NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the global restructuring team at Norton Rose Fulbright

Q3 2024

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To our clients and friends:

To our clients and friends:

With this issue, I am pleased to have the opportunity to congratulate my partner and co-head of the Norton Rose Fulbright restructuring group, Scott Atkins, on an extremely successful three-year term as president of INSOL International. INSOL is the leading global organization of insolvency professionals.

Scott was instrumental in developing a comprehensive strategic review of INSOL through the landmark INSOL 2030 Strategic Plan and by leading several new future-shaping initiatives to enable INSOL to continue to serve its members in the decade to come.

Scott led the INSOL conferences in London 2022, in Tokyo 2023 and, most recently, in San Diego 2024. These were milestone events for INSOL, including celebrating INSOL's 40th anniversary and driving membership growth to a record 12,300 members from over 108 countries.

As the co-leader of our Restructuring group, Scott provides a fantastic global perspective to help us advise our clients through these turbulent times. Scott's clear and strategic leadership will be invaluable as the world realigns around geopolitical and technological disruption.

Enjoy our new issue,

Howard Seife
Global Co-Head of Restructuring
New York

In the news

INSOL International Annual Conference

May 22–24, 2024

Norton Rose Fulbright was a main sponsor of INSOL's annual conference in San Diego. Our team had a large cross-border group in attendance with representation from our offices in the US, Germany, the Netherlands, UK, Singapore and Australia. Over 700 professionals representing more than 300 firms from 60 countries attended the week-long conference of ancillary meetings and exceptional conference programming.

International Insolvency Institute

June 9-11, 2024

Scott Atkins (Sydney), Meiyen Tan (Singapore), Mark Craggs (London) and Omar Salah (Amsterdam) attended International Insolvency Institute's 24th annual conference in Singapore. The annual conference is the premier international insolvency conference for practitioners, academics, and members of the judiciary.

Australian Banking Association Annual Conference

June 24, 2024

Natasha Toholka (Melbourne) moderated a panel session at the ABA's annual conference in Melbourne. Panellists included Shayne Elliott, CEO of Australia and New Zealand Banking Group and Peter Gartlan, CEO of Financial Counselling Australia. The panel discussed customer resilience.

R3 & INSOL Europe - International Restructuring Conference

June 27, 2024

Prof. Omar Salah (Amsterdam) participated on a panel a the 18th annual R3 & INSOL Europe Conference on cross-border restructuring in London. The conference is co-hosted by the UK trade body, R3, and its European-wide equivalent, INSOL Europe. Omar's panel spoke on parallel restructuring proceedings called "Multi-process restructurings - Unlocking Opportunities: Strategies for Success in the Evolving European Restructuring and Special Situations Market."

WHOA Training: Legal Restructuring Expert

July 4-5, 2024

The Centre for Professional Legal Education (CPO), which is part of the Radboud University, Nijmegen, organized a professional executive education in Amsterdam for the training of legal restructuring expert (juridische herstructureringsdeskundige) under the Dutch WHOA. Prof. Omar Salah and Judge Ruud Hermans were the course organizers and they lectured the course together with a team of experts in this field.

Advanced Real Estate Law Course

July 11-13, 2024

Ryan Manns (Dallas) spoke at the 46th Annual Advanced Real Estate Law Course in San Antonio where he gave a bankruptcy update. The conference was co-sponsored by the Real Estate, Probate and Trust Law Section of the State Bar of Texas.

International Insolvency Institute

Francisco Vazquez (New York) was invited to join the International Insolvency Institute (III). The III is a global membership of leading practitioners, academics, judges, and financial industry professionals with expertise in international insolvency law and practice to improve law and practice related to domestic and international insolvencies and restructurings in order to promote economic wellbeing, investment and the efficient administration of justice.

INSOL International - 2024 Fellowship Class

Laura Johns (Sydney) and Francisco Vazquez (New York) have been named Fellows in INSOL International's 2024 class of inductees. They are members of a class of 24 new Fellows worldwide who have completed the Global Insolvency Practice Course, INSOL's pre-eminent advanced educational qualification focusing on international insolvency.

Sydney University Law School

July 2024

David Goldman (Sydney) met with a delegation of regulators from Shenzhen Province, the Commonwealth Inspector General in Bankruptcy and local academics at Sydney University Law School to discuss the recent in introduction in Shenzhen of China's first personal insolvency system.

UNSW Law School

June—August 2024

From June to August this year David Goldman (Sydney) is running the postgraduate corporate insolvency course at UNSW Law School, in his capacity as Adjunct Associate Professor. Students were pleased to receive a guest lecture from Scott Atkins on his work as former President of INSOL and international insolvency initiatives he has been involved in.

Women in Insolvency and Restructuring Victoria (WIRV)

Awarded Gender Diversity Organisation of the Year Award for 2024 by WIRV in Australia. This award is to recognise organisations in the insolvency and restructuring industry that demonstrate a balance of gender diversity and commitment to progression of women within their business and more broadly within the industry.

Considerations on forbearance and enforcement of security on Canadian loans

Jennifer Stam

Introduction

The legal landscape for secured lending in Canada is well established. Across Canada, all of the common law provinces and territories have personal property legislation and registration systems that allow lenders to confidently take security, and an equally secure regime exists in the Province of Quebec. Further, where restructuring or enforcement proceedings are required, Canada has the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA), which are federal statutes and can be implemented across the country.

Lenders can rest assured that they can and will be entitled to enforce their security if and when necessary. The lead up to enforcement, however, can be less black and white and significantly more grey. Where a borrower is in default, a lender is often faced with the challenge of determining what response is appropriate. Responses can range from a simple acknowledgement, to a default notice, a forbearance agreement or immediate steps to enforcement.

A lender may agree to forbear for many reasons and on many terms. This article sets out just a few of the legal considerations that are specific to Canadian law and the Canadian legal regime, which lenders should consider in determining whether to forbear and on what terms.

Jurisdiction

The province where a borrower is headquartered as well as the province or provinces where its assets are located can be a key consideration. While a number of the provinces across Canada have sophisticated commercial courts and/or experienced commercial judges, others do not. In certain provinces, commercial hearings can only be scheduled periodically. Further, different provinces may have additional local procedures that are required to be followed in order to commence a proceeding. In the Province of Quebec, for instance, the lender must send and file "prior notices" at least 20 days in advance of an enforcement on mobile assets and 60 days in advance of an enforcement on immobile assets. In other provinces, it is still far more common for receivers to be appointed privately than through court order, and succeeding in a court application can be challenging without prior consent to the appointment.

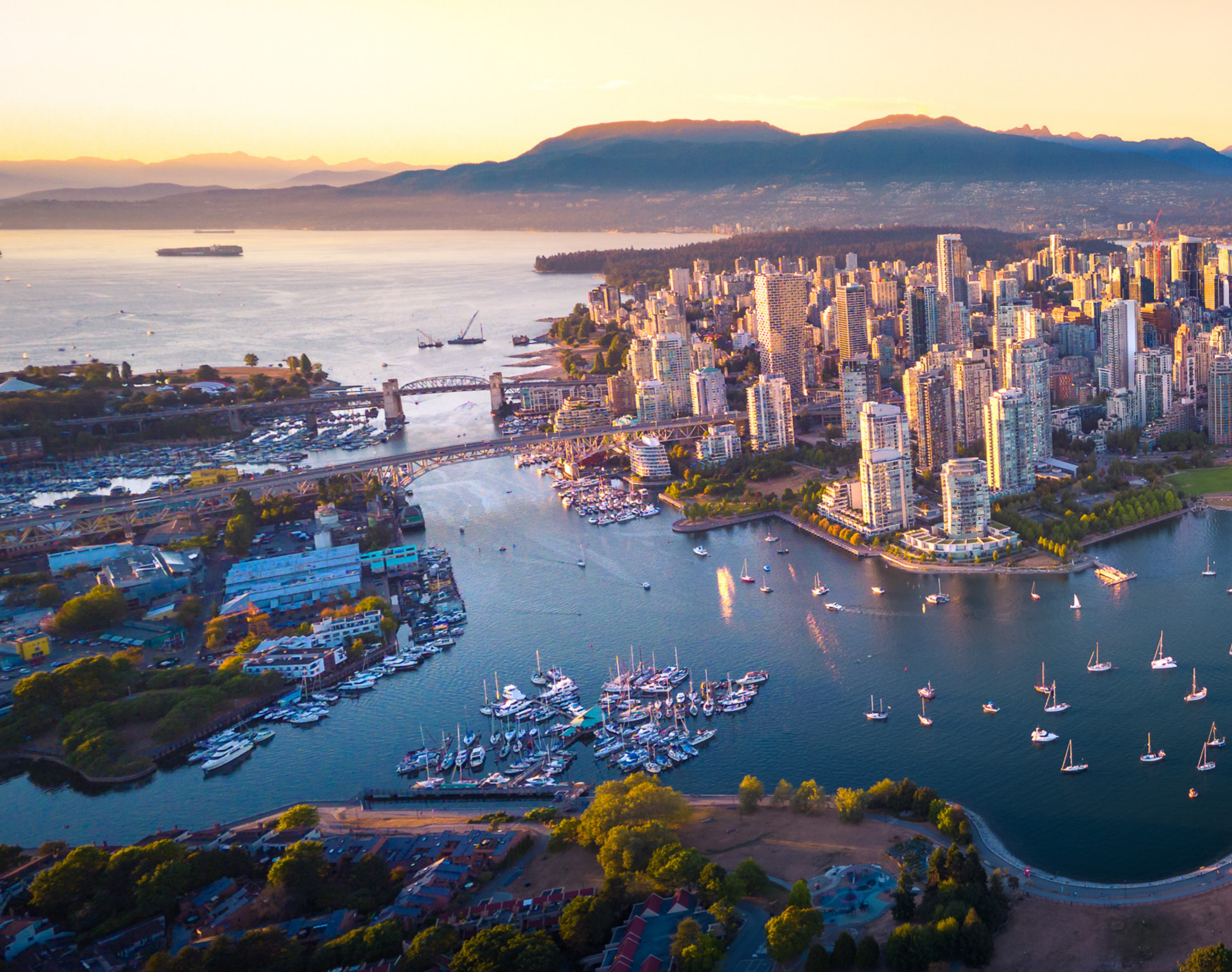
These local considerations in filing for and/or enforcing security may factor into a lender's agreed forbearance period, cure periods for curing defaults and/or governing laws and/or attornment to jurisdiction. Therefore, it is critical to get the right advisors and expertise based on the relevant jurisdictions.

Business operations and collateral base

Collateral make up is crucial to structuring a forbearance. Of course this is a crucial consideration for any lender in any jurisdiction, but within Canada, there are a number of additional Canadian legal considerations, which again, may impact the terms of a forbearance.

Understanding whether assets dispersed across several provinces is important. If assets or inventory are located in remote parts of the country, can they easily be consolidated? If assets are mobile, such as aircraft, vehicles or otherwise, has the lender complied with all elements of the provincial personal property systems in every province?

Additional consideration should be given to the level of regulation in the industry in which the borrower operates. Companies that are in certain industries, such as transportation, are federally regulated and are subject to the Canada Labour Code. Commonly, the issue of additional requirements for termination and severance arise, including the personal liability of directors for such payments. In the event that the borrower requires licenses to operate its business, such as businesses in the cannabis industry, a debtor must generally remain in possession of its assets in order to restructure, which means that the appointment of a receiver may not be the ideal remedy for a lender. In those



instances, a lender may consider including provisions in the forbearance agreement with respect to a cooperative CCAA filing or a lender led CCAA filing.

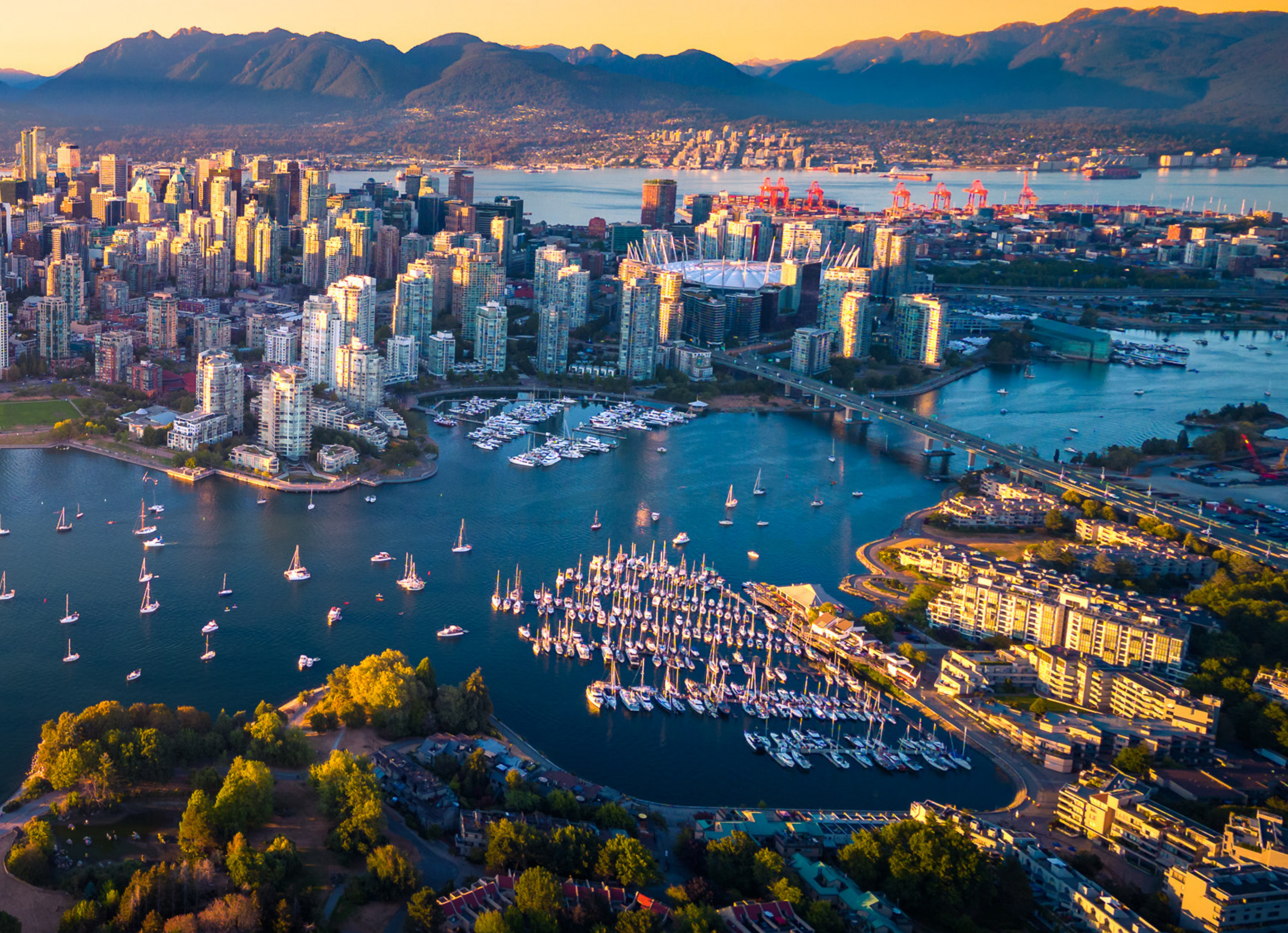
Position of management/the board

The degree to which management and the board are experienced, demonstrate cooperation and have a clear path towards a turn around and repayment can play a significant role in forbearance terms. Conversely, in many instances management and/or the board may lack sophistication, bandwidth or experience or have other considerations which are unhelpful to a situation. In such situations, a lender may want to lay the ground work early for the appointment of a chief restructuring officer, operational consultant or additional interim management. Where this is not immediately necessary, it may still be advisable to include in the forbearance agreement a provision granting the lender the right to require the borrower to retain additional help upon request. Cost and pricing, as well as consent rights, should also be negotiated.

Lenders may also wish to request observer status at board meetings (or in some instances a seat on the board). However, before proceeding with the latter, further consideration should be given as to whether the benefits outweigh any corresponding risks.

Employee and pension considerations

It is important for a lender to understand the employee base of the borrower. Are employees unionized? Does the borrower maintain any registered pension plans? If so, do any of them have a defined benefit component?



A key consideration for lenders relates to borrowers that sponsor defined benefit plans. As a result of the *Pension Protection Act*, solvency deficiencies and liability for special payments (which previously did not have priority) will now have priority over all other claims, including secured lender claims.[1] While the grandfathering provisions of the statute defer the enactment of the priority claim for most situations until 2027, lenders should consider whether forbearance terms with respect to monitoring or retiring defined benefit plans should be considered.

Additionally, in Canada, there is personal liability and, in some instances, priority for other employee related requirements, such as payroll deductions and remittances to applicable tax authorities. Lenders should require their borrowers to remain up to date in terms of those super priority amounts.

Conclusion

While there are many other considerations that a lender will need to make when determining how to work with a borrower in default, the foregoing provides a few considerations specific to the Canadian legal regime that may impact forbearance terms or may lead to lenders making different decisions than they might otherwise make. Ultimately, every situation will have its own nuances, and lenders, together with their financial and legal advisors, will assess situations with due consideration to all the circumstances.

Jennifer Stam is a partner in our Toronto office in the firm's global restructuring group.

1 See Canadian legislation aimed at protecting pension plans may mean significant changes for lenders, borrowers and employees, *Norton Rose Fulbright International Restructuring Newswire* (Q2 2023).

Trading in the zone of insolvency: English High Court orders directors to pay highest ever penalty

Helen Coverdale and Mark Craggs

Overview

The English High Court has ordered[1] two directors (the Directors) of four companies in the British Home Stores group (BHS) to make payments exceeding £18 million in connection with BHS' trading prior to commencing insolvency proceedings.

Each director has been ordered to pay £6.5 million for continuing to trade past the point at which the Court concluded the Directors knew or ought to have known that insolvency was inevitable and there was no reasonable prospect of avoiding liquidation. This order represented the largest ever award made by an English court for wrongful trading, although it has been reported that an even larger award has been made against former owner and director, Dominic Chappell. Unusually, his trial was severed and dealt with separately to the trial of the other Directors, as Mr. Chappell was considered in poor health at the relevant time. Mr. Chappell previously had been disqualified from acting as a director for a period of 10 years and jailed for tax offences relating to BHS.

The Directors also were ordered to compensate the companies for breaching their directors' duties by continuing to trade the companies past the (earlier) point in time at which they ought to have concluded that an insolvency process was likely. In respect of this breach, they could be ordered to pay more than £133 million, with the final sum to be determined at a separate hearing.

While the Directors were found liable for certain other breaches of duty relating to pre-insolvency transactions, this article focuses on the claims in relation to trading in the period prior to commencement of formal insolvency proceedings. It looks at the primary remedies under English law that a liquidator may pursue in respect of so-called 'insolvent trading,' and reflects on the practical implications of the case for directors of distressed companies.

Trading in the zone of insolvency – wrongful trading

Unlike certain other jurisdictions, in England and Wales there is no requirement for directors to file for insolvency within a specific period. Likewise, there is no offence of trading whilst insolvent. Instead, the UK has adopted a more nuanced approach to companies continuing to trade in the zone of insolvency.

Under English law, directors may face personal liability for wrongful trading[2] if the directors continue to trade past the point at which they know - *or ought to know* - that the company has no reasonable prospect of avoiding insolvent administration or liquidation and they do not take *every* step to minimise losses to creditors (the statutory defence).

If liability is established, the Court has a discretion to order that the directors make a personal contribution to the company's assets. This is generally capped at the increase in the company's net deficiency during the period of wrongful trading. This period will start from the point at which the directors knew or ought to have concluded (whichever is the sooner) that there was no reasonable prospect of avoiding insolvency and runs through the point at which the company in fact entered insolvency proceedings. The court may also exercise its discretion to make no award at all.

It is notoriously difficult for liquidators to bring successful wrongful trading claims. However, the risk of personal liability naturally focuses the minds of directors and generally serves as a deterrent for excessive risk-taking. Rarely, an alternative claim of fraudulent trading[3] may be brought, although the bar for establishing liability is higher.

1 *Re BHS Group Ltd & Others* [2024] EWHC 1417 (Ch)
2 Section 214 of the Insolvency Act 1986
3 Under section 213 of the Insolvency Act 1986

Breach of duty

In the context of continuing to trade a distressed company, wrongful trading is not the only offence directors may incur personal liability in respect of. The UK Supreme Court's landmark judgment in *Sequana*[4] confirmed that directors and shadow directors may face liability for breaching their fiduciary and statutory duties under the UK Companies Act 2006.

The Supreme Court confirmed that the duty under the Companies Act 2006 to promote the success of the company for the benefit of members[5] is modified when the company is in the zone of insolvency. Essentially, when a company is bordering insolvency, cash flow or balance sheet insolvent, or where administration or liquidation is probable, the directors must consider the interests of creditors - as well as equity owners - and carry out a balancing exercise between the two when making decisions. Once insolvency is inevitable, directors should be focused solely on the interests of creditors, as these become the stakeholders with the economic interest in the company. This is known as the Creditor Duty, albeit the duty is owed to the company rather than to creditors themselves.

The Creditor Duty is a separate cause of action from wrongful trading. This means that liability may be triggered at earlier stage in the company's trading period and in circumstances where insolvency is not yet inevitable. Prior to the BHS case, the English courts had not made an award against directors for breach of the Creditor Duty involving 'misfeasant trading.' This has now changed, with implications for future restructurings and insolvencies.

Background to the BHS litigation

BHS was established in 1928 and became a household name in the UK. It specialised in the sale of clothing, homeware, home lighting and furniture, operating in 164 stores and 67 franchise stores in 16 countries.

In the decade prior to its collapse, its profitability declined, and by 2015 it had a cumulative operating loss of £442 million. In March 2015, Retail Acquisitions Limited (RAL) purchased the entire issued share capital of the parent company, British Home Stores Group Ltd, for £1. New directors were appointed to the BHS companies. These included the respondent Directors, Mr Chandler and Mr Henningson. Following a further unsuccessful trading period, the BHS companies entered administration in April 2016.

The liquidators brought various claims against the Directors, which for convenience can be divided into the following categories:

- Wrongful Trading
- Misfeasant Trading
- Further Misfeasance Claims

The liquidators argued that from the date of RAL's acquisition of BHS, the Directors ought to have known there was no reasonable prospect of avoiding insolvency.

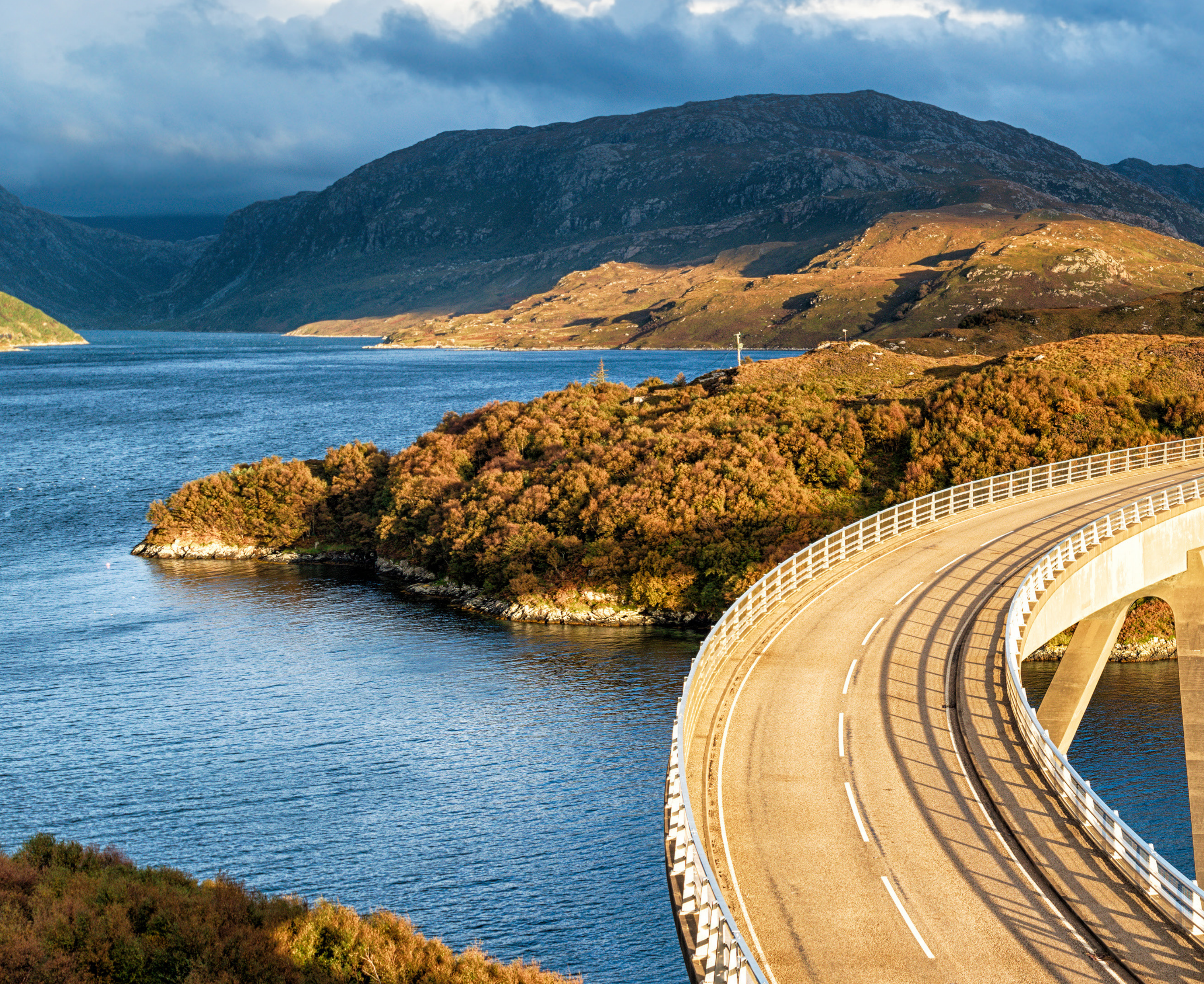
Wrongful trading

The liquidators proposed six potential dates at which the knowledge requirement for wrongful trading had been met (i.e. that they knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent administration or liquidation). The first five of these dates were rejected by the judge, Mr Justice Leech. The Court found that the knowledge requirement was satisfied on 8 September 2015, six months after RAL's acquisition. At this point, BHS was cash flow insolvent and it should have been clear that the unsecured creditors would be prejudiced by the Directors decision to continue trading. Entering into new, expensive financing had a degenerative effect on BHS' assets because, in addition to the financing being on onerous terms, it was to fund loss-making stores, therefore increasing BHS' debt. There was no reasonable prospect of BHS achieving its business plan, and no plan to remedy the substantial pension deficit.

The four BHS companies in fact entered administration on 25 April 2016, seven months after the knowledge requirement had been satisfied. The joint experts submitted that the interim trading period was associated with an increased net deficiency in BHS' assets of £45.5 million.

In relation to the statutory defence to a claim of wrongful trading – i.e. that the directors took "every step with a view to minimising the potential loss to the company's creditors that they ought to take" - the case confirms that this is a high bar to meet. The meaning of "every step" will depend on the facts. The judge confirmed that obtaining professional advice will not always be essential, but where such advice is not taken, it will be more difficult for directors to demonstrate that they took every step.

4 BTI 2014 LLC v Sequana & Others [2022] UKSC 25
5 Section 172(1) Companies Act 2006



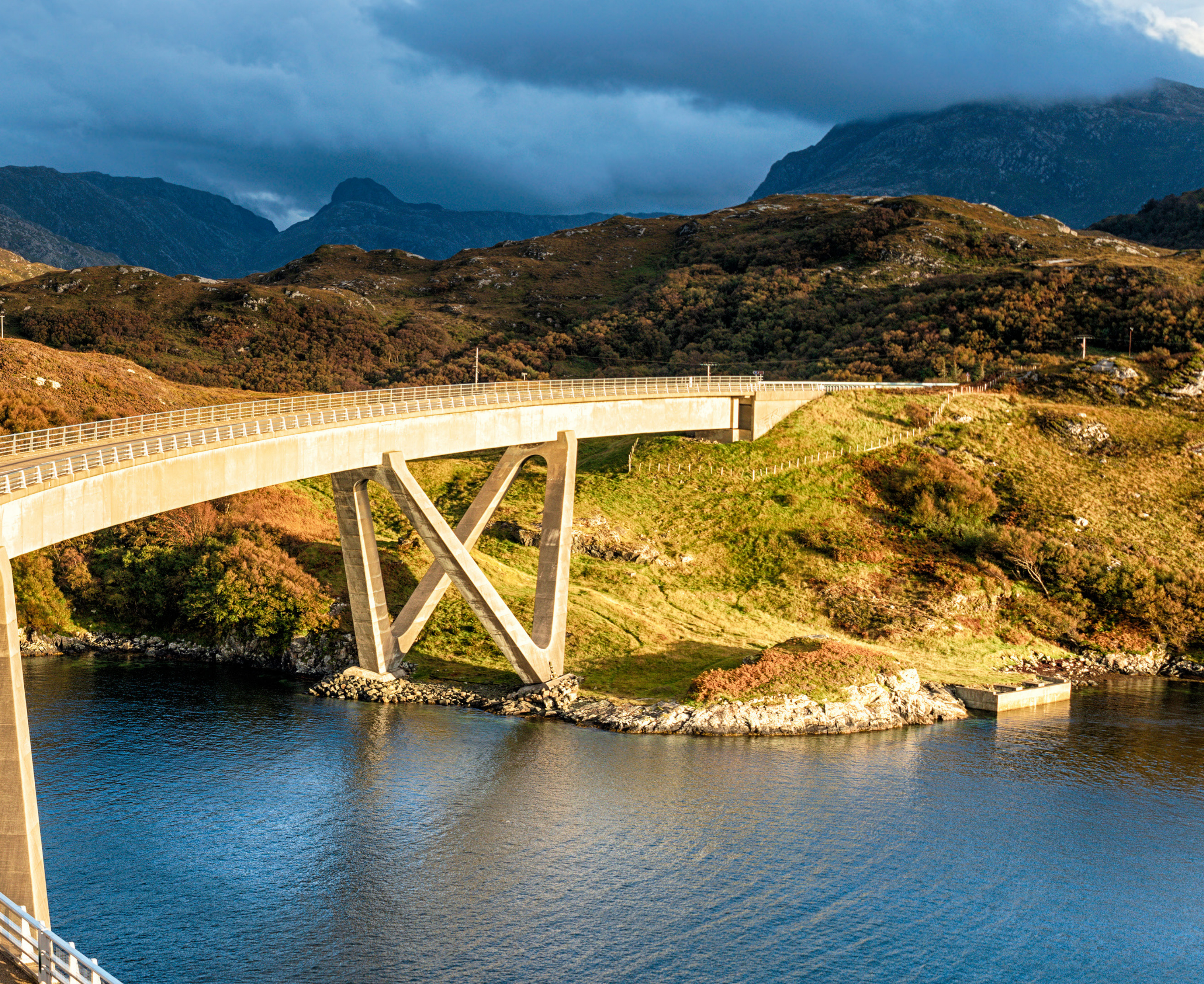
Professional advice and the importance of board minutes

As noted above, obtaining professional advice will assist evidentially in demonstrating that the directors discharged their duties. Procuring professional advice will also assist in demonstrating that the directors properly understood their statutory and fiduciary duties in the first place. However, the BHS case illustrates how the court will examine the circumstances and quality of the advice received. The court will be prepared to look at the scope of the engagement, the instructions to professional advisers, the accuracy of the information provided to the advisers, and the nature of the advice received. Not least, the court will look at whether the advice was in fact acted upon by the directors.

The judge observed that:

"*...all the right questions... [were raised by the lawyers, but]... never tabled or discussed at a... board meeting before the decision was taken to enter into [the financing]...*" and "*...if Mr Chandler [as general counsel] had called a board meeting to consider each of the issues raised by [the lawyers] before entering into [financing arrangements], then I have no doubt that Notional Directors carrying out the functions of [the Directors] would have concluded that there was no reasonable prospect of avoiding insolvent liquidation or administration and that the immediate course was to take advice from an experienced insolvency practitioner*".

Well-advised boards will know the importance of documenting their decisions. Directors of financially healthy companies may be familiar with board minutes being



prepared in advance of meetings. This practice is generally discouraged; especially so when a company is facing insolvency, since directors will need to carefully document not only their decisions and reasons, but also the discussions relating to those decisions (for example, the decision to continue trading or the decision to enter into certain transactions). Should a liquidator subsequently be appointed, the board minutes may be scrutinised to examine whether the directors acted appropriately.

It is therefore important that board minutes accurately describe what has occurred at the meetings. The judge stated that he assigned less weight to board minutes which had obviously been prepared in advance by BHS' lawyers. Moreover, he attributed less weight to language or statements which had been drafted by BHS' lawyers and simply repeated at subsequent meetings. In this case, the minutes were "*formulaic and none of them record[ed] that there was any genuine discussion between board members about the risk of insolvency or the risks to individual creditors*".

It is important to note that board minutes are not the only records a judge is likely to consider when reaching a view on liability. In addition to board minutes, a Court may consider contemporaneous correspondence, including emails, handwritten notes of meetings, and text messages. These may be read out in court and parties therefore should be mindful of this possibility when discussing and commenting on company matters in crisis situations.

"Misfeasant trading"

Acting with reasonable care and skill is a statutory duty of directors under the Companies Act 2006. As discussed above, directors also must act to promote the success of the company, as modified in the zone of insolvency by the Creditor Duty. A breach of duty may result in a subsequently appointed liquidator bringing misfeasance proceedings against the director.

In the BHS case, misfeasance proceedings were brought in relation to specific transactions (and in several cases the liquidators were successful). More interestingly, for the first time misfeasance proceedings were successfully brought against directors for breaching the Creditor Duty by continuing to trade in the zone of insolvency without taking proper account of creditors' interests. In the case of BHS, the Court found that the Creditor Duty was engaged and breached in June 2015, ten months before the BHS companies entered administration and *before* the Directors were in breach of wrongful trading provisions. The Court held that the Directors ought to have known by that point that it was more probable than not that BHS would enter insolvent administration. There were several reasons for this, including that the Directors knew that if BHS did not secure sustainable new financing, BHS would be unable to cover rental payments and liabilities. However, the available financing was on onerous terms and not in the interests of creditors. Once the Creditor Duty had been engaged, the interests of creditors were not properly taken into account when the directors made important decisions.

The judge reasoned that:

"…if [the Directors] had complied with their duties on or before 26 June 2015 and on or before 8 September 2015 the Companies would not have continued to trade but would have gone into insolvent administration immediately."

The joint experts submitted that by not filing for insolvency on 26 June 2015, the BHS companies' net deficiency increased by £133.5 million. The actual amount the Directors will be ordered to pay in respect of misfeasant trading will be determined at a later hearing.

In summary, even when a company remains cash flow and balance sheet solvent and there is no breach of the wrongful trading provisions, directors still may face liability for 'misfeasant trading' by breaching the Creditor Duty.

The judge reiterated that there is a minimum objective standard of the general knowledge, skill and experience that is reasonably expected of a person carrying out a director's functions. If a director's actual knowledge, skill and experience is higher than the minimum level, the director will be held to a higher standard. However, a lower level of knowledge, experience and skill does not lower the objective standard. While acting in good faith is important, acting honestly alone may not be enough to avoid personal liability. This is true for wrongful trading and for breach of duty, although there is a statutory defence to breach of duty if the director acted honestly and reasonably and in all the circumstances ought fairly to be relieved of liability[6]. The judge commented:

"I accept that Mr Chandler did not receive substantial rewards from being a director of the Companies [and] that an award of compensation [for wrongful trading] will be potentially ruinous for him. However, I am not persuaded that it is appropriate to take these matters into account. Again, ***it will send a green light to risk-taking or, even, dishonest directors if the Court reduces the amount of compensation…on the basis of his ability to pay…****"* [emphasis added]

D&O Insurance

Having established liability for wrongful trading, the Court ordered the Directors be equally but severally liable (given the difference between their involvement and culpability, with Mr Chandler having done his best, albeit falling below the minimum standard to be expected). The judge considered that Mr Chappell should bear liability for 50% of the losses, while the two Directors each should be liable for 15% of the losses incurred, being £6.5 million each.

The Directors argued the liability should be capped at the level of the Directors and Officers (D&O) policy and reflect their means to pay, rather than being based on the increase in the net deficiency of the BHS company's assets. The D&O policy was capped at £20 million, including defence costs. Rejecting this argument, the judge considered that restricting an award to the D&O policy limit would *"send the wrong message to risk-taking directors that they could escape liability if they did not obtain adequate cover to indemnify themselves against wrongful trading"*. The judge also emphasised that the level of D&O coverage must be adequate for the size of the business. In the present case, the £20 million limit was clearly inadequate.

6 Section 1157 of the Companies Act 2006

Practical implications for boards of directors

Boards of distressed companies should take note of this decision. It confirms the benefits of obtaining professional advice, particularly in the context of discharging the burden of showing that the directors acted appropriately in the period prior to insolvency proceedings being commenced. It will often be appropriate for the board of directors to obtain their own professional advice from a personal liability perspective, separate and independent to the advice obtained by the company. In certain cases, individual directors may need to take specific advice separate to the rest of the board. While the BHS companies obtained professional insolvency advice, the directors did not instruct lawyers to advise them on the risk of their personal liability.

Notwithstanding the above, the decision makes clear that obtaining advice alone will not act as a shield against personal liability. The courts will look at the quality of the information provided to the advisers, the advice received and – crucially – whether that advice was acted upon. The major problem was that the BHS Directors did not properly engage with that advice and had regarded it as a 'tick box' exercise.

Directors sometimes ask their professional advisers whether they ought to continue trading. This decision confirms that directors cannot delegate that decision to their advisers and they must exercise independent judgement. Directors are not expected to throw in the towel at the first sign of distress and it is usually legitimate to investigate turnaround and funding options. However, the prospect of trading out of insolvency and avoiding liquidation or administration must be "more than fanciful and a reasonable one". As the judge noted, "blind optimism" will not be enough.

Each case will depend on its own unique facts, highlighting the need for specialised, tailored advice.

Mark Craggs is a partner and Helen Coverdale is a senior knowledge lawyer in our London office and members of the firm's global restructuring group.

The Hill's the Limit in Canada: British Columbia Court of Appeal confirms jurisdiction to grant reverse vesting orders in receivership proceedings

Candace Formosa

Reverse vesting orders (RVO) are a structure uniquely available in Canada and have grown increasingly popular in Canadian insolvency proceedings since 2020. An RVO allows for the transfer of liabilities and unwanted assets from the debtor company to a newly formed entity rather than a traditional vesting order that transfers the purchased assets out of the debtor company to the purchaser. As a result, the purchaser is able to acquire the existing corporate structure without any unwanted assets and liabilities, allowing the debtor company to emerge from the restructuring proceeding and continue as a going concern.

Courts have allowed the use of RVOs in restructuring proceedings for a number of reasons, among others: RVOs further the remedial objectives of the insolvency statutes, the transactions are pursued in good faith and there is no other viable option that would allow for the successful restructuring of the debtor company.

Although RVOs have increased in popularity over the years, courts continue to caution that RVOs should be sanctioned only when such transaction furthers the remedial objective of the insolvency legislation. In other words, these transactions should not be regarded as the norm to circumvent processes in insolvency proceedings that may otherwise prejudice creditors.

RVOs have been used to restructure the affairs of companies under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (**CCAA**) or via the proposal provisions under *the Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3 (**BIA**). The British Columbia Court of Appeal has recently confirmed the expansion of the use of RVOs in the decision of *British Columbia v. Peakhill Capital Inc.*, 2024 BCCA 246 (**Peakhill**), to receivership proceedings, which are generally driven by and for the benefit of secured lenders and are not debtor-in-possession proceedings.

Peakhill

In February 2023, pursuant to an application made by Peakhill Capital Inc., the British Columbia Supreme Court appointed a receiver over all of the assets, undertakings and business of various companies related to a property located in Vancouver, British Columbia, and the buildings thereon (the **Real Property**). Approximately one month later, the Court made an order approving a sale process in respect of the Real Property.

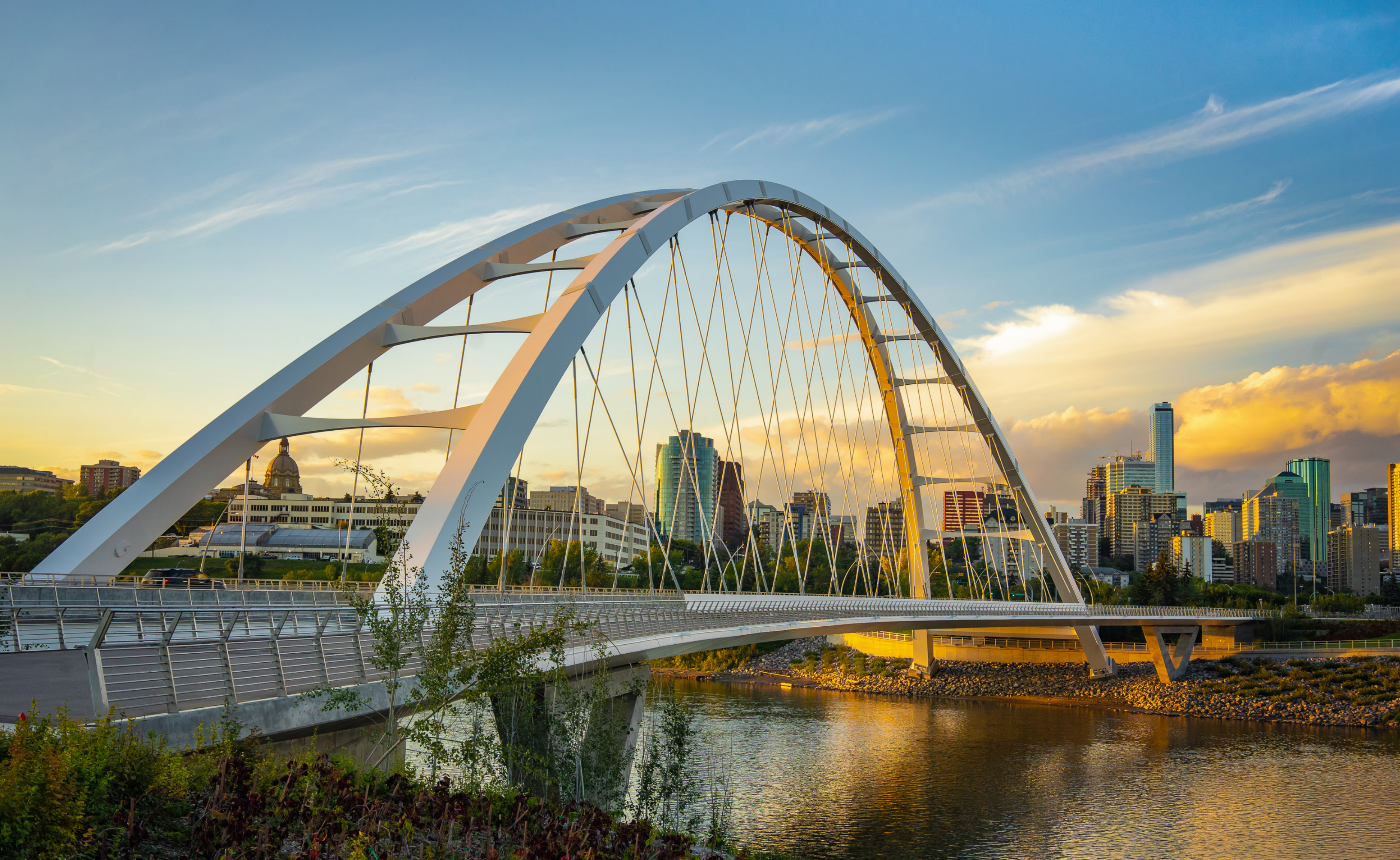
The highest offer that resulted from the sale process proposed to complete part of the transaction by way of an RVO. The Province of British Columbia (the **Province**) opposed the transaction as completion in this manner would avoid paying CAD $3.5 million in property transfer tax. The Province raised two arguments to support its opposition:

1. the language of sections 183 and 243 of the BIA do not provide a court with jurisdiction to grant an RVO in receivership proceedings; and
2. even if section 183 provides a court with jurisdiction to grant an RVO, it cannot do so in the circumstances where it interferes with the *Property Transfer Tax Act*, R.S.B.C. 1996, c. 378, contrary to section 72(1) of the BIA.

The judge, at first instance, rejected the Province's arguments and held that the court had jurisdiction to approve RVO transaction.

On appeal, the Court of Appeal also rejected the Province's arguments, finding that the general jurisdiction granted in section 243 of the BIA encompasses the jurisdiction to authorize the sale of a debtor's assets by way of a vesting order in receivership proceedings, relying on *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, 2019 ONCA 508 (at para. 87) and *Yukon (Government of) v. Yukon Zinc Corporation*, 2021 YKCA 2.

In reaching this conclusion, the court noted that the question is simply whether an RVO furthers the purposes and objects of the applicable statute which, in the case of receiverships, is whether a receiver is liquidating assets to allow for the maximum recovery to creditors. This was confirmed to be a bona fide objective of the BIA regardless of whether the means to achieve such objective is by avoiding property



transfer tax. By avoiding this tax, it allowed for greater recovery to the companies' creditors thereby achieving the stated purpose.

The Province's argument related to the transfer tax avoidance was also rejected by the court as the proposed RVO contemplated a transaction that is routine outside the insolvency context (i.e., the sale of shares of a company), in so far as it structured a transaction to avoid the transfer of title and thereby the associated tax consequences. As the structure was a legitimate commercial practice and perfectly proper outside the insolvency regime, the court found that the transaction should not be viewed differently because it was to occur within the receivership proceeding.

Accordingly, the appeal was dismissed.

Looking forward

The decision in Peakhill raises the question of whether the test for RVOs continues to be one of necessity rather than convenience. Although the appellate court confirmed that RVOs are only to be utilized in extraordinary circumstances, it is arguable whether a receivership meets this test. In this case, the judge expressly found that the RVO was not necessary to avoid foreclosure or bankruptcy, but rather that it was necessary to preserve CAD$3.5 million in value for the creditors. This finding suggests that creditors will be able to utilize RVOs in receivership proceedings as long as the transaction substantially increases the return to creditors.

As a practical matter, if secured creditors expect a substantial shortfall in the sale of real property, it may be beneficial to commence a receivership proceeding rather than avail itself of its lawful and just remedies under the applicable enforcement legislation. The main consideration will be whether the tax savings (or similar liabilities that may be avoided by an RVO) outweigh the costs of the receivership.

It remains to be seen how courts will interpret and apply Peakhill in practice. However, this decision appears to expand the use of RVOs as an acceptable method to achieve the objectives of insolvency legislation and confirms that the main focus in receivership proceedings is to maximize recoveries for creditors. Although a receivership may not be appropriate or available in all circumstances, it will be interesting to see whether secured creditors will shift the focus to receiverships rather than conventional enforcement proceedings. If there is an increase in receivership proceedings, it raises the question of whether courts will interpret Peakhill narrowly to rein in the "necessity" requirement in the future. Time will tell. Stay tuned.

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