NORTON ROSE FULBRIGHT

International Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

Q3 2021

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To our clients and friends:

The COVID-19 epidemic has had a truly global impact. No major economy has escaped the virus and the pandemic remains a constant concern. This is the context in which businesses in every region confront restructuring decisions. The global restructuring market is responding as numerous countries are reforming their legal frameworks that govern restructurings. In this issue, we take a close look at some key jurisdictions: Italy's new code dealing with the business crisis; Hong Kong's cross border insolvencies with mainland China; developments in Canada's CCAA; and Australia's judiciary's response to the COVID-19 crisis.

Certain reforms in the restructuring laws in various countries are no doubt an effort to address underdeveloped or inadequate laws that can result in inconsistent outcomes across jurisdictions. These shortcomings in restructuring laws have led to increased instances of distressed companies availing themselves of formal legal restructuring proceedings outside their home jurisdiction. There are often good and legitimate reasons to do so: predictability of how the law will be applied, transparency, experienced judiciary, and the ability to bind creditors. The Chief Justice in Singapore even went so far as to suggest that forum selection is the "necessary and responsible thing" to do to achieve the best outcome for all constituencies. Distressed debtors will need to consider all of these legal changes and reforms in selecting their forum for restructuring.

Here at Norton Rose Fulbright we have restructuring professionals in every major economic center to help guide distressed companies, creditors and other parties caught up in restructurings. The ascendency of our restructuring practice is nowhere more evident than with the appointment of our partner Scott Atkins to the role of President of INSOL International. Scott epitomizes the global perspective and expertise of our firm.

Enjoy the issue.

Howard Seife
Global Head
Bankruptcy, Financial Restructuring and Insolvency

In the news

International Corporate Rescue

Scott Atkins, Francisco Vazquez, Eric Daucher and Dr Kai Luck had their article, "Contagion Liability Risk in the United States and Australia for Parent Entities Arising from the Insolvency of a Subsidiary," published in Volume 18, Issue 1 of the 2021 edition of International Corporate Rescue. The article looks at when parent entities can be made liable for the debts of their insolvent subsidiaries in both countries through veil piercing, substantive consolidation and other means and also addresses measures for possible law reform.

Financial Post

Luc Morin commented on Reverse Vesting Orders (RVOs) in his article "New insolvency rules help energy companies carve out their environmentally-compromised assets" which was published in the May 26, 2021 edition of Financial Post.

South Square Digest

Scott Atkins and Kai Luck authored an article, "The Case for Further Reform to Strengthen Business Rescue in the UK and Australia," with Felicity Toube QC and Hilary Stonefrost that was published in the December 2020 edition of the South Square Digest. The article explores how pre-packs and DIP finance could create a stronger rescue culture in both countries.

California Bankruptcy Journal

Rebecca Winthrop co-authored an article in California Bankruptcy Journal (Vol. 35 Cal. Bankr. J. No 3 (2020)) entitled "So Many Troubled California Health Care Districts, So Many Have Filed Chapter 9 — Lessons To Be Learned."

International Corporate Rescue

Scott Atkins and Dr Kai Luck had their article, "Cross-Border Insolvency in Hong Kong: Will the New Cooperation and Coordination Framework with Mainland China Provide the Impetus for Broader Reform," published in Volume 18, Issue 3 of the 2021 edition of International Corporate Rescue.

SMU – Singapore Global Restructuring Initiative

Scott Atkins and Dr Kai Luck had their article, "An Australian Perspective – Directors' Duties in an Insolvency Context: Existing Regulations and Opportunities for Reform Under UNCITRAL Legislative Guide Framework," published in the June 14, 2021 edition of the Singapore Global Restructuring Initiative blog.

Asian Business Law Institute Webinar

March 3, 2021
Scott Atkins presented for an Asian Business Law Institute webinar entitled "Insolvency for Micro and Small Businesses – Global and Regional Perspectives."

Talking Insolvency - Podcast

April 15, 2021
Dr. David Goldman participated in an episode on "Priorities in Insolvency" for this podcast where the panel discussed the development of statutory priorities in Australian and UK insolvency law, focusing particularly on employee entitlements and the priority of tax authorities.

Association of Corporate Counsel Symposium

April 29, 2021
Rebecca Winthrop and Ryan Manns spoke at the Association of Corporate Counsel's Annual In-House Symposium. The panel discussed proactive measures that in-house counsel can take to manage contract counter-party bankruptcy risk.

INSOL International 4IR Academic Webinar

May 4, 2021

Scott Atkins gave opening remarks for a webinar where the panel discussed the impact of Artificial Intelligence (AI) on the insolvency and restructuring profession.

INSOL International Virtual 2021

June 8–10, 2021

Howard Seife chaired a panel session at the INSOL International Virtual 2021 conference on June 10. The panel spoke on "Diversity, Equity and Inclusion and the Insolvency Profession." Mark Craggs presented on a panel webinar for the INSOL Financiers Group on "Blue Sky Flights: Turnaround of Distressed Airlines."

Scott Atkins closed the Virtual 2021 conference with outgoing President Julie Hertzberg.

Norton Rose Fulbright Canada Webinar

June 9, 2021

Luc Morin, Head of Canada's insolvency and restructuring group, hosted a French webinar for directors and boards alongside colleagues Guillaume Michaud and Christian Roy, covering practical advice for transferring an insolvent company. The conversation also included Eric St-Amour, Senior Vice President at Ernst & Young.

ABI Southeast Conference 2021

July 29 – August 1, 2021

Jason Boland will be a speaker on an energy panel at the ABI Southeast Conference at the Breakers in Palm Beach, Florida.

UNCITRAL Academy

September 7–8, 2021

Scott Atkins will speak at the inaugural UNCITRAL Academy, which is jointly organised by the Singapore Ministry of Law and the United Nations Commission on International Trade Law (UNCITRAL). It will be part of the annual Singapore Convention Week, a series of events related to dispute resolution, which will run from September 6–10, 2021

Forum on Asian Insolvency Reform

September 13–14, 2021

Scott Atkins will chair an expert panel that will explore the impact of COVID-19 on MSME sectors, the various reforms that have been introduced globally over the last 18 months in response to the pandemic, and the potential for further insolvency and non-insolvency measures to assist MSMEs in the post-pandemic recovery period.

Scott Atkins appointed as INSOL International President

Norton Rose Fulbright Australia Chair, Partner and Head of Risk Advisory, Scott Atkins, was appointed as the new President of INSOL International for a two year term, taking over from outgoing President Julie Hertzberg. INSOL – the International Association of Restructuring, Insolvency & Bankruptcy Professionals – is the peak global association for restructuring and insolvency professionals with over 44 member associations and over 10,500 members. It also has a number of ancillary groups and colloquia that represent the judiciary, regulators, academics, mediators and financiers.

As INSOL plans its strategic future through to 2030, we sat down with Scott to chat about INSOL and his priorities as President. Scott's priorities are a reflection of the important role restructuring, turnaround and insolvency plays not just as a 'fall back' when businesses fail, but in driving innovation, efficiency, economic and financial stability and growth, as well as enabling social change and progress towards a more equitable and sustainable future.

I am incredibly excited and humbled to take on the mantle as INSOL President for the next two years. This role comes at a very challenging period globally, marked by rapidly evolving business and regulatory settings and a very clear appetite – which I do not think we have ever seen to this degree in our lifetimes – for genuine restructuring and insolvency law reform.

There are three priority areas I would like to focus on in my term as President. The first relates to **technological transformation and digitisation.** Technology-driven change and digitisation are transforming businesses and economies with lightning speed. As professionals, we have an opportunity to comprehensively upskill to be fully-equipped to ensure that we most effectively, and efficiently maximise value for all stakeholders and the broader economy as countless businesses transition their operating models.

One of the core priorities I therefore wish to pursue is to arm and empower our members with the knowledge, skills and expertise they need to be able to not just respond to the rapid changes that are happening systemically across industries, but to perceive these changes ahead of time and harness new technology and data to drive the inevitable change. To be on a quest for continuous improvement and to deliver innovation and ingenuity – as an organisation and individually – is something to which we can all aspire.

Related to this, a key focus I'd like to pursue is the use of advanced technology, including AI – particularly by our members – to assist in managing the copious amounts of corporate information in the Big Data era and to maximise the efficiency of restructuring and insolvency systems and processes globally. INSOL has an important ongoing role to play in educating our members on the benefits of AI and the technologies that are available to be used right now.

Snapshot: INSOL International

INSOL International is a worldwide federation of national associations of accountants and lawyers who specialise in restructuring, turnaround and insolvency. INSOL has a unique global perspective across the world economy, where cross-border operations and business transactions continue to be shaped by rapid technological advancement and integration. In that context, the organisation plays a significant role in global restructuring and insolvency law reform and the development of policy and regulatory settings that maximise efficiency and value in insolvency processes and position those processes as key drivers of economic and financial stability, entrepreneurship, investment confidence, innovation and growth.

INSOL also takes a leading role in capacity building, including the training of judges and insolvency practitioners in developing nations, and creating greater stakeholder engagement in restructuring and insolvency across the world, through its Judicial Insolvency Programme, Asia Hub and various other initiatives. It also works with a number of other organisations such as the World Bank, the International Monetary Fund, the Financial Stability Board and UNCITRAL in devising solutions to build better insolvency systems on a cross-border, regional and domestic basis.

"It is a great privilege and honour to lead INSOL International especially at such a critical juncture in the global economy. INSOL's focus will be on supporting members to pursue restructuring and insolvency solutions and systems that maximise global economic value. Through a global lens, we will continue to influence practice and policy of the profession as INSOL and its members shape legal and regulatory trends internationally."

Photograph by Robbie Pattemore

Scott Atkins

Scott assumes the INSOL Presidency with over 25 years of industry experience and after having just completed a two-year term as the President of the Australian Restructuring Insolvency and Turnaround Association (ARITA), Australia's peak restructuring and insolvency association with over 2,100 members.

Scott is a leading lawyer in one of the most reputable restructuring and insolvency practices in the Asia-Pacific region, having been recognised as Australia's only Eminent Practitioner in this arena by Chambers and Partners. Adjacent to his restructuring practice, in 2018, Scott established a dedicated Risk Advisory practice which is now a market leader. It gives him unique insights into rapidly evolving regulatory challenges and complexities faced by businesses across multiple industries on a global basis and which often precipitate or otherwise intertwine with obligations owed in a turnaround, restructuring or insolvency context.

Scott has worked on some of the most complex and sensitive restructuring and insolvency matters Australia has seen. He is also recognised by his peers for his leading experience in cross-border insolvency, acting on both inbound engagements in Australia and advising Australian clients on outbound engagements in jurisdictions including the United States, the United Kingdom, the Cayman Islands, the UAE, Hong Kong, New Zealand, Indonesia, Singapore, Nauru and The Netherlands. Recently, Scott jointly led a team over a three-year period, working with the Asian Development Bank and the Union Supreme Court of Myanmar, to draft a new insolvency and restructuring framework for Myanmar, culminating in the passage of Myanmar's Insolvency Law in February 2020. This work was transformative, representing a critical pillar in Myanmar's law modernisation process and its broader economic development in the face of ongoing political instability.

The tailored insolvency measures for MSMEs developed as part of Scott's Myanmar work have also served as a best practice model that has shaped insolvency law reform in other nations globally.

Scott brings a strategic mindset to INSOL. As an inaugural Fellow of INSOL and Chair of its strategic think-tank, TaskForce 2030, Scott is steeped in an appreciation of the opportunities that lie ahead for INSOL's members.

The second priority focus area will be **regulatory reform and capacity building.** The global pandemic has been the catalyst for over 80 countries to review, reform and adapt their restructuring and insolvency laws to stave off and address unwelcome economic impacts. This has presented an opportunity to maintain and expand INSOL's law reform, capacity-building efforts and advocacy, focusing in particular on building a stronger framework for out-of-court workouts, the adoption of simplified restructuring and insolvency processes for MSMEs (particularly in emerging economies), and progressing regional and global initiatives to enhance cross-border insolvency recognition, cooperation and coordination.

This work is of the utmost importance to INSOL and a constellation of globally leading organisations including UNCITRAL, The World Bank and the IMF. A well-functioning restructuring and insolvency system is one of the key legal and economic pillars in promoting entrepreneurship, innovation, access to finance and economic growth. Indeed, best practice restructuring and insolvency systems help to maximise value, support the efficient recycling of capital for use in the most profitable and innovative ventures, and also to promote financial stability and investment confidence through clear processes for dealing with complex and often inconsistent rights in adverse financial circumstances. Insolvency and restructuring is, in a very real sense, the driver of global economic stability and growth – and this is especially important in a COVID-19 world.

The third focus area I'd like to prioritise is **global sustainability initiatives pursued in the context of restructuring.** The push for businesses to be run more sustainably will drive restructuring activity, demanding professionals with environmental, social and governance expertise. On current statistics, more than one in five of the world's largest companies have made some form of commitment to reaching net zero emissions. At the same time, investors and financiers are sharpening their focus on the social impact of companies. INSOL members are uniquely positioned, together with specialists in corporate sustainability, to advise businesses and support their response to the impact of these inevitable forces. It seems unarguable that the need for action on this front will accelerate as the global economy emerges from its pandemic-induced strictures.

"A well-functioning restructuring and insolvency system is one of the key legal and economic pillars in promoting entrepreneurship, innovation, access to finance and economic growth."

It is a great privilege and honour to lead INSOL International, especially at such a critical juncture for the global economy. INSOL's focus will be on supporting members to pursue restructuring and insolvency solutions and systems that maximise global economic value. Through a global lens, we will continue to influence practice and policy of the profession as INSOL and its members shape legal and regulatory trends internationally.

Italy's new Code of the Business Crisis and Insolvency: Focus on early detection of the debtor's state of crisis and safeguarding the going concern

Tiziana Del Prete and Giuseppe Pastore

For nearly 80 years, the Italian bankruptcy system was regulated by the Royal Decree 16 March 1942, No. 267 (the Bankruptcy Act). Although amended several times, especially in the last 15 years, the original structure of the Bankruptcy Act remained more or less the same.

But now, the dawn of a new era is coming for Italian restructuring and insolvency cases.

On January 12, 2019, the Italian Government issued Legislative Decree No. 14, which introduced the Code of the Business Crisis and Insolvency (hereinafter, the **New Code**). The New Code is designed to replace the Bankruptcy Act. The New Code applies the general principles and guidelines set forth by the Italian Parliament with Law No. 155 of 19 October 2017, and also takes into account suggestions from the European Union.

For the most part, the New Code should have entered into force in August 2020, but this date was pushed to September 1, 2021 to give time to a parliamentary committee to adapt the New Code to circumstances related to the Covid-19 pandemic. The implementation of the New Code may be further postponed. Until the New Code enters into force, insolvency proceedings will continue to be governed by the Bankruptcy Act.

Given the importance of bankruptcy law reform both globally and in Europe, the following is a brief review of the New Code and some of the regulatory amendments that are expected.

The aim of the New Code – rehabilitation

As to the structure, the New Code appears to be more in line with the legal systems at a European level. In this sense, the scope of the New Code is to create functional instruments to facilitate the early identification of the debtor's financial crisis in order to prevent the insolvency and, where such efforts fail, to manage the insolvency with the aim of overcoming the crisis and restoring the company to profitability.

In a departure from the Bankruptcy Act, the primary goal of the New Code is the restructuring of companies in crisis and the preservation of going concern values. Liquidation procedures will be a means of last resort.

In this sense, the New Code introduces for the first time a clear distinction between the "state of crisis" and the "state of insolvency," concepts that the Bankruptcy Act tended to treat in a similar way. The New Code defines "state of crisis" as a state of economic and financial condition that makes it likely that the debtor will become insolvent in the future. For the company, this may be reflected in the inadequacy of the cash flows necessary to regularly meet its future obligations. By contrast, "insolvency" continues to mean the state where the debtor is no longer able to regularly meet its exiting or current obligations. Therefore, the "state of crisis" becomes the first formal step before the "state of insolvency."

Another important novelty introduced by the New Code is the elimination of the term "bankruptcy", which is replaced by the term "judicial liquidation." The rationale for this modification lies in the intention to reduce the reputational damage and negative social stigma historically linked to the word "bankruptcy," with the aim of offering to any entrepreneur, which has been declared insolvent, a better chance of a fresh start and the restarting of its business. The judicial liquidation (formerly, "bankruptcy"), therefore, represents the last resort to be initiated only when the debtor has been unable to identify other suitable solutions.

The Out-of-Court Early Warning and Assisted Negotiation Procedure

Generally, the New Code requires companies to adopt specific and appropriate administrative and accounting structures to help identify a crisis situation at an early stage.

Among the measures geared to the early detection of a state of crisis, the New Code introduces the "Out-of-Court Early Warning and Assisted Negotiation Procedure." This is a confidential out-of-court procedure that encourages the early detection of a crisis situation and facilitates negotiations between the debtor and its creditors through the intervention of the OCRI, *Organismo di Composizione della Crisi*, an entity of a non-judicial nature and with adequate professionalism, set up at each Chamber of Commerce.

The Out-of-Court Early Warning and Assisted Negotiation Procedure can be activated upon request of the company's supervisory bodies and qualified public creditors when certain crisis metrics are present, for example: income, equity or financial imbalances in relation to the specific characteristics of the company and the activity carried out by the debtor.

The New Code states that the company's supervisory bodies (board of statutory auditors, auditors and auditing firms), must : (i) review the adequacy of the company's governance; (ii) notify the board of directors of any potential situation of crisis; and (iii) in the event that the board of directors fails to take any required corrective action in a timely manner, promptly report this failure to the OCRI. It is important to note that such timely reporting to the OCRI constitutes an exemption from liability for the legal consequences of the omissions or actions carried out by the management of the company.

The New Code imposes similar reporting requirements on qualified public creditors (Revenue Agency, National Social Security Institute and Collection Agent), who are obliged to give notice to the debtor when its debt exposure exceeds a certain threshold. If, within 90 days after receiving such notice, the debtor has not (i) discharged its debt or at least settled his debt in full; or (ii) initiated one of the restructuring procedures provided for by the New Code, the public creditors must notify the OCRI.

Once the OCRI has received any such reports by the supervisory bodies or qualified public creditors, it convenes an investigation of the debtor and, after a series of technical evaluations, if the state of crisis is confirmed, the OCRI discusses the situation with the debtor in order to better identify the measures to be taken and the timeframe for compliance; all of these steps involve a rapid and confidential out-of-court procedure.

Furthermore, upon request of the debtor at the conclusion of the technical evaluations, the OCRI may also be entrusted to conduct an "Assisted Negotiation Procedure." In this case, the OCRI establishes a term not exceeding nine months (which can be extended for a further three months in the presence of positive negotiations) in order to verify whether the conditions exist for a viable negotiated solution to the business crisis can be reached with the creditors. If the procedure has a positive outcome, the agreement between the debtor and its creditors is reflected in a written document, which is binding only on those parties who have signed it. If, on the other hand, the outcome is negative, the OCRI invites the debtor to apply for access to one of the other procedures as per articles 37 et seq. of the New Code (for example, composition with creditors proceedings, debt restructuring agreements, judicial liquidation).

Unified procedures for the regulation of crisis and insolvency

The New Code provides for a more efficient, consolidated procedure of judicial ascertainment of the crisis or insolvency before the Court where the debtor has its center of its main interests. In this context, all the requests and petitions, even opposing ones, presented by creditors, supervisory bodies, the public prosecutor's office, and the debtor himself, are collected and examined at the same time, in order to adopt the most appropriate solution. The New Code, therefore, establishes a form of connection, compulsory by law, for all legal initiatives originating from the same crisis or insolvency.

Moreover, in line with the purpose of the New Code, when examining the various requests and petitions, the Court will give priority to those aimed at overcoming the crisis by means of procedures other than judicial liquidation, provided that they are accompanied by a plan that recognizes the position and interests of the creditors.

The main amendments to composition with creditors and debt restructuring agreements

An important feature of the composition with creditors proceedings (*concordato preventivo*) under the Bankruptcy Act, was the automatic suspension of enforcement and precautionary actions by its creditors upon the mere filing of a

petition for composition. Even the filing of a "blank" petition by the debtor - one that did not contain all the formal elements of a complete plan – was sufficient.

The New Code provides that this suspension will no longer be automatic. Rather, it must be explicitly requested by the debtor and confirmed by the Court, which will establish its duration, or revoke it at the first hearing following the filing of the petition. In any case, such suspension may not last longer than 12 months.

As stated above, the intention with the New Code is to favor going concern solutions rather than liquidation. In this context, the composition procedures that envisage the complete liquidation of the debtor's assets will be permitted only in the following circumstances: (i) payment to unsecured creditors of not less than 20% of the total amount of their claim and (ii) contribution of external resources from third parties that increases the payment to unsecured creditors by at least 10% as compared to the distribution that would be made in a judicial liquidation scenario.

With regard to the debt restructuring agreements, the New Code provides that support from a limited percentage of creditors representing not less than 30% of the overall debt of the debtor can be sufficient to enter into a restructuring procedure in the cases in which: (i) a moratorium in the payment of the non-consenting creditors is not requested; and (ii) no temporary protective measures are requested. In all other cases, 60% of the overall debt of the debtor is required.

Corporate group restructuring

The New Code also fills a gap in the current Bankruptcy Act: the law introduces a set of rules governing the crisis of corporate groups. Therefore, in the event that the crisis affects several companies belonging to the same group, all having the center of their main interests in Italy, it is possible to present a single petition for access to the procedures for composition with creditors or approval of a debt restructuring agreement. The petition must be filed with the Court where the parent company has its main center of activity or, in the alternative, the Court of the place where the affiliated company with the greatest debt exposure is located.

Even though the separateness of the respective assets and liabilities of the companies remains unaffected, the *concordato* plan may envisage the continuity of the business of some of the companies and the liquidation of others. It may also envisage intra-group transactions involving the transfer of resources from one company to another, provided an independent expert certifies that such transfer of resources is required for business continuity and is the best way to satisfy the creditors of all the companies. The group plan cannot be terminated or cancelled when the conditions for termination or cancellation only occur with regard to one or some companies in the group. Instead, the status of the entire group as a whole must be considered, before declaring that the group composition agreement be terminated.

By the same token, if several companies belonging to the same group having the center of their main interests in Italy are insolvent, it is possible to unify the judicial liquidation procedures for reasons of economy and to ensure uniform treatment of creditors, without prejudice to the separateness of the respective assets and liabilities.

Conclusions

The New Code certainly represents a significant step forward with a view to aligning Italian legislation with the most recent provisions and principles issued by the European Union and other member states such as Germany and The Netherlands. The warning measures, together with the various provisions aimed at the early detection of a business crisis, as well as the support given to the continuity of the business of the going concern, constitute a concrete step forward in Italian bankruptcy law.

In practice, the implementation of this new system is still to be tested. We will know much more in the second half of 2021.

Undoubtedly, legal advisors will have to quickly become familiar with the new set of rules and guide companies to ensure compliance. Challenging situations with no direct precedent may arise. At the same time, however, there will be opportunities to create new case law and precedent, aimed at supporting companies in crisis and helping them overcome the difficulties presented by disruptive and unforeseeable situations, such as those experienced as a result of the Covid-19 pandemic.

Tiziana Del Prete is a partner in our Milan office in the firm's financial restructuring and insolvency group and Giuseppe Pastore is an associate in our Milan office in the firm's corporate group.

Hong Kong advances its restructuring credentials in its new cross border insolvency framework with Mainland China

Scott Atkins, Camille Jojo, Dr. Kai Luck and Daniel Ng

In our Q1 2021 Issue of the *International Restructuring Newswire*, we outlined the existing approach to recognition and cooperation in cross-border insolvency matters in Hong Kong and the limitations of that approach.

Specifically, Hong Kong currently relies on a dated common law recognition and cooperation framework, under which the Companies Court is willing to recognise foreign insolvency processes for entities that are incorporated outside Hong Kong but only to the extent that those processes are consistent with Hong Kong's own local insolvency laws and public policy.

On that basis, while the Companies Court has recognised foreign administration, liquidation and provisional liquidation processes previously, it has not been willing to allow foreign administrators the benefit of a stay on the enforcement of secured creditors' rights, nor the operation of cram-down provisions in facilitating a reorganisation plan. That is because Hong Kong insolvency law does not provide for a reorganisation process that incorporates the kind of enforcement moratoria and comprehensive restructuring provisions found in many other jurisdictions globally, including the United States, Singapore, the United Kingdom and, since 2006, the People's Republic of China (**PRC**).

The limited nature of Hong Kong's recognition and cooperation framework is in contrast to the broad-based approach under the United Nations Commission on International Trade Law Model Law on Cross Border Insolvency (**Model Law**).

Notably, a foreign insolvency process will be recognised under the Model Law on *objective grounds* simply when a debtor has its centre of main interests (**COMI**) (which provides a basis for recognition as a 'foreign main proceeding') or otherwise has an 'establishment' (which provides a basis for recognition as a 'foreign non-main proceeding') in the relevant foreign jurisdiction. There is a limited basis for a local court to refuse recognition on public policy grounds, but the Guide to Enactment and Interpretation for the Model Law recommends that signatory nations should only do so in exceptional circumstances. The Model Law also sets out provisions for courts in signatory nations to cooperate and communicate to enhance efficiency in cross-border matters.

The Hong Kong Court has however in the recent decision of ***Re Lamtex*** Holdings Ltd [2021] HKCFI 622 accepted for the first time that the Court may look to and rely on a company's COMI or a jurisdiction with which it has a sufficiently strong connection to justify recognition of liquidations commenced in those foreign jurisdictions. This is a welcomed decision and one-step closer to the approach under the Model Law. The authors believe that Hong Kong's willingness to move towards adoption of principles under the Model Law would provide a more comprehensive and predictable framework, which would foster greater international investment and further promote Hong Kong as a regional restructuring hub by providing local and international businesses with access to cheap, flexible and efficient insolvency processes.

In *Re CEFC Shanghai International Group Limited* [2020] HKCFI 167 (***Re CEFC***), the Companies Court recognised a liquidation process in Mainland China for the first time and ordered a stay on garnishee proceedings that had been commenced by a creditor after obtaining a default judgment against the debtor company in Hong Kong. However, this was on the basis that a comparable liquidation process existed in Hong Kong, and the decision accordingly did not represent any advance on the ability to obtain recognition and assistance to bind secured creditors under a reorganisation process under the current common law approach. Importantly, in his reasons for decision, Harris J also emphasised that, in any future recognition hearing in other matters, the Court's willingness to provide assistance to Mainland administrators would 'have to be decided on a case

by case basis', and would depend on 'the extent to which the Court is satisfied that the Mainland, like Hong Kong, promotes a unitary approach to transactional insolvencies.'

In our Q2/Q3 2020 issue of the *International Restructuring Newswire*, we summarised how the Companies Court also signalled that it views cross-jurisdiction recognition as a "two way street", and would expect Mainland courts to also recognise and provide assistance to non-Mainland insolvency proceedings. In this connection, while Article 5 of the 2006 Enterprise Bankruptcy Law of the Mainland envisages the possibility of recognition of foreign liquidators by the Mainland courts, there have been cases where the Mainland courts have refused to recognise Hong Kong insolvency proceedings. It was therefore unclear how the Mainland courts would generally approach applications for recognition and assistance by foreign liquidators.

The above limitations – at least in relation to Mainland China – have now been addressed in a significant recent development that should provide both predictability and efficiency in recognition proceedings and enhance cooperation between insolvency Courts in the Mainland and Hong Kong.

Specifically, on 14 May 2021, the Hong Kong Government and the Supreme People's Court (**SPC**) of the PRC signed a joint record of meeting on mutual recognition of and assistance to bankruptcy and insolvency proceedings between the courts of the Mainland and of Hong Kong (**Record of Meeting**). Details of the implementation of the arrangement are also set out in an

Opinion of the Supreme People's Court and a Practical Guide issued by the Hong Kong Government.

According to the proposed arrangements:

- the SPC will designate 'pilot areas' in which Intermediate People's Courts (**IPCs**) in Mainland China may initiate cooperation with Hong Kong courts in relation to mutual recognition and assistance in bankruptcy and insolvency matters;
- where the relevant company's COMI is in Hong Kong, a liquidator or provisional liquidator in Hong Kong insolvency proceedings may then apply to the relevant IPC in a pilot area in the Mainland for recognition of the liquidation or provisional liquidation that is being undertaken in accordance with the laws of Hong Kong, as well as recognition of and assistance in the discharge of the duties of the liquidator or provisional liquidator. The adoption of the COMI test opens the door to recognition of Hong Kong insolvency proceedings relating to companies incorporated offshore but nonetheless with contacts sufficient interests in Hong Kong. This is especially important as a significant number of businesses in Hong Kong with assets in Mainland China have been permitted to list in Hong Kong using corporate vehicles incorporated in foreign jurisdictions such as the Cayman Islands and BVI;
- an administrator in bankruptcy proceedings in Mainland China may apply to the High Court of Hong Kong for recognition of either bankruptcy liquidation, reorganisation or compromise proceedings under the Enterprise Law of the PRC, as well as recognition of and assistance in the discharge of the duties of the relevant administrator. Given that Hong Kong courts have shown a readiness to grant recognition and assistance to Mainland insolvency officials in previous cases, it has been suggested that Mainland insolvency proceedings would continue to be recognised in Hong Kong under the existing common law mechanism, i.e. Hong Kong court shall recognise collective insolvency proceedings commenced in a company's place of incorporation outside Hong Kong, and in the case of a insolvency office-holder appointed in such jurisdiction with similar insolvency regime to Hong Kong, the Court can grant assistance in the form of an order similar to one available to a Hong Kong provisional liquidator or liquidator. The Practical Guide issued by the Hong Kong Government now sets out the procedures on how a Mainland administrator should seek recognition and assistance of the Hong Kong Court, including seeking a letter of request from the appropriate Mainland court and making an *ex parte* application to the Hong Kong Court for a standard form recognition order;
- the application procedure will take place in accordance with the process of the relevant court to which an application is made; and
- the SPC and the Hong Kong Government will issue a guiding opinion and practical guide on mutual recognition and assistance and will progress further improvements over time.

As a result, pending implementation of the relevant arrangements for the co-operation framework, it will now be possible for reorganisation processes for debtors incorporated in Mainland China to be recognised in Hong Kong, overcoming the existing limitation in the common law framework. Correspondingly, it will also be possible for Hong Kong insolvency processes to be recognised in Mainland China, overcoming the previous inertia that motivated Harris J's remarks in *Re CEFC*. The arrangement would give Hong Kong a boost to becoming a regional restructuring hub, particularly where a vast number of Hong Kong listed entities have their business operation based in Mainland China, and Hong Kong has been one of Mainland's largest source of and top destinations for foreign direct investment.

The above developments coupled with the Hong Kong government's plans to relaunch the long awaited Companies (Corporate Rescue) Bill, which envisages a comprehensive corporate rescue regime with accompanying insolvent trading provisions that assists viable entities to restructure their affairs in circumstances of financial difficulty, would create a modernised, effective and efficient insolvency regime favourable for doing business and investment.

There is indeed now an even stronger incentive for Hong Kong to do so with the continued economic and financial impact of COVID-19, and the importance that effective insolvency processes play as a major contributor to long term economic growth and financial stability.

Stay tuned for further developments with Hong Kong poised to join other jurisdictions that have added new and upgraded restructuring laws in recent years geared to corporate rescue.

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The continued role of the Australian judiciary in shaping voluntary administration processes during the COVID-19 pandemic

Jeffery Black, Natasha Toholka

This article is the second in a series of articles reflecting upon the evolving judicial role in Australian voluntary administrations during the COVID-19 pandemic.[1] Legislative responses globally to the COVID-19 pandemic in the context of voluntary administrations have been well documented. However, in Australia the judiciary has also played a significant role in shaping voluntary administration processes to ensure those processes take into account the unique circumstances and remain a viable option for companies during the COVID-19 pandemic. This article explores some of the most significant developments in this respect, and compares the responses of Australian courts with those in the United States.

Voluntary administration is the most common form of corporate reorganisation in Australia. Part 5.3A of the *Corporations Act 2001* (Cth) (**Act**) contains the main provisions dealing with voluntary administrations. Voluntary administration is intended to provide a fast, flexible and relatively inexpensive procedure designed to be able to reach a variety of outcomes that align with its primary purpose - maximising the chances of the company or its business continuing in existence or, if that is not possible, to obtain a better return for the company's creditors and members than would be achieved by an immediate winding up of the company.

When a company enters voluntary administration, an administrator (being an insolvency professional) takes control of the company and its business. The administrator also becomes personally liable for the debts the company incurs during the voluntary administration period. As a result, where the assets of the company are (or may become) insufficient to meet future debts, the likelihood of the company continuing to trade and operate as a going concern is greatly diminished.

Australian Courts do not play a direct role in the commencement of, or decision making process during, a voluntary administration. Rather, the Courts typically play a benign supervisory role in the process. Nevertheless, in this supervisory role the Courts do have wide ranging powers under section 447A of the Act and section 90-15 of the Insolvency Practice Schedule (Corporations) being Schedule 2 to the Act (**IPSC**) to shape the operation of Part 5.3A and to give effect to its objectives. Under these provisions, a voluntary administrator is permitted to seek orders from the Court limiting or excluding their liability for debts incurred or any other obligations that may apply during a voluntary administration.

Historically, and reflective of their supervisory role, Australian Courts have taken a cautious approach in relieving voluntary administrators of their obligations under Part 5.3A - ensuring the legislative framework is not altered in a fundamental way. However, the COVID-19 pandemic has imposed unprecedented challenges on legislators, businesses and the economy on a global scale. Accordingly, it is unsurprising that the Courts have demonstrated a willingness to respond to those challenges in a more proactive manner.

The Q2/Q3 2020 Newswire article "Voluntary administration and the evolving judicial approach to the reallocation of financial risk in the face of COVID-19" explored the approaches taken by Australian Courts in relieving administrators of personal liability for payment of rent and the deferral of rent. This article explores the broader role the Australian judiciary has played in shaping the voluntary administration process throughout the COVID-19 pandemic and compares this approach to that taken by some companies that commence a voluntary petition under Chapter 11 of the United States Bankruptcy Code.

1 See Laura Johns, Jonathon Turner, Tim Mornane and Shelley Merenda, "Voluntary administration and the evolving judicial approach to the reallocation of financial risk in the face of COVID-19" Q2/Q3 (2020) *Norton Rose Fulbright International Restructuring Newswire*-5.

Relief against personal liability – the Virgin Group administration

One of the features of Australian administrations is that the administrators are personally liable for post-administration operating costs and debts to the extent not paid by the estate. This obviously has an impact on the extent to which an administrator will operate the debtor's business.

Section 447A of the Act, however, gives the Courts the power to make any such orders as it thinks appropriate about how Part 5.3A is to operate in relation to a particular company. Similarly, s 90-15 of the IPSC affords the Court powers to make any such orders as it thinks fit in relation to the voluntary administration of a company. In making orders under these provisions, the Courts' main considerations are the overall objectives of Part 5.3A and, in particular, what is in the best interest of creditors.

One of the first, and arguably the most complex, matters to come before the Australian Courts so far in the COVID-19 pandemic was a series of applications made by the voluntary administrators of the Virgin Australia Airlines Group (**Virgin Group**). The Virgin Group administration provides an example of the way the Courts are flexible in applying the legislative provisions governing the voluntary administration process during the pandemic.

The Virgin Group is one of two national airlines that operates a domestic and international passenger and cargo airline business and, at the time of its administration, employed approximately 10,000 personnel nationally and operated 114 aircraft.

The voluntary administrators advised the Court that the COVID-19 pandemic had, and was continuing to have, considerable adverse affects on the Virgin Group's revenue. Although the voluntary administrators desired to continue to trade on a 'business as usual' basis in an effort to sell the business or recapitalise it, it was likely that the Virgin Group would continue to generate losses throughout the administration period while state and federal restrictions introduced in response to COVID-19 remained in place.

At the date of the voluntary administrators' appointment, the Virgin Group had entered into more than 1,330 contracts with approximately 500 unique suppliers, which triggered the administrators' personal liability under the Act. In order to insulate themselves from personal liability while pursuing a course of action that, in their view, was in the best interest of creditors, the voluntary administrators sought orders, described by the Court as "*extraordinary*", to limit their personal liability for debts incurred in respect of the following arrangements:

1. an agreement entered into with an individual customer regarding specific charter flights to be provided to that customer;
2. intercompany loans between various entities within the Virgin Group;
3. the Commonwealth government's wage subsidy program (known as "Jobkeeper"); and
4. future arrangements entered into/adopted by the voluntary administrators in connection with the maintenance of the operation of the Virgin Group's business (**Future Arrangements**).[2]

The granting of the orders in relation to categories 1 to 3 above was largely uncontroversial given:

- that the relevant individual customer had agreed to the voluntary administrators' proposal;
- the administrators agreed to ensure proper accounting and reconciliation of the financial records of the applicable Virgin Group entities; and
- the Court recognised that in the absence of the ongoing wage subsidies being on paid to employees, those employee creditors would suffer considerable hardship.

However, the orders sought in respect of the Future Arrangements tested the boundaries of the Court's willingness to intervene. Here, the voluntary administrators gave the following reasons supporting their position that the orders ought to be granted:

- the voluntary administrators wished to enter into/adopt the Future Arrangements to facilitate the ongoing trading of the business (and its possible expansion);
- the entry into such arrangements was consistent with the objective of selling or recapitalising the business as a going concern in the best interests of all creditors;
- a counterparty's entry in any arrangement would be entirely voluntary;
- if the voluntary administrators were exposed to personal liability under the Future Arrangements, then it was unlikely they would adopt them; and
- if operating the business was not possible, the practicalities, costs and time associated with a new owner sourcing new counterparties and negotiating agreements with them at a

2 ***Strawbridge, Virgin Australia Holdings Ltd (Admins Apptd) (No 2), Re*** **(2020) 144 ACSR 347.**

future date would make a sale of the Virgin Group's business as a going concern impractical.

Notably in the first application brought before the Court by the Virgin Group's voluntary administrators, the Court made the following statement:

> *"The COVID-19 pandemic is causing great disruption to the whole Australian community and the economy. Nevertheless, existing laws that are made or authorised by Federal or State Parliaments must be adhered to and enforced by the courts. However, the COVID-19 pandemic, and the consequent restrictions on the movement and behaviour of people, is a reason to apply flexibility in the application (and perhaps adaptation) of existing laws, and to exercise any discretion residing in a court to ensure that the Australian community and economy are supported during this time of crisis."*[3]

It was against this background that the Court granted the orders sought by the Virgin Group's voluntary administrators. In reaching its decision the Court noted that its main concern was to consider the best interest of creditors. However, the Court also took into account the following factors:

- the particular circumstances confronting the voluntary administrators and the uncertainty that arose from the COVID-19 pandemic;
- the national interest, since the Virgin Group was one of two national airlines and employed thousands of people whose lives had been dramatically impacted by the Virgin Group entering into voluntary administration; and
- the ability of the Virgin Group's suppliers to continue to receive revenue if arrangements were adopted by the voluntary administrators (thereby further supporting those businesses and the Australian economy generally).

Given the AU$3.5b sale of the Virgin Group (described by its administrators as being "like no other in Australian corporate history"[4]) completed in November 2020, it is difficult to argue that the Court erred in limiting the voluntary administrators'

3 *Strawbridge, Re of Virgin Australia Holdings Ltd (Admins Apptd)* (2020) 144 ACSR 310 at [5].

4 Nassim Khadem, "Sale of Virgin Australia to Bain Capital during COVID pandemic was like no other in Australian corporate history, says administrator" (18 November 2020) ABC News.

personal liability which, in turn, facilitated the sale. Rather, in the novel circumstances faced by the voluntary administrators, the orders fell squarely within the flexible nature, and overall objective, of the voluntary administration process.

Practical assistance during COVID-19

The voluntary administrators of the Virgin Group also relied upon the Court to provide practical assistance with fulfilling their obligations under part 5.3A of the Act throughout the pandemic.

For example, prior to COVID-19, creditor meetings under Part 5.3A required in person attendance, and the Court had not considered the validity of virtual meetings. During the Virgin Group administration, however, Virgin Group's voluntary administrators sought orders to enable all creditors' meetings to be conducted solely by video-link or telephone (rather than in person). The Court found that there was no practical impediment to creditors' meetings being held by electronic means and it was appropriate (if not necessary) that this occur in the current environment.

Shortly thereafter, various temporary measures were introduced by the federal government to enable voluntary administrators to conduct meetings of creditors electronically. However, the decision in *Re Grocon Pty Ltd (admins apptd) (No 1)*[5] (***Grocon***) highlighted that there remained a number of legislative requirements relating to creditors' meetings that had not been modified by these temporary measures. These requirements related to the conduct of virtual meetings, communications to and from creditors, participation in virtual meetings and the provision of notices. As occurred in the Virgin administration, the Court in *Grocon* relieved the voluntary administrators of their obligation to strictly adhere to these legislative requirements instead adopting the alternative processes put forward by Grocon's administrators.

Following the Courts' decisions in the Virgin Group administration and in *Grocon*, the Act has recently been amended to embrace the use of technology by external administrators previously supported by the Courts. These amendments permanently:

- expand the situations in which documents relating to the voluntary administration of a company may be given electronically;
- permit persons to sign documents relating to the voluntary administration of a company electronically; and
- allow meetings to be held virtually (or a hybrid virtual/in person model).

Comparison with the United States

The Court's decisions in relation to the Virgin Group administration, as well as other subsequent cases, demonstrate that Australian Courts are willing to embrace the flexibility of the voluntary administration process and support innovative measures proposed by voluntary administrators as long as they are in the best interest of creditors. Further, the decisions reinforced the Courts' longstanding view that there is a public interest in not permitting voluntary administration to continue for lengthy periods of time and, as such, there ought to be an efficient and timely progression of the voluntary administration as far as circumstances permit.

Various companies in Chapter 11, such as Modell's Sporting Goods, Inc., Pier 1 Imports, Inc. and CraftWorks Parent, LLC, requested Bankruptcy Courts to temporarily suspend their Chapter 11 proceedings, to accommodate the suspension or "mothballing" of their business operations during COVID-19.

Following the introduction of COVID-19 restrictions such as the shutdown of non-essential businesses and the impact of local and global supply chain disruptions, companies in Chapter 11 faced the risk of expenses continuing to accrue at the same time as a drastic reduction in revenue and, consequently, the potential elimination of hope for a successful reorganisation under Chapter 11.

Accordingly, some companies relied on a previously seldom used provision of the Bankruptcy Code, being section 305(a), which affords US Bankruptcy Courts powers to suspend all proceedings if it is in the interests of creditors and the debtor.

The granting of these "mothballing" orders restricts the ability of creditors to seek disruptive relief against the debtor company and its assets and otherwise suspends payment of noncritical expenses for a period of time set down by the Court. The objective of these orders is to preserve value in the business for all stakeholders. In making these orders, the Courts acknowledge creditors' arguments that such orders frustrate the purpose of Chapter 11 proceedings, but on numerous occasions have ultimately found that a going concern sale or

5 [2020] VSC 833.

an orderly business wind down is a far superior outcome than a chaotic "free-for-all" that could ensue if the Bankruptcy Courts do not grant the suspension orders sought.

The benefits of "mothballing" orders can be seen by CraftWorks' announcement of a deal for a semi-private sale described by the Court as a "welcome prospect"[6]in the midst of the COVID-19 crisis.

The cases highlighted in this article illustrate that Australian and US Courts are willing to exercise their discretionary powers to strike a balance between strictly enforcing corporate insolvency/bankruptcy laws and obligations against the stark reality of the ongoing impact of the COVID-19 pandemic.

Limitation on orders available under section 447A

It is important to note, however, that although the powers afforded to the Australian Courts under s 447A of the Act are wide, they are not without limitation. Such limitations were apparent in the recent decision of *Kipoi Holdings Mauritius Ltd v Tiger Resources (Subject to DOCA)*[7] (***Tiger***). *Tiger* involved a dispute relating to competing deed of company arrangement (**DOCA**) proposals put forward by the plaintiff (**KHML**) and another company (**YYT**) in respect of Tiger Resources' administration. During the administration, the requisite majority of creditors voted for YYT's DOCA proposal. KHML applied to the Court seeking orders to have, among other things, YYT's DOCA proposal set aside. KHML sought to rely, in part, on s 447A of the Act as the basis for the Court's power to grant the orders it sought. YYT submitted to the Court that one limitation on the Court's powers under s 447A was that "*rights that have accrued before the date of the proposed s 447A order may render orders that are inconsistent with those rights either without power or outside the permissible exercise of the court's discretion.*"[8]

The Court found that there was "*considerable force in YYT's argument.*"[9] The Court noted that significant steps had been taken by YYT, the administrators and Tiger Resources' unsecured creditors since YYT's DOCA had been entered into. These steps included the creation of a creditors' trust and the payment of funds into that trust. The Court ultimately held that its power under s 447A was not sufficient to order the unwinding of the creditors' trust. In so finding, the Court observed that an order unwinding the creditors' trust would be tantamount to an order to "*unscramble the egg.*"[10]

The Court therefore acknowledged an important limit on its otherwise broad powers under s 447A of the Act, being that proposed s 447A orders interfering with rights accruing prior to the date of the proposed orders may be impermissible.

Conclusion

Despite a large number of support measures introduced by both state and federal governments to support business survival no longer being available, including in relation to rental relief, employee wage subsidies and supplemental insolvent trading protection for directors, the reality is that the COVID-19 pandemic is ongoing in many regions. Accordingly, it may only be a matter of time before the Australian courts are again asked to exercise their broad discretion to assist voluntary administrators in achieving the objectives of Part 5.3A and to otherwise support the Australian community and economy, including by flexibly applying their powers under s 447A in novel ways.

Moreover, with the federal government recently announcing a number of reviews into Australia's insolvency laws (only several months after introducing the most significant reforms to Australia's corporate insolvency regime in almost 30 years[11]) it is clear that Australia's corporate insolvency framework remains very much an evolving landscape.

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The authors gratefully acknowledge the assistance of Nakita Wilkinson and Will Nelson, lawyers in the firm's Australian financial restructuring and insolvency group, for their invaluable assistance in preparing this article.

6 *In re: CraftWorks Parent LLC et al.*, Case Number 1:20-bk-10475 (BLS).

7 [2021] WASC 165. It is noted that Norton Rose Fulbright represent the administrators appointed to Tiger Resources.

8 Ibid at [73].

9 Ibid at [76].

10 Ibid at [75].

11 For a discussion of these reforms, see Jeffery Black and Tim Mornane, "Insolvency law reform in Australia: big benefits for small and medium enterprises?" Q1 (2021) *Norton Rose Fulbright International Restructuring Newswire*-6.

The reverse vesting order is here to stay: Continued innovative use of the Companies' Creditors Arrangement Act to save distressed companies

Arad Mojtahedi and Luc Morin

In the Q1 2020 issue of our *International Restructuring Newswire*, we reported on the Canadian *Companies' Creditors Arrangement Act* (**CCAA**) proceedings of Stornoway Diamond Corporation (where our Montreal office acted as counsel to the debtors) and its innovative use of the CCAA sale process and reverse vesting orders (**RVO**) as an alternative to plans of arrangement (a **Plan**).

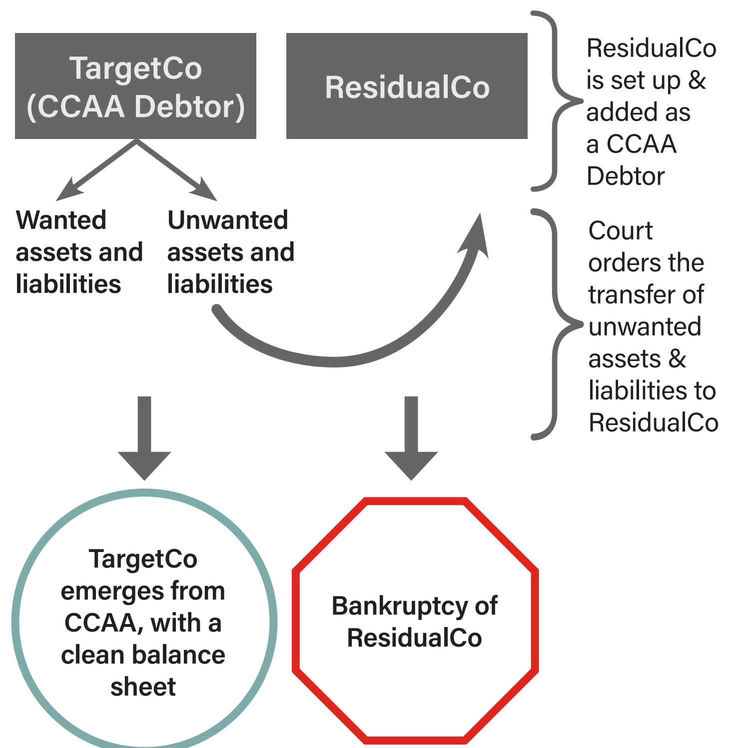
Following the *Stornoway* case, the RVO structure was contested for the first time in the restructuring proceedings of Nemaska Lithium Inc.[1] Ultimately, both the Quebec Court of Appeal and the Supreme Court of Canada refused to grant objecting parties leave to appeal the RVO.

An RVO was also the subject of two more contested hearings in the CCAA proceedings of Quest University Canada in front of the British Columbia Supreme Court and the British Columbia Court of Appeal. The British Columbia courts similarly granted the RVO and refused to grant objecting parties leave to appeal the RVO.

Following their formal recognition in Quebec and British Columbia, RVOs are poised to become extremely valuable tools in insolvency and restructuring proceedings in Canada.

Essentially, an RVO allows for the transfer of liabilities/unwanted assets out of the debtor companies into newly created "ResidualCos", rather than transferring purchased assets out of the insolvent debtor into a newly formed entity. The end result of an RVO is to expunge the existing corporate structure of the debtor companies of anything the purchaser does not want, and see the debtor companies successfully emerge from their CCAA process cleansed of those unwanted liabilities and assets. The unwanted liabilities and assets reside in ResidualCos, who will then be liquidated or placed into bankruptcy. In most cases where RVOs have been used, the main objectives are to preserve the permitting/licensing and preserve the tax attributes that cannot be transferred out of the debtor company's existing corporate structure. RVOs have also been used, for example in the *Quest University* case, to sidestep the voting requirements that would arise under if the restructuring proceeded under a Plan where certain opposing creditors may hold a veto on the restructuring process to the detriment of the majority of stakeholders.

The structure of an RVO



1 Norton Rose Fulbright represented Investissement Quebec (IQ), which was one of the debtor's secured creditors that acquired the debtor through the RVO.

RVOs offer an efficient and effective alternative to Plans and traditional approval and vesting orders (**AVO**), particularly in a highly regulated environment where the parties intend to maintain the going concern operations of the debtor company. While initially the use of RVOs was limited to circumstances where there was no value remaining for any creditors beyond the realization of secured debt, in more recent CCAA proceedings (such as in *Quest University*), the RVO has been used where the realization of assets has led to distributions to unsecured creditors as well.

The rise of the RVO

Stornoway and *Nemaska* were not the first cases of an RVO being granted. Indeed, the first was granted in 2000 as part of retailer T. Eaton Co's restructuring. In 2015, the RVO was used again in the insolvency proceedings of Plasco Energy Group, a waste-to-energy company.

Stornoway, however, brought the RVO into the mainstream. Since then, RVOs have been featured in nine insolvencies in 2020 alone: Wayland Group Corp., Tidal Health Solutions Ltd., Beleave Inc. and Green Relief Inc. (all in the highly regulated cannabis sector), fashion retailer Cormark Holdings Inc., Quest University Canada, Cirque du Soleil and Nemaska.

The CCAA proceedings of Nemaska

To recap, the Nemaska entities were involved in developing a lithium mining project in Quebec. Due to the declining price of lithium, they sought CCAA protection in December 2019 and in January 2020, the Superior Court approved a sale or investment solicitation process (SISP), which led to the acceptance of a bid from a consortium of Nemaska's largest secured creditors: IQ, Orion Mine Finance, and The Pallinghurst Group. This bid required that the sale transaction be effected via an RVO.

Two shareholders (one of whom was also an alleged creditor) filed motions opposing the issuance of an RVO on multiple grounds, notably that the court does not have the authority to grant a vesting order for anything other than a sale or disposition of assets, that the RVO is impermissible under the CCAA because it permits Nemaska to emerge from CCAA protection outside the confines of a Plan (and without a creditor vote), that the corporate reorganization contemplated by the RVO was not allowed under securities laws, and that the release in favour of Nemaska's directors and officers pursuant to the proposed transaction should not be authorized.

Justice Gouin, J.S.C., approved the RVO on October 15, 2020, after having reviewed the SISP process that led to the offer by

IQ and the other participants in the bid, the absence of credible alternative transactions, and the potentially catastrophic consequences to Nemaska's stakeholders, including its employees, creditors, suppliers, the Cree community and the affected local economies. The alternative would have been to put the restructuring process on hold in order to re-initiate a SISP in an uncertain market that had already been thoroughly canvassed or, alternatively, to put the Nemaska entities into bankruptcy. In coming to this conclusion, the court noted that:

- When approving a vesting order pursuant to section 36 of the CCAA, the court must first assess (i) whether sufficient efforts to get the best price have been made and whether the parties acted providently; (ii) the efficacy and integrity of the process followed; (iii) the interests of the parties; and (iv) whether any unfairness resulted from the process;
- It is not for the court to dictate the terms of the offer, the legality of which should be analyzed against the backdrop of the uncontested SISP order. A purchaser is entitled to request releases in favour of the debtors' directors and officers via an RVO, particularly when the release is modulated so as to protect the rights of shareholders and creditors who may have a valid claim based on wrongful or oppressive conduct of the directors and officers;
- Canada's insolvency statutes pursue an array of overarching remedial objectives, which include: providing for timely, efficient and impartial resolution of a debtor's insolvency; preserving and maximizing the value of a debtor's assets; ensuring fair and equitable treatment of the claims against a debtor; protecting the public interest; and, in a commercial insolvency, balancing the costs and benefits of restructuring or liquidating the company;
- The CCAA generally prioritizes "avoiding the social and economic losses resulting from the liquidation of an insolvent company" by facilitating the reorganization and survival of the pre-filing debtor company in an operational state — that is, as a going concern;
- To further the objectives sought by the law, a CCAA supervising judge enjoys wide discretion pursuant to section 11 of the CCAA. This authority must be exercised in furtherance of the remedial objectives of the CCAA and the court must keep in mind three "baseline considerations," which the applicant bears the burden of demonstrating: (1) that the order sought is appropriate in the circumstances, and (2) that the applicant has been acting in good faith and (3) that the applicant has been acting with due diligence.

On seeking leave to appeal, the shareholders reiterated the CCAA judge lacked the power to approve a transaction that was structured to allow the debtor companies to emerge from CCAA protection free and clear of their pre-filing obligations outside the confines of a Plan and without the benefit of an approval by a vote of the required majority of creditors. They also argued the CCAA judge focused exclusively on the outcome of the proposed transaction, which he qualified to be the "best and only alternative available in the circumstances," while failing to give any meaningful consideration to creditor rights.

The Court of Appeal, while recognizing the novelty of the RVO transaction, questioned the appellants' good faith. The court noted that the contesting shareholders, representing a mere 4% of the total value of unsecured creditors' claims, have been using the arguments advanced on appeal as a "bargaining tool" during their negotiations with the debtors.

The Court of Appeal therefore rejected the leave to appeal, as the appellants failed to convince the court that their appeal would not hinder the progress of the proceedings and that it was not purely strategic or theoretical.

The contesting shareholders made a second attempt by seeking leave to appeal this matter to the Supreme Court of Canada, which applications were ultimately dismissed on April 29, 2021.

The CCAA proceedings of Quest University

Quest University is a not-for-profit post-secondary education institution located in Squamish, British Columbia. Quest initially sought to restructure its debt by way of a traditional AVO, which was conditional upon the approval of a Plan. When it became apparent that any Plan would fail because of the objections of a major creditor, the transaction took the form of an RVO instead. The contesting creditors opposed the granting of the RVO on similar grounds as the contesting creditors in *Nemaska*.

Madam Justice Fitzpatrick, however, granted the RVO by relying on the CCAA Court's discretion to "grant relief that represents an innovative solution to any challenges in a proceeding". She observed that the proposed RVO transaction was the only transaction that could save Quest. Justice Fitzpatrick commented that the contesting creditors

potentially held "the sword of Damocles over the head of the significant broad stakeholder group" who stood to benefit from the transaction, and that they had nothing to lose in "this dangerous game of chicken".

Justice Fitzpatrick was, however, cognizant of the fact that an RVO structure should not be used "to simply rid a debtor of a recalcitrant creditor who may seek to exert leverage through its vote on a plan." Rather, the RVO in Quest was justified based on the unique circumstances of the case, and in light of the fact that granting such relief was appropriate in the circumstances in order to preserve the value created by an educational institution.

The British Columbia Court of Appeal rejected the contesting creditors leave to appeal. The Court, referencing *Nemaska*, noted that granting leave would likely be catastrophic for the transaction and to the detriment of Quest's stakeholders.

The CCAA proceedings of Quest University exemplify how RVOs can be used where there is value for unsecured creditors, and yet a creditor holding a veto is unreasonably exercising their vote to the detriment of the mass of stakeholders.

Takeaways

Today, RVOs are the most efficient manner to facilitate a going concern transfer of the operations of the debtors while preserving key attributes attached to the existing corporate structure. Additionally, an RVO allows for an effective change of control with broad releases in favour of third parties, notably the directors and officers of the debtors who played a key role in the reorganization.

The remedial nature of the CCAA is designed to enable insolvent companies to restructure, particularly where such transactions are to permit an internal reorganization that is fair to the interests of affected stakeholders and there is no prejudice to the applicants' major creditors.

RVOs are at the forefront of the flexibility that CCAA proceedings offer for distressed M&A transactions, and may become the predominant transactional path to effectuate and implement a restructuring in a distressed context.

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