court of Canada decision (29 April 2021), SCC Docket 39464.

[24] *Re Green Relief Inc,* 2020 ONSC 6837 (Ont SCJ) (hereafter *Re Green Relief Inc*). *Wayland Group Corp, 2751609 Ontario Inc and Nanoleaf Technologies Inc,* Approval and Vesting Order of Hainey J (21 April 2020), Toronto CV-19-00632079-00CL (Ont SCJ) (hereafter *Wayland Group*), Approval & Vesting Order (pwc.com). *FIGR Brands, Inc., Canada's Island Garden Inc., and FIGR Norfolk Inc* (*Re FIGR Brands, Inc et al*), Approval and Vesting Orders of McEwen J, (10 June 2021), Toronto CV-21-00655373-00CL (Ont SCJ), 27675192_3.doc (fticonsulting.com) and 27674637_2.doc (fticonsulting.com). *Beleave Inc,* Order of Conway J, (18 September 2020), Toronto CV-20-00642097-00CL (Ont SCJ [Comm List]); *Re Tidal Health Solutions Ltd,* Order of Pacquette J, (20 November 2020), Montreal 500-11-058600-202 (Que SC), TIDAL - Approval and Vesting ORDER (2020-11-20) SIGNED.pdf (pwc.com); see also Motion for the issuance of a distribution order and for ancillary reliefs (pwc.com).

[25] *Bankruptcy and Insolvency Act,* RSC1985, c B-3, as amended (*BIA*).

[26] *Re Port Capital Development (EV) Inc*, 2021 BCSC 1272, (hereafter *Port Capital* (BCSC), leave to appeal granted, to be heard by a five-person panel, *Port Capital Development (EV) Inc v 1296371 BC Ltd,* 2021 BCCA 319; appeal granted, *Re Port Capital Development (EV) Inc v 1296371 BC Ltd* 2021 BCCA 382. *JMX Contracting Inc, JMX National Inc, BRND Properties Inc, and JMX Leasing Inc* (collectively *JMX Contracting Inc et al*), Transaction Approval and Reverse Vesting Order of Hainey J, (29 January 2021), Toronto CV-20-00648528-00CL (Ont SCJ), Transaction-approval-and-reverse-vesting-order-jan-29. *JMB Crushing Systems Inc* (16 October 2020), Calgary File No 2001-05482 (Alta QB) (hereafter *JMB Crushing Systems*).

[27] Cirque du Soleil, Approval and Vesting Order of Gouin, (26 October 2020), Montreal 500-11-058415-205 (Que SC), https://documentcentre.ey.com/api/Document/download?docId=32343&language=EN.

[28] *Comark Holdings Inc, Bootlegger Clothing Inc, cleo fashions Inc, and Ricki's Fashions Inc (collectively, Comark),* Vesting Order of Hainey J, (13 July 2020), Toronto CV-20-00642013-00CL (Ont SCJ), approval_and_vesting_and_ccaa_termination_order_july_13_2020.pdf (alvarezandmarsal.com).

[29] *Re Salt Bush Energy Ltd et al*; *Re Salt Bush Energy Ltd et al,* Reverse vesting Order of Eidsvik J, (19 May 2021), Calgary File No 2101-06512 (Alta QB), 2101-06512_May 21 2021_Reverse Vesting Order_KO.pdf (deloitte.ca).

[30] ILTA Grain Inc, Approval and Vesting Order of Walker J (25 August 2020), Court File No S-197582 (BCSC).

[31] Stornoway Diamond Corporation, Stornoway Diamonds Canada Inc., Ashton Mining of Canada Inc., and FCDC Sales and Marketing Inc, (collectively 'Stornoway Diamond Corporation'); *Stornoway Diamond Corporation',* Approval and Vesting Order of Gouin J, (7 October 2019), Montreal 500-11-057094-191 (Que SC), Approval and Vesting Order - Justice Gouin - 2019-10-07.pdf (deloitte.ca). *Dominion Diamond Mines ULC et al*, Transaction Approval and Reverse vesting Order of Eidsvik J, (16 November 2021), Calgary Court File 2001-05630 (Alb QB).

[32] *Ibid* at paras 29-35, 101-.

[33] *Re Quest University Canada* 2020 BCSC 921 (BC SC).

[34] *Quest University, supra* note 6.

[35] *Ibid* at paras 45-49, 50-67.

[36] *Re Vert Infrastructure Ltd,* Approval and Vesting Order, (8 June 2021), Toronto CV-20-00642256-00CL (Ont Sup Ct [Comml List]); *2056706 Ontario Inc, Kozo Holdings Inc, Cancor Debt Agency Inc and Pure Global Cannabis Inc, PureSinse Inc et al,* Approval and Vesting Order of Hainey J, Toronto CV-20-00638503-00CL (7 January 2021), (Ont SCJ [Comm List]) and Order Appointing Receiver of Hainey J, (1 May 2020), (Ont SCJ) pursuant to s 243(1)(c) of the *BIA* and s 101 of the *Courts of Justice Act* of Ontario.

[37] *Quest University, supra* note 6 at para 135.

[38] *Beleave Inc,* Order of Conway J (18 September 2020), Toronto, CV-20-00642097-00CL (Ont SCJ [Comm List]).

apply in approving RVO.[39] Some cases have involved what the court perceived as inappropriate behaviour of an objecting party, viewing their objection to the RVO as a bargaining tool.[40]

Of concern is that there may be an unwarranted presumption in the RVO jurisprudence that such objections are tactical only, made by 'out of the money' creditors. Creditors are able to legitimately represent their interests within the framework of the statute.

In uncontested cases, other than the first decision, there is almost no discussion of the court's jurisdiction or the principles it has applied in approving the RVO, other than to acknowledge that it has been approved in other proceedings.[41] This situation is exacerbated by some parties arguing great time pressure for the transaction to be approved, contending it is the only viable alternative to preserve the going-concern value of the debtor. However, the evidence establishing this urgency is not cited in the court's reasoning. The 2019 amendments on the scope of first day orders and interim financing were intended to push back on the artificial urgency created by some debtors except in truly urgent cases; the same standard should be applied to consideration of RVO.

In the United Kingdom, the courts have pushed back on proponents claiming that the insolvency scheme/plan needs to be rushed through due to extreme urgency or because it is the only viable option. For example, Mr Justice Richard Snowden in Re *Noble Group Ltd* observed:

> It is important that the Court is not taken for granted and its willingness to assist must not be abused. That means that the Judge hearing a scheme case needs to be given adequate time for pre-reading and for the hearing, including time to consider what decision to make and to prepare a judgment. The parties involved in restructuring discussions must understand that they cannot run things down to the wire for their own benefit and without due regard for the proper process of the Court. Negotiations must be finalised in good time. The position should not be reached in which the Court is presented with a metaphorical "gun to the head" and the Judge is in effect told that if he does not comply with the company's application immediately, he will be responsible for the collapse of the company because other creditors (and in this case the SIC) will be unwilling to extend their deadlines."[42]

The majority of the decisions approving RVO do not offer any reasoning why the statutory provisions of proposing a plan and conducting a creditor vote could not be complied with by the applicant.[43] There are usually no reasons in the court's endorsement of whether creditors are prejudiced by the RVO, for example, assessment of whether the liquidation value under the *BIA* is higher than realization under the RVO, given that the *BIA* sets out a clear hierarchy of claims and requires the trustee to maximize value of the estate for the benefit of creditors.

To date, there have been four contested RVO proceedings. These cases have been described in detail elsewhere,[44] but a few points of note are raised here for discussion.

In approving the RVO in *Nemaska Lithium*, the *CCAA* judge conducted nine days of hearing on the proposed transaction, having the parties explain the rationale for each step of the complex corporate and commercial

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[39] *Re JMB Crushing Systems Inc*, 2020 ABQB 763. The issue of whether the supply contract created a trust in favour of the subcontractors for their outstanding claims was adjourned and not decided in this judgment. In a subsequent decision in this proceeding, the Court held that the supply contract did not create an express trust and no portion of the funds paid had to be kept in trust for the wide group of potential beneficiaries, including the subcontractors, who may have provided direct or indirect services or products to the debtor. Any putative trust failed because it lacks certainty of intention, object, and subject, and would have been impracticable to administer; *Re JMB Crushing Systems Inc*, 2021 ABQB 8.

[40] *Nemaska Lithium* (Que SC), *supra* note 23 at paras 36-48.

[41] *Stornoway Diamond Corporation* (7 October 2019), Montreal 500-11-057094-191 (QSC [Comm Div]). The motions materials indicate that the purchasers acquired substantially all the debtor's assets by purchasing 100% of the shares of one debtor company (SDCI, which held the acquired assets). In consideration, the purchaser released certain liabilities owed by the debtors and agreed to assume others. *Wayland Group Corp, supra* note 24 in which Hainey J approved a sale of substantially all the debtor's assets to the successful bidder under a share purchase agreement; the Court did not engage in any reasoning other than to note it was unopposed.

[42] *Re Noble Group Ltd* [2018] EWHC 2911 (Ch) at paras 178, 179.

[43] See for example *Wayland Group Corp, supra* note 24; *Comark Holdings Inc, supra* note 28.

[44] See for example, notes 4 and 5.

transaction.[45] The transaction arose out of an approved sale and investment solicitation process (SISP) that involved 18 months of canvassing the market, and resulted in only one remaining offer.[46] The Court cited extensively from the SCC in *Callidus* regarding the role of the *CCAA* judge and the objectives of the *CCAA,* including, to resolve the insolvency of a debtor in a timely, efficient and impartial manner; preserve and maximize the value of assets; ensure fair and equitable treatment of claims; protect the public interest; and balance the costs and benefits of restructuring or winding up a company, the Court noting that the *CCAA* generally prioritizes avoiding social and economic losses resulting from the liquidation of an insolvent company.[47] In applying the s. 36 criteria, the Court held that the structure of the *CCAA* allows it to balance these remedial objectives on a case-by-case basis.[48] The Court concluded that the debtors had acted in good faith and with the required diligence, and held that « La refuser serait catastrophique! » (to not approve it would be catastrophic).[49]

The Court in *Nemaska Lithium* found that the RVO structure was efficient; would not require the reissuance or transfer of the debtors' mining lease, mining claims or environmental permits, allowing the business to be developed on an expedited timeline; substantially all of the current employees would be retained; and the rights of the Cree parties pursuant to an agreement would not be affected.[50] Only one creditor voiced objection to the RVO; however, the court offers no reasoning on why a positive vote on a plan under the statutory framework could not be achieved. If bypassing plans is to be allowed, the proponents need to lead evidence to justify the need for such an exceptional remedy and an impartial assessment should be reported by the monitor to the court.

The Québec Court of Appeal denied two applications for leave to appeal the decision of the *CCAA* judge in *Nemaska Lithium*, with further leave denied by the SCC.[51] The Court of Appeal held that the RVO allows the purchaser to continue to carry on operations in a highly regulated environment by maintaining existing permits, licences, essential contracts and fiscal attributes, and leave would hinder the progress of the proceedings. The Court held that the "proposed RVO provides for the acquisition by the impleaded parties of the shares of Nemaska entities free and clear of the claims of creditors which are transferred along with unwanted assets to a newly incorporated non-operating company, as part of a pre-closing reorganization",[52] noting that the "*CCAA* judge also insisted on the fact that the expungement of real rights was contemplated by s. 36(6) and was a necessary condition to the implementation of a solution, and served to prevent a veto on the part of the holders of those real rights."[53] The appellate court affirmed the judge's approval of the RVO, finding that it was essentially a credit bid whereby the shares of the Nemaska entities are acquired in return for the assumption of the secured debt.[54]

With great respect, s. 36 discusses asset sales outside the ordinary course of business and there is nothing in the statutory language that refers to vesting liaiblities. The Court of Appeal could have taken the opportunity to consider the implications of this interpretation of s. 36, and to set some guardrail protections for creditors. Moreover, s. 36(6) expressly states that where the court authorizes a sale free of any security or charge, it "shall order" that other assets of the company or the proceeds of the sale be subject to a security, charge or other restriction in favour of the affected creditor. There has been no judicial consideration of what that provision means in the context of an RVO, and arguably, it does not mean leaving the charge over assets that have little or no value as the assets of value have been moved out of reach of creditors.

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[45] *Nemaska Lithium* (Que SC), *supra* note 23 at paras 7, 12. *Nemaska Lithium* (Que CA), *supra* note 23 at para 11.
[46] *Nemaska Lithium* (Que SC), *supra* note 23 at paras 84, 116.
[47] *Ibid* at paras 51, 74, citing *Callidus Capital, supra* note 9 at para 41 and *Century Services, supra* note 9 at para 70.
[48] *Ibid* at para 51, citing *Callidus Capital, supra* note 9 at para 46.
[49] *Nemaska Lithium* (Que SC), *supra* note 23 at para 55, quote at para 117. The purchasers subsequently obtained permission to delist the company under Québec and Ontario securities law; *Nemaska Lithium Inc* 2020 CanLII 98839 (14 December 2020) (QC AMF). In approving liability releases, the Court noted that s 5.1(2) of the *CCAA* prevents release of claims against directors are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors, at para 104, 105.
[50] *Nemaska Lithium* (Que SC), *supra* note 23 at para 56.
[51] *Nemaska Lithium* (Que CA), *supra* note 23.
[52] *Ibid* at para 4.
[53] *Ibid* at para 21.
[54] *Ibid* at para 5.

In *Quest University*, an RVO was approved in a *CCAA* proceeding of a financially distressed university in order to preserve a license to operate and grant post-secondary degrees.[55] The *CCAA* judge noted that the ability of a judge to be innovative is not boundless, and the court must exercise its authority in furtherance of the *CCAA*'s remedial objectives.[56] The Court must keep in mind three baseline considerations: the applicant bears the burden of demonstrating that the order sought is appropriate in the circumstances, advancing the policy objectives underlying the *CCAA,* and that the applicant has been acting in good faith and with due diligence.[57] The exercise of discretion by the *CCAA* court should advance basic fairness, and "fairness demands that supervising judges be in a position to recognize and meaningfully address circumstances in which parties are working against the goals of the statute," and the substantive aspect of fairness is based on the assumption that all involved parties face real economic risks and the courts must be able to recognize when people have conflicting interests and are working actively against the goals of the statute."[58] The Court in *Quest University* held: "In my view, in the vein of the Court's discussion in *Callidus*, these are unique and exceptional circumstances where the Court may grant the relief by allowing Quest to employ the RVO structure within the context of this sale transaction."[59] The British Columbia Court of Appeal (BCCA) declined to grant leave to appeal the RVO decision in *Quest University*, finding that granting leave would likely doom the transaction and harm Quest's stakeholders.[60]

In both of the above judgments, one point is of note. The Court in *Nemaska Lithium* held that its role is not to tell the offerors which terms and conditions must form part of the transaction,[61] and the Court in *Quest University* held that "it is not up to the Court to dictate the terms and conditions that are included in an offer".[62] Yet the SCC has made clear in the context of directors' statutory duties that the court "should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made."[63]

In *Clearbeach and Forbes,* the Ontario Superior Court of Justice approved an RVO without a plan vote. This approval was granted notwithstanding the objection of several municipalities to which the debtor owed municipal taxes that the RVO would extinguish. These creditors argued that the "lost tax arrears will significantly impact vulnerable taxpayers and affect services and infrastructure".[64] The debtor also owed an estimated $9 million in mine abandonment and reclamation costs. The RVO was aimed at preserving Ministry of Natural Resources' licenses and ensuring that stewardship and environmental obligations in connection with abandonment stayed with the debtor company.[65] The Court's decision applies the s. 36 *CCAA* requirements and *Royal Bank v Soundair* tests.[66] The Court noted that "the proposed RVO includes a release in favour of landowners upon whose property the oil and gas assets are situated with respect to any outstanding municipal tax liabilities in relation to those assets",[67] and acknowledged that the RVO will prejudice holders of gross overriding royalty agreements and the municipalities, but found that prejudice would also occur in bankruptcy, as the debtor would have to pay its environmental

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[55] *Quest University, supra* note 6.
[56] *Century Services, supra* note 9 at paras 59, 70; *Callidus, supra* note 9 at paras 49, 70; *Quest University, supra* note 6 at paras 154, 155.
[57] *Quest University, supra* note 6, at para 155, citing *Century Services, supra* note 9 at paras 59, 70; *Callidus, supra* note 9 at paras 49, 50, 70. *CCAA* s. 18.6.
[58] *Quest University, supra* note 6 at para 155, citing Janis Sarra, "The Oscillating Pendulum: Canada's Sesquicentennial and Finding the Equilibrium for Insolvency Law" at 27; see also *Century Services, supra* note 9 at paras 70 and 77
[59] *Quest University, supra* note 6 at para 168; see also paras 160-161, finding that "Akin to the tax losses, permits and licences that could not be transferred in those RVO cases, is Quest's ability to confer degrees under its statutory authority under s. 4(2) of the *Sea to Sky Act*, SBC 2002, c 54 (the "*Sea to Sky Act*"). The courts must be able to recognize when people have conflicting interests and are working actively against the goals of the statute"; PWC, Status Update as at 26 November 2021, Quest University Canada | PwC Canada.
[60] *Quest University* Appeal, *supra* note 6.
[61] *Nemaska Lithium* (Que SC), *supra* note 23 at para 16. "[16] L'offre Orion/IQ/Pallinghurst est soumise au Tribunal telle que déposée, et il ne revient pas au Tribunal d'indiquer aux Offrants quels termes et conditions doivent en faire partie." The purchasers subsequently obtained permission to delist the company under Québec and Ontario securities law; *In the matter of the securities legislation of Québec and Ontario and in the matter of a revocation of a failure-to-file cease trade order and in the matter of the process for cease to be a reporting issuer application and in the matter of Nemaska Lithium Inc* 2020 CanLII 98839 (QC AMF), Dossier no 29444 (14 December 2020).
[62] *Quest University, supra* note 6 at para 158.
[63] *Peoples Department Stores Inc (Trustee of) v Wise,* [2004] 3 SCR 461, 2004 SCC 68 at para 67.
[64] *Clearbeach and Forbes*, 2021 ONSC 5564, 2021 CarswellOnt 12453 (Ont SCJ [Comm List]) at para 11.
[65] *Ibid* at para 10.
[66] *Ibid* at paras 13, 14.
[67] *Ibid* at para 16.

obligations in priority in bankruptcy.[68] In response to the municipalities' complaint of deficient consultation with them regarding the RVO transaction, the Court noted that the federal government was consulted and that "Creditor consultation is only one of the factors to be considered by the Court in the approval of the proposed RVO in accordance with the *Soundair* principles and s. 36(3) of the *CCAA*."[69] There are no written reasons given by the court as to why plan negotiations and a vote needed to be by-passed.

As many *CCAA* proceedings in the past have illustrated, negotiations and a creditor vote can lead to innovative and fairer outcomes in which parties compromise rights today for future upside value.[70] Negotiations can lead to higher value being paid for the licenses and the shedding of liaiblities; or the debtor can negotiate deferral or compromise of claims until such time as the debtor is once again a viable entity.

Absent negotiations, the purchaser gets all the forward-value of the debtors' activities and the creditors whose claims are transferred to newco receive nothing of that forward-value for the value of their pre-filing claims. Yet the participation of creditors can enhance asset value in some cases. A presumption that the delay and costs of a vote are not worth it does not address the risk of opportunistic behaviour by debtors/secured creditors if they can bypass a vote.

A recent example of the Ontario Superior Court of Justice declining to approve a sale transaction under the *CCAA* (not an RVO) illustrates the importance of the court being satisfied that parties are acting in compliance with the statute and importance of creditor negotiations. Chief Justice Morawetz held that the court has the jurisdiction to approve the sale of the assets of a debtor company in the *CCAA* proceeding in the absence of a plan where such sale is in the best interests of stakeholders generally and where the sale as a going concern is consistent with the purposes of the *CCAA.*[71] However, the Court declined to approve the transaction because the sale was to related parties, and the parties had not met the s. 36(4) criteria, specifically, that good faith efforts were made to sell or otherwise dispose of the assets to parties not related to the company, and the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.[72] No efforts were made to sell to unrelated parties.[73] The monitor had not objected to the statutory violation.

Chief Justice Morawetz held that the consideration referenced in the proposed transaction was not superior to the receivership/bankruptcy alternative and the s. 36(4) requirements had not been satisfied.[74] Chief Justice Morawetz rejected the argument of the debtor MEI and owner Mr McEwan that it was not practicable to consider a sale to a third party, given that McEwan as 'celebrity chef' was key and McEwan "was not interested in continuing this type of a business operation under ownership of an unrelated purchaser"; the Court finding the explanation fell short of establishing that good faith efforts were made to sell the assets to unrelated persons.[75] There was no evidence provided by MEI or the monitor that would allow the court to conclude that the consideration to be received was superior to the consideration to be received under any other offer made in accordance with a sale process.[76] The ruling resulted in the parties going back into negotiations and ultimately resolving creditor objections and terminating the *CCAA* proceedings.[77]

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[68] *Ibid* at para 27.
[69] *Ibid.*
[70] See for example, *Algoma Steel Corp v Royal Bank*, 1992 CarswellOnt 2843, [1992] OJ No 795 (Ont Gen Div); Mr Justice Farley, "The Judges Speak", in J Ziegel, ed *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford University Press, 1994) at 764; *Canadian Red Cross Society/La société canadienne de la croixrouge* (Ont SCJ), Order of Blair J, Toronto 98-CL-002970 (6 November 1998), (Ont SCJ). *ATB Financial v Metcalfe & Mansfield Alternative Investments II Corp*, 2008 CarswellOnt 2652 (Ont SCJ [Commercial List]), affirmed 2008 CarswellOnt 4811 (Ont CA), leave to appeal refused 2008 CarswellOnt 5432, 2008 CarswellOnt 5433 (SCC).
[71] *McEwan Enterprises Inc,* 2021 ONSC 6878 (Ont SCJ [Comm List]), at para 42.
[72] *Ibid* at para 51.
[73] *Ibid* at para 52.
[74] *Ibid* at para 60.
[75] *Ibid* at para 63.
[76] *Ibid* at para 64.
[77] *McEwan Enterprises Inc*, 2021 ONSC 8423. See also Factum of the Applicant for Motion to Terminate the *CCAA* proceeding, (17 December 2021), Court File No CV-21-00669445-00CL, Factum of the Applicant ret. December 21, 2021.pdf (alvarezandmarsal.com).

The judgment highlights two points. First, the court's obligation to satisfy itself that the statutory provisions are being complied with, even where its court-appointed officer has failed to alert the court to a violation. Second, the reality is that when a court rules against commercial parties that claim they will not agree to any changes or compromises, they ultimately do bargain further and come to an agreement with creditors. The current practice of endorsing RVO without consideration of the policy and statutory framework of the *CCAA* undermines the ability of all creditors to bargain.

In *Re Port Capital Development (EV) Inc*, the British Columbia Supreme Court approved a sale transaction as an RVO; and while the case was contested, no one challenged the authority to approve an RVO structure and the Court did not consider the matter, except to cite its previous decision in *Quest* that it will garner significant benefits to stakeholders.[78] After a prolonged and contested dual-track SISP, the Court approved the RVO transaction,[79] noting the court must exercise its discretion with a view to the remedial purposes of the *CCAA*, and the requirements of appropriateness in advancing the *CCAA's* policy objectives, good faith, and due diligence.[80] The BCCA granted leave to appeal this decision to a panel of five judges to consider the question of how to treat competing offers under the *CCAA*.[81] On the merits, the Court of Appeal allowed the appeal and held that "it would be impractical to remit this matter at this late stage to the Supreme Court for reconsideration."[82] The Court of Appeal did not discuss criteria or authority in respect of RVO, although it did endorse the idea that there can be arrangements that are not subject to approval by creditors, the court reasoning that interim financing and liquidations in a number of cases have not required a plan vote.

Some RVO transactions are being driven by secured creditors whose interests are not fully covered by their security and can involve the purchaser paying for value inherent in licenses and permits to assist in paying out secured claims. This approach is a reasonable business decision, but the court should be satisfied that the valuation of these assets is not satisfying only secured claims without considering whether value could be maximized for other creditors under a plan of arrangement, a proposal or *BIA* bankruptcy proceeding, processes that require the debtor and the insolvency professional to satisfy creditors and the court that it has maximized the value of the assets for the general benefit of creditors. The court should also be satisfied that the transaction is not leaving the value of the assets in the debtor to satisfy the unsecured portion of secured claims and transferring other unsecured claims into newco and out of reach of realizing on the value those assets to meet their claims.

The policy implications are that RVO may be covertly introducing cramdown by another name into the Canadian insolvency regime, obtaining *de facto* approval of a transaction, with the RVO approach dispensing with any need to incentivize out-of-the-money creditors to support the proposed transaction. In this respect, it undermines creditor democracy and can deprive certain unsecured creditors of their proportionate share of accretive value of the debtor's assets.

### *i. Transparency and Accountability Concerns*

The monitors in many proposed RVO transactions rely on previous endorsements of uncontested decisions as justification for the RVO, and their reports are very uneven in respect of offering evidence of the rationale for bypassing the statutory provisions in the circumstances of the case. While benefits of an ongoing business are discussed, there is no explanation as to why it is necessary or reasonable to bypass the statutory framework of creditor voice/vote.

In a number of cases, significant parts of the monitor's report are under seal, without any express consideration of the tests for sealing orders in the court's approval of the sealing order sought, as set out by the SCC in *Sierra Club*

[78] *Re Port Capital Development (EV) Inc* (BCSC), *supra* note 26 at para 113; leave to appeal granted, to be heard by a five-person panel, *Port Capital Development (EV) Inc* (BCCA 319), *supra* note 26; appeal granted *Port Capital Development (EV) Inc v 1296371 BC Ltd,* 2021 BCCA 382 (hereafter *Re Port Capital Development (EV) Inc* (BCCA 382).
[79] *Re Port Capital Development (EV) Inc*, 2021 BCSC 1272, *ibid* at paras 4, 12.
[80] *Ibid* at para 52, citing *Century Services, supra* note 9 at para 70.
[81] *Port Capital Development (EV) Inc v 1296371 BC Ltd,* 2021 BCCA 319, note 26.
[82] *Port Capital Development (EV) Inc v 1296371 BC Ltd,* 2021 BCCA 382, note 78 at para 88. It exercised its discretion to find that 129's proposal was appropriate and superior, from the point of view of all the stakeholders, to Solterra's Backup Offer.

*of Canada v Canada (Minister of Finance*), specifically, that a confidentiality order should only be granted when such an order is necessary to prevent a serious risk to an important interest because reasonably alternative measures will not prevent the risk, and the salutary effects of the confidentiality order outweigh its deleterious effects, including the public interest in open and accessible court proceedings.[83]

In 2021, the SCC affirmed and strengthened the *Sierra Club* tests in *Sherman Estate v Donovan*, finding that the open court principle is essential to the proper functioning of our democracy and helps make the justice system fair and accountable.[84] Accordingly, there is a strong presumption in favour of open courts, and an applicant that seeks to justify a sealing order must demonstrate, as a threshold requirement, that openness presents a serious risk to a competing interest of public importance, a high bar, and must then show that the order is necessary to prevent the risk and that, as a matter of proportionality, the benefits of that order restricting openness outweigh its negative effects.[85] Affirming the *Sierra Club* test of necessity and proportionality of the proposed order, the SCC in *Sherman Estate v Donovan* held that this test rests on three core prerequisites: the person asking a court to limit the open court presumption must establish that: (1) court openness poses a serious risk to an important public interest; (2) the order sought is necessary to prevent this serious risk because reasonably alternative measures will not prevent this risk; and, (3) as a matter of proportionality, the benefits of the order outweigh its negative effects, such as an individual trying to protect their core identity in the public sphere to the extent necessary to preserve their dignity.[86]

Only where all three prerequisites have been met can a discretionary limit on openness, such as a sealing order, properly be ordered.[87] The concern in this context is that the RVO endorsements are not considering the SCC tests in granting sealing orders.

*ii. Lack of a Claims Process*

In an RVO, there may be no claims process where creditors can be involved in protecting their interests and consider avenues to resolve the insolvency because there may be no funds available to pay unsecured claims in the newco. For suppliers that are asked to continue to supply to the purchased entity, they must be convinced that they should continue to supply to the same customer that no longer owes them money, which undermines certainty in commercial relations. The purchased entity's obligations to trade creditors and other unsecured creditors are not separate and discrete for other participants; rather, they are connected and intersecting. In *Green Relief,* pursuant to the RVO, all pre-closing payables and post-filing payables were transferred to the newco, which intended to satisfy post-filing obligations out of the proceeds of sale that were made available to it.[88] However, additional professional costs incurred to address a contested matter and appeal of the RVO were paid out of the court-ordered priority charge out of proceeds of sale in priority to the transferred post-filing trade payables.[89]

*iii. Overly Broad Liability Releases*

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[83] *Sierra Club of Canada v Canada (Minister of Finance),* [2002] 2 SCR 522, 2002 SCC 41 at 524; specifically, that "A confidentiality order should only be granted when (1) such an order is necessary to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonably alternative measures will not prevent the risk; and (2) the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which in this context includes the public interest in open and accessible court proceedings… First, the risk must be real and substantial, well grounded in evidence, posing a serious threat to the commercial interest in question. Second, the important commercial interest must be one which can be expressed in terms of a public interest in confidentiality, where there is a general principle at stake. Finally, the judge is required to consider not only whether reasonable alternatives are available to such an order but also to restrict the order as much as is reasonably possible while preserving the commercial interest in question."

[84] *Sherman Estate v Donovan*, 2021 SCC 25, [2021] SCJ No 25 (SCC) at paras 1, 30, 43, protected by the constitutional guarantee of freedom of expression.

[85] *Ibid* at paras 2, 3.

[86] *Ibid* at para 38, citing *Sierra Club of Canada, supra* note 83 at para 53, and para 73.

[87] *Ibid* at para 38. The SCC held that "the risk to this interest will be serious only where the information that would be disseminated as a result of court openness is sufficiently sensitive such that openness can be shown to meaningfully strike at the individual's biographical core in a manner that threatens their integrity", at para 85.

[88] *Green Relief* Endorsement, *supra* note 24 at paras 3 – 4.

[89] M Pickett and L Rogers, "The Business Side of Reverse Vesting Orders", in J Corraini and the Honourable B Nixon, eds, *Annual Review of Insolvency Law, 2021,* at para 1; the article deals primarily with tax and other business issues associated with an RVO. *Re Wayland Group Corp,* Stay of Extension Endorsement, (18 February 2021), Toronto CV-19-00632079-00CL (Ont SCJ [Comm List]).

Also of concern are the broad releases in respect of potential liability claims being granted against directors, officers, insolvency professionals, and third-parties, without the reasoning that usually underpins such broad releases, including contributions to the value of the assets that remain to satisfy creditors' claims.[90] Prior to RVO, the courts had established clear tests for endorsing broad liability releases, which both protect the integrity of the insolvency system and encourage parties to negotiate in the shadow of liability risk.[91] The tests have included: whether the claims to be released are rationally connected to the purpose of the plan; whether the plan can succeed without the releases; whether the parties being released contributed to the plan; whether the releases benefit the debtors as well as the creditors generally; whether the creditors voting on the plan have knowledge of the nature and the effect of the releases; and whether the releases are fair, reasonable, and not overly-broad.[92]

While willful misconduct and fraud liability are often excluded from the release, in a number of the RVO cases, releases are being granted in respect of a broad range of statutory claims without discussion of potential prejudice from such releases or reference to the developed jurisprudence.[93] As one commentary observes, courts have granted broad releases in RVO transactions, thereby achieving third-party releases without creditors being asked to vote on this issue,[94] undermining one of the key criteria for approval that the courts have used.

There is also a question of whether companies will be able to shed substantial environmental remediation and reclamation obligations under the RVO, leaving few assets to satisfy the obligations and transferring these costs ultimately to taxpayers. In most cases, the relevant regulator has not been involved at the stage the court is being asked to approve the RVO, which means the court is not receiving important information on possible implications for regulatory oversight legislation. The court should not be approving any transaction that ignores or misdirects responsibilities for environmental liability, given the critically important nature of these issues.

*iv. Authority to Approve RVO under Receivership has Never Received Judicial Consideration*

The approval of an RVO through receivership is even more problematic because there is not the broad statutory authority accorded the court pursuant to the *CCAA*. Further, to date, there appear to be no judgments that discuss the court's authority to bypass creditor rights and endorse such transactions. For example, in *Pure Global Cannabis,* the receiver argued that s. 243(1)(c) of the *BIA* and s. 101 of the *Courts of Justice Act* (Ontario) provided the jurisdiction, which was accepted by the court without any reasons given. Yet there is nothing in the language of s. 243 that suggests such authority,[95] and it seems critically important that transactions that bypass key provisions of the comprehensive insolvency and bankruptcy framework are carefully scrutinized by the courts. The RVO in a receivership context does not involve collective participation or compel the involvement of all creditors.

### 4. Situating RVO in the Statutory Framework Suggests It Should be Approved in Exceptional Circumstances, Not as the Norm

Overall, we are left with 20 recent proceedings in which RVO have been approved outside of a plan of arrangement, with few guardrails or principles set out in 16 of these decisions. The Court in *Quest University* makes clear that

[90] *Comark Holdings Inc, supra* note 28. *Nemaska Lithium, supra* note 23. *Green Relief*, *supra* note 24.

[91] See for example: *Re Metcalfe & Mansfield Alternative Investments II Corp*, 2008 ONCA 587; *Re Canwest Global Communications Corp,* 2010 ONSC 4209; *Re Nortel Networks Corp*, 2010 ONSC 1708; *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corp*, 2013 ONSC 1078, leave to appeal to CA refused, 2013 ONCA 456, leave to appeal to SCC refused, [2013] SCCA No 395, 472 NR 395 (SCC).

[92] *Re Lydian International Limited* 2020 ONSC 4006 at paragraph 54.

[93] In one case, the court did apply the test for releases as set out in the caselaw *Re Green Relief Inc,* 2020 ONSC 6837 (Ont SCJ).

[94] L Morin and A Mojtahedi, "Catch Me If You Can: Third-Party Releases Under the *Companies' Creditors Arrangement Act*", in J Corraini and the Honourable B Nixon, eds, *Annual Review of Insolvency Law, 2021,* at paras 4, 24.

[95] Section 243 (1) of the *BIA* states: "Subject to subsection (1.1), on application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so: (a) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt; (b) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or (c) take any other action that the court considers advisable." Section 101 of the *Courts of Justice Act* states: "101 (1) In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted or a receiver or receiver and manager may be appointed by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so."

approval of RVO is an exceptional circumstance. Building on these observations, this part considers what the court should be expecting of parties and its court-appointed officer.

The *CCAA,* particularly in its various amendments over the years, has sought to achieve an appropriate balance between various interests affected by a debtor company's insolvency. Part I sets out the framework of the statute, well-known to practitioners and Canadian courts. It allows for a compromise or arrangement to be proposed between a debtor company and its secured and unsecured creditors, a meeting of the creditors to vote on the plan, and, if a majority in number representing two-thirds in value of the creditors, or the class of creditors, present and voting either in person or by proxy at the meeting, agree to any plan of compromise or arrangement, the plan may be sanctioned by the court and, if so sanctioned, is binding.[96] There are specific provisions addressing Crown claims, employees and pensioners, and treatment of equity claims,[97] all designed to balance multiple interests in complex proceedings.

Pursuant to s. 5.1 of the *CCAA,* the terms of the plan may include provision for the compromise of claims against directors of the company that arose before the commencement of proceedings and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for payment of such obligations, but the court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances or where claims are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.[98]

In disclaiming any contract, parties must satisfy the court that the s. 32(4) *CCAA* criteria have been met, specifically, whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; whether the monitor approved the proposed disclaimer or resiliation; and whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.[99]

This statutory framework represents a careful balancing of interests and prejudice, and gives voice and vote to the creditors that are the residual claimants to the value of the debtor company. Many of the provisions are aimed at mitigating the imbalance in power that secured creditors have in insolvency proceedings, at least during the period of negotiations for a plan, with a view to maximizing the value of the assets, preserving going-concern value, and protection of employees and the public interest.

It makes sense, therefore, that in any application to bypass this carefully crafted statutory process, the court consider whether there are compelling and exceptional circumstances to justify this extraordinary remedy, even where the RVO is not specifically contested, as the court needs to be satisfied of the integrity of the system and the potential prejudice to creditors and other stakeholders that may not be appearing before it. Reasons are important for stakeholders to understand the benefits and prejudice that may accrue to any particular transaction.

The court should consider a proposed RVO in the context of the statutory framework, with reasons why the circumstances require the exception to the statutory regime. That scrutiny needs to be even higher where the purchaser is a related party. In some instances, the objective of the RVO is to place the newco in bankruptcy, but without access to the assets to which creditors had a *pro rata* claim based on their statutory priorities at the commencement of the insolvency proceeding. The RVO process can deprive some creditors of meaningful recovery and, therefore, the decision must be supported by reasons.

To protect the integrity of the insolvency process in the context of RVO, courts need to require their court-appointed officers to advise them why and on the basis of what evidence, in their professional view, the requirements of a plan should be bypassed in the circumstances. While findings of good faith and due diligence are important hallmarks

[96] *CCAA,* ss. 4, 5 and 6.
[97] *CCAA,* ss. 6(3)-(8).
[98] *CCAA,* s. 5.1.
[99] *CCAA,* s. 32(4).

of the court's approval, courts should not unquestionably accept submissions of self-interested parties at face value that there are no alternatives.

If the bargain is the best that could be negotiated, it should be put to creditors, who will vote their self-interest. Without a vote by creditors, purchasers will not be held accountable for the terms and conditions of purchase. If the vote fails, a plan can be renegotiated, or if a receiver or trustee is appointed, it does not automatically result in liquidation - there is no bar to further negotiations or to selling parts of the business as a going concern, but the process is managed by an insolvency professional whose integrity (and license) is on the line for ensuring that rights and interests are balanced in compliance with the insolvency law framework.

While a plan of arrangement is not necessary to approve a sale of assets pursuant to s. 36, the section is not designed to bypass the other statutory requirements. It is not sufficient to say that creditors will be allowed eventually to vote on a plan under newco, when the assets available for distribution have been transferred away by the RVO from the estate in which creditors have claims. One reason that would appear not to be appropriate is the rationale that an RVO should be approved because the value of one or more creditor claims would swamp a class vote and prevent approval of a plan by creditors or that any one of several claims could effectively veto a plan, and thus the RVO should be approved to avoid the creditor vote. While funds transferred to newco may be equivalent to funds that may have been distributed under a plan, that plan is precisely the plan that creditors with significant claims would have voted not to approve.

The guardrail should be what creditors are entitled to under all avenues to resolve the insolvency, including liquidation, unless the creditors agree otherwise to compromises for their benefit, and the framework should not be bypassed absent compelling circumstances. In analogous circumstances, courts have consistently held that the fact a secured creditor states it will not support a plan under any circumstances is no reason not to grant relief pursuant to the *CCAA*. The entire structure of the statute is to allow the claimants to the residual value of the assets a 'voice' in the workout strategy, and the value of claims under the voting procedure draws parties to the negotiation table. It raises the question of whether the court has authority to override a veto position, which is quite different than urging parties back to the bargaining table.

The assets excluded from transfer to the newco are often some of the most valuable assets because the purchaser under the RVO has the bargaining power to demand such assets be left in the original debtor company while transferring liabilities and obligations into the newco. It therefore bypasses the point of the *CCAA* – to prevent a race to the assets by the most powerful parties, to treat stakeholders in a fair and equitable manner, and to collectivize the negotiations in a manner that is fair and reasonable in the circumstances.

The "only option available" rationale may be legitimate, but absent reasons, and given lack of access to records that are sealed such that less sophisticated creditors cannot assess their options, the resulting order does a disservice to the *CCAA*. One question is whether RVO should be authorized by way of legislative amendment, with careful consideration of creditor safeguards. Just as the s. 36 language was added to the *CCAA* to create guardrails in approval of asset sales that were being approved prior to these provisions being enacted, similar safeguards may be required in respect of a sale of shares in conjunction with RVO. In the interim, however, it is important to discuss how Canadian courts should be considering these issues as they are presented with proposed transactions.

The court has an important role in protecting the integrity of the insolvency regime and its legislative framework. While the court cannot always be expected to render detailed reasons, it is appropriate to signal to parties the court's consideration of its statutory authority and the well-established tests for orders such as sealing orders, release from liability, and that the court has taken the time to understand the transaction and to hear from its court-appointed officer as to which creditors are not before the court and whether they will be prejudiced. It means that even where the parties before the court are agreed on a strategy, the court should be satisfying itself that the statutory requirements are being met and the policy considerations underpinning the statute are being respected. The court should expect its court-appointed officer to provide a balanced and impartial account of both the benefits and prejudice of any RVO in opining on its support or not.

If a judge concludes it just and fair that a court order be issued that is the product of a process that stands outside the normal statutory requirements for the matter, then it is incumbent on the judge to give reasons. Time may be of the essence, but the judge can always sign an order and release reasons a week or two later. At the very least, some sort of written endorsement should issue in each case, and that endorsement should address the key questions that the court has asked of the monitor and debtor. This procedural process is important to safeguard the transparency, accountability, and integrity of the system. The following are some initial suggestions as to questions the courts should be asking:

- Is the monitor satisfied that the debtor acted with due diligence and in good faith to comply with the statutory framework and that all parties are acting in good faith; and has the monitor satisfied the court that the relief sought is appropriate in the circumstances and accords with the statutory objectives and framework of the *CCAA* in both what the order will achieve and the means to achieve those objectives?

- Has the monitor discharged its responsibility, as a court-appointed officer, to provide the court with evidence that there are compelling and exceptional circumstances such that the RVO transaction cannot be undertaken as a plan of arrangement or compromise pursuant to s. 6 of the *CCAA*, including evidence as to why a creditor vote is not possible? Has the monitor given an opinion that the creditors should be permitted to vote on the proposed RVO under a plan, or why the circumstances are so exceptional that some of the most significant requirements of the statute should be bypassed?

- Has the monitor in its report offered an evidence-based rationale as to why the proposed transaction is at least equivalent to respecting the rights and remedies of creditors under a plan of arrangement?

- Are the assets or value of the assets being transferred to newco at least <u>equivalent</u> to the value of assets that would be available to meet creditors' claims under a *CCAA* plan, *BIA* proposal or a bankruptcy liquidation? The consideration given in the transfer of the unwanted assets and liaiblities should be at least equivalent to assets that are available under the insolvency framework, which includes, either transferring some the debtor's most valuable assets to newco; or paying a price for the licenses, permits, and tax attributes that leaves creditors in the same position that they would be in if they were able to vote on a plan. Merely approving clauses that specify that creditors will continue to have all the rights, remedies, and recourses against the newco created during the RVO as they did against the debtor originally is just not sufficient in itself. The value of assets to satisfy the claims must also be transferred to protect the integrity of the system.

- Has the objective of preserving the going-concern value of the business been balanced against the prejudice to creditors and other stakeholders? Has the court required objective evidence of the balance of protections and prejudice?

- If a transaction was originally presented as a plan of arrangement, then converted to an RVO, is the court satisfied the reasons for doing so are consistent with the aims of the *CCAA*?

- Has the monitor given an opinion that it is confident that the RVO is not being sought to bypass employment agreements and pension and benefits obligations that would otherwise continue in a going-concern resolution or where their claims are being extinguished without equivalent compensation?

- Has the monitor given an opinion that it is confident that the RVO is not being used to avoid or bypass environmental reclamation responsibilities and the relevant regulator has been given notice of and supports the transaction? If the regulator does not support the transaction, has the monitor opined that the RVO is still the most viable alternative and complies with any applicable remedial legislation, along with the appropriate reasons?

- Has the monitor provided compelling reasons why any sealing order of the monitor's report or other information on the transaction meets the conditions set out by the SCC in *Sierra Club of Canada* and *Sherman Estate v Donovan*?

- Is the court satisfied that any requested releases in favour of the debtor's directors, officers and third-parties under the RVO do not inappropriately shield them from claims and meet the tests articulated by the courts? Is the court satisfied that the RVO approach is not being used to achieve third-party releases without creditors being asked to vote on the issue?

- Where claims are preserved in the newco, are there sufficient assets also allocated to newco or set aside in trust for a period to be available to satisfy claims? Are the rights and remedies of creditors preserved until the vote on a plan with newco?