NORTON ROSE FULBRIGHT

International Restructuring Newswire

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

Q1 2024

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International Restructuring Newswire

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Published by Norton Rose Fulbright – Q1 2024 – Issue 24

Editor
David Rosenzweig
+1 (212) 318-3035
david.rosenzweig@nortonrosefulbright.com

Publication Coordinator
Helen M. Lamb
+1 (212) 408-5172
helen.lamb@nortonrosefulbright.com

To our clients and friends:

To our clients and friends:

It is always a bit of a challenge to write a new and fresh introduction to the *International Restructuring Newswire*. So, for this issue, I decided to seek help from Copilot, the new AI-powered chat mode of Microsoft. Given the profession of many of our readers, I asked Copilot: "what are the prospects for business financial restructuring professionals given the strong US economy coupled with the geopolitical problems around the world?" I really didn't know what kind of answer to get from our AI friend—but you can judge for yourself:

"While the strong economy provides opportunities, geopolitical complexities demand vigilance. Business financial restructuring professionals must stay informed, anticipate risks, and navigate uncertainty. Their role extends beyond numbers—it's about safeguarding businesses in a dynamic world. Remember, adaptability and foresight are their compass in uncharted waters." [citing to a KPMG article].

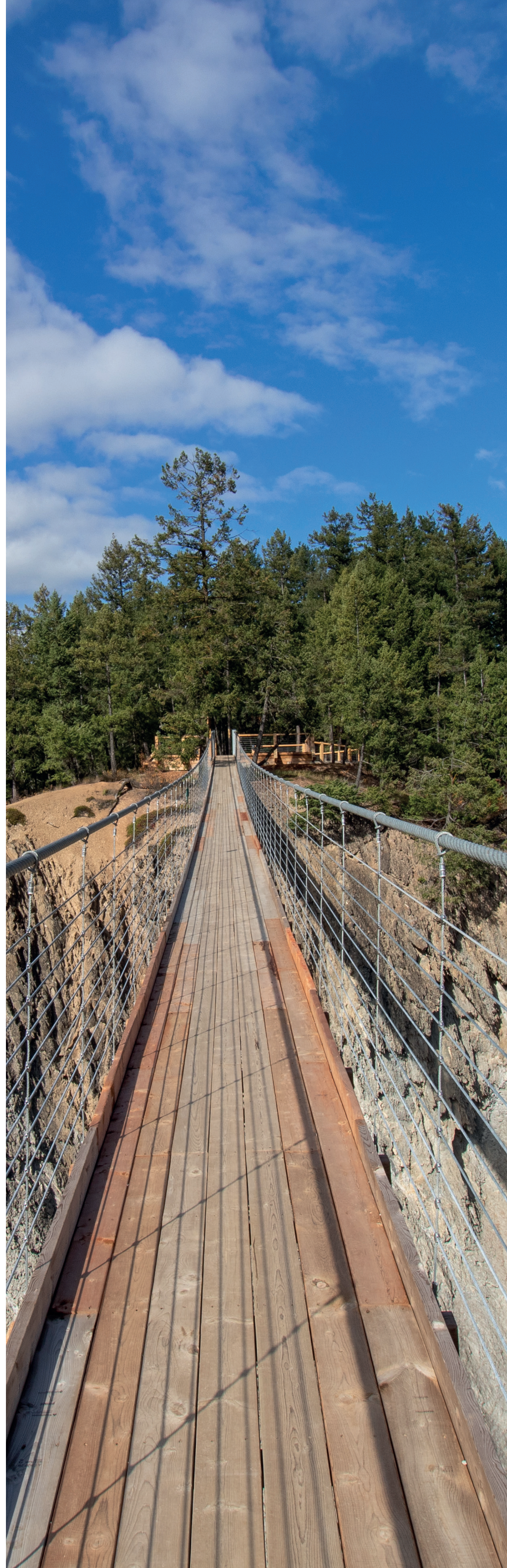
Not bad, but pretty generic and obvious. We offer something different in this issue: articles providing specific analysis of recent developments in the cross-border restructuring world from our lawyers in the US, UK, Netherlands, and Canada. Not to shame my friend at Copilot, but I would think the information in these articles will be of greater value as you face real problems in the nonvirtual restructuring world.

I trust you will agree...

Good reading,

Howard Seife
Global Co-Head of Restructuring
New York

Scott Atkins
Global Co-Head of Restructuring
Sydney



In the news

INSOL International

November 1, 2023
Scott Atkins delivered a keynote address at the joint INSOL International-Asian Development Bank Restructuring and Governance Conference in Jakarta. This was a major event on cross-border insolvency and best practice insolvency systems, and was attended by government ministers, judges and key regulators and policy makers.

December 5, 2023
Scott Atkins delivered a welcome address at the INSOL International Seminar in Kuala Lumpur, a key opportunity for law reform, education and capacity building in the Asian region.

January 20, 2024
Scott Atkins delivered a welcome address at the INSOL International Seminar in Delhi, and also led a panel discussion on out of court restructuring frameworks.

January 22, 2023
Scott Atkins delivered a welcome address at the INSOL International Seminar in Riyadh, the first ever INSOL event in Saudi Arabia.

Insolvency Academics Network Research Colloquium

November 30, 2023
Dr. David Goldman (Sydney) presented a paper at this colloquium held at the University of Technology Sydney, evaluating the recent parliamentary report into Australian corporate insolvency. David also delivered the closing remarks at this event for academics, sponsored by Norton Rose Fulbright.

COP 28 UN Climate Change Summit

December 6-7, 2023
Scott Atkins attended the COP 28 UN Climate Summit in Dubai, representing Norton Rose Fulbright and advancing our 2023 Global Charitable Initiative.

UNCITRAL – 63rd Session of Working Group V

December 11-15, 2023
Scott Atkins attended the 63rd Session of UNCITRAL's Working Group V in Vienna as an official Australian representative. This was an important opportunity to advance asset tracing and recovery and applicable law frameworks in cross-border insolvency.

Indonesia A&M Distress Alert

January 18, 2024
Scott Atkins participated in a panel discussion in Jakarta at the launch of the PT Alvarez and Marsal Indonesia Distress Alert Report. The panel discussion focused on insolvency law reform and best practice frameworks for distress management.

Who's Who Legal

Omar Salah (Amsterdam), Luc Morin (Montreal) and Mark Craggs (London) have been recognized for the first time in Who's Who Legal for Insolvency & Restructuring for 2024. The directory recognizes lawyers for their market-leading work advising stakeholders in matters across the space. The annual guide is compiled through in-depth research into the restructuring and insolvency legal markets around the world which includes recommendations from top private practice lawyers and general counsel. View the full rankings here.

Best Lawyers in America

Ryan Manns (Dallas) was recognized as a "Lawyer of the Year" in Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law in Dallas/Fort Worth by *The Best Lawyers in America*.

Australian Restructuring Insolvency and Turnaround Association

Fiona Murray-Palmer (Melbourne) was appointed a Fellow of the Australian Restructuring Insolvency and Turnaround Association (ARITA) in recognition of a "long, diligent and unblemished membership".

Texas Lawyer's 2023 Professional Excellence Awards

Ryan E. Manns (Dallas) was named «Attorney of the Year» by *Texas Lawyer's* 2023 Professional Excellence Awards. This award honors the lawyer who had the biggest impact on the law or the Texas legal community or did the most to advance the cause of justice in 2022.

The Banker

Gemma Long, Jade Porter and Matthew Thorn (London), together with other team members, published an article on January 15, 2024 in *The Banker* on what to expect in the syndicated loan market for 2024. The article sets out their predictions for restructuring and insolvencies, more complicated capital structures, more bridge financings and amend/extends, preference for series of bilateral financings among some treasurers and sustainable finance.

Singapore Global Restructuring Initiative (SGRI) Blog

The SGRI blog recently published an article by James Copeland (New York) and Maria Mokrzycka (Houston) -- "Liability Management Transactions - providing new capital and laying the groundwork to cramdown of those left behind." The blog also published an article by Francisco Vazquez (New York) and Michael Berthiaume (Dallas) -- "When is a Caymans Islands liquidation not a foreign proceeding?"

The European Commission's proposed directive harmonising certain aspects of insolvency law – What does it say and where does it stand?

Prof. Omar Salah, Koen Durlinger, Rik van der Laan, Bas van Hooijdonk, Enes Altintop, Jan de Wit, Alexander Govers and Martijn Knigge

1. Introduction

International insolvency law has been an important topic in the corridors of power in the European Union (EU) during the past several years. We have seen the Recast Insolvency Regulation[1] of 2015, which applies to insolvency procedures opened after 26 June 2017. In 2019, the Preventive Restructuring Directive[2] followed, resulting in legislative amendments in all key jurisdictions in the EU. On 7 December 2022, the European Commission stepped forward again and published a Proposal for a Directive of the European Parliament and the Council harmonising certain aspects of insolvency law (the Insolvency Law Proposal). In this article, we will focus on this most recent Insolvency Law Proposal.

The Recast Insolvency Regulation provides for rules of private international laws in relation to cross-border insolvency proceedings while the Preventive Restructuring Directive prescribes (among other things) the implementation of preventive restructuring frameworks in the EU Member States. Neither of these instruments seek to harmonise insolvency procedures across Member States. The Insolvency Law Proposal, as its title gives away, steps into the breach and seeks to harmonise certain aspects of the substantive insolvency laws in the Member States. The initiative is rather ambitious since the insolvency laws of the various Member States are deeply rooted in the cultural background of the Member States and very much interlinked with the other substantive laws of the relevant Member State. The harmonisation of substantive insolvency laws across the Member States, however, would contribute to achieving the EU's plan to create a Capital Markets Union to enhance the financial and economic integration within the EU.

We will address a number of key topics in the Insolvency Law Proposal. We will also discuss how it may impact the restructuring landscape in the EU, and to what extent all or parts of the Insolvency Law Proposal may be difficult to finalize as an actual directive. We will conclude with some observations regarding the status of the Insolvency Law Proposal and the lack of movement on its approval.

2. Purpose and scope

The purpose of the Insolvency Law Proposal is to achieve minimum harmonisation on certain insolvency law topics across Member States. This means that the Insolvency Law Proposal sets minimum rules that each Member State must have, but with the freedom to implement further-reaching rules than those prescribed as minimums in the Insolvency Law Proposal. This is important because, although the Insolvency Law Proposal may provide guidance as to what rules each Member State should have, the rules may still in the end differ per Member State. A few examples are described below.

Although its name clearly indicates that the Insolvency Law Proposal seeks to provide for minimum harmonisation of insolvency proceedings, the first point to ponder is that Insolvency Law Proposal does not explicitly and clearly define what are 'insolvency proceedings.' The Insolvency Law Proposal could be improved by explicitly mentioning which insolvency proceedings fall within the scope of the proposal. Reference to the Recast Insolvency Regulation may contribute to this improvement, but not all insolvency proceedings listed on Annex A to the Recast Insolvency Regulation may need to be covered by the definition, as this will then also include preventive restructuring proceedings. Further, as will be

1 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast)

2 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132

discussed below in connection with the obligation to file for insolvency, the Insolvency Law Proposal lacks a definition of 'insolvency' or 'insolvent.' Moreover, the Insolvency Law Proposal does not apply to insolvency proceedings relating to – in short – financial institutions, public enterprises, and private individuals not running a business.

3. Avoidance actions

The Insolvency Law Proposal aims at harmonising certain rules relating to avoidance actions. Avoidance actions seek to annul legal acts that have been concluded prior to the opening of insolvency proceedings and which are detrimental to the general body of creditors. Avoidance actions aim at the reversal of those detrimental effects in order to protect the value of the insolvency estate. These avoidance actions rules are currently characterised by significant differences between jurisdictions across the EU.

The Insolvency Law Proposal outlines three different grounds for avoidance actions:

- legal acts benefitting one or more creditors;
- legal acts made for no consideration or at undervalue; and
- legal acts which are intentionally detrimental to the general body of creditors.

According to the Insolvency Law Proposal, the effect of an avoidance action should be four-fold. First, the counterparty may not assert against the insolvent estate any rights, claims, or obligations it has obtained from the transaction that is the subject of an avoidance action. Second, the party that benefited from the legal act that is the subject of the avoidance action is bound to compensate the insolvent estate for the damages suffered by the other creditors due to the voidable legal act. Third, the avoidance action damages cannot be set off by the counterparty against a claim it has on the insolvent estate. Lastly, the avoidance action claim against the counterparty for compensation is assignable.

Given that the Insolvency Law Proposal intends to establish only minimum standards for avoidance actions, Member States may adopt additional rules for avoidance, voidability, or unenforceability of legal acts detrimental to the joint creditors to the extent that those rules offer better protection to the joint creditors. To a certain extent, this may interfere with the Insolvency Law Proposal's objective to promote cross-border investment. Cross-border investors may not attribute (further) comfort to the minimum rules, as there likely will remain discrepancies between the avoidance rules of various Member States with which those cross-border investors may not be familiar with. Such comfort could have been provided if the avoidance rules mandated in the Insolvency Law Proposal were required to be the same across Member States. That is easier said than done since avoidance action rules are interlinked with the substantive laws of the relevant Member States.

4. Enhancing transparency in relation to asset tracing under the Insolvency Law Proposal

Asset-tracing related to insolvency estates is one of the main topics of the Insolvency Law Proposal. Asset-tracing can be described as the legal process of identifying and locating misappropriated assets or their proceeds. It includes both the preservation (i.e. freezing) of the assets identified and the repatriation of assets that are located in another Member State.

Pursuant to the Insolvency Law Proposal, insolvency practitioners within the EU should gain access to centralised registers of the EU in respect of bank accounts, UBO-information and asset title information, simplifying and improving the process of identifying assets located in Member States. If implemented, this would enable insolvency practitioners to trace debtors' assets easier, faster and at lower cost, which is expected to result in (among other things) higher recovery in cross-border (European) insolvency proceedings. As the registers contain sensitive information, belts-and-braces in the form of judicial control entrusted to designated courts are put in place to safeguard the rights and interests of European citizens and companies.

Under the Insolvency Law Proposal, insolvency practitioners appointed in any of the other Member States should be equipped with the same access to various registers as 'local' insolvency practitioners of a Member State and stipulates that such insolvency practitioners may not be subjected to further professional standards.

An important limitation in this respect is that under the Insolvency Law Proposal insolvency practitioners will not have access to information on accounts held with certain payment providers (i.e. crypto-currency service providers and service providers that do not offer accounts with IBAN codes). This gap is driven by the absence of European legislation requiring these types of payment providers to include identification data in centralised electronic systems. Considering the intensive (crypto) monetary traffic that takes place through payment providers such as ICS, Paypal, Klarna and Strike, potentially important assets therefore cannot adequately be traced back to an insolvency estate despite the Insolvency Law Proposal.

Although the Insolvency Law Proposal generally improves the ability to trace assets for insolvency practitioners, it does not equip practitioners with new instruments to recover assets belonging to insolvency estates as this was considered too controversial by the Member States. Granting insolvency practitioners access to national registers across all Member States can be considered harmonisation in a sense, but the level of accessible information is only limited. Given recent case law in the European Court of Justice (the **ECJ**), entailing that general access to UBO-registers interferes with the EU's Charter of Fundamental Rights, equipping insolvency practitioners with access to the UBO-registers across all Member States could instigate interesting litigation and court rulings.

5. The harmonisation of pre-pack procedures

The Insolvency Law Proposal also addresses the harmonisation of pre-pack procedures within the EU. In the EU, a pre-pack procedure is usually characterised by the sale of a debtor's assets or enterprise in an insolvency procedure with court approval (the liquidation phase), but with the deal having been agreed upon prior to the commencement of the insolvency procedure (the preparation phase). The (brief) insolvency procedure is utilised to leverage the benefits of such a procedure to, for instance, terminate employment contracts to right-size the workforce. By preparing the sale prior to the actual insolvency procedure, the pre-pack minimises potential loss of creditor value at an early stage since the negative effects of a formal insolvency procedure are less likely to materialise between the opening of these proceedings and the actual sale. As such, pre-pack procedures are seen to maximise creditor recovery in insolvency proceedings.

It is challenging to harmonise pre-pack procedures across Member States since they are characterised by relatively little court involvement and are largely extra-judicial given the pre-filing preparation procedures. This is illustrated by the fact that the Insolvency Law Proposal provides Member States with much discretionary authority to implement the Insolvency law Proposal on pre-packs as they deem appropriate. The Insolvency law Proposal contains mostly high-level general norms and descriptions of pre-pack procedures, which are to be designed and finetuned by the Member States themselves. As a consequence, the level of harmonisation of pre-pack procedures provided for in the Insolvency Law Proposal is rather limited.

Specifically, the Insolvency law Proposal prescribes that Member States shall have in place either: (i) a procedure that protects the competitiveness, transparency and fairness of the sales procedure in the preparation phase; *or* (ii) a public auction shortly following the commencement of the liquidation phase. If a Member State chooses the latter alternative, the public auction in the liquidation phase does not necessarily imply that there will be no sales process in the preparation phase. Hence, it mainly serves as a market-testing exercise – similar to the usual practice for "363 sales" in US chapter 11 cases.

The Insolvency Law Proposal is aligned with the ECJ's ruling in *Heiploeg*,[3] by requiring the liquidation phase to be (i) an insolvency proceeding (ii) that has been instituted to liquidate the assets of the transferor (iii) under the supervision of a competent authority. In the context of a Dutch pre-pack, the *Heiploeg* judgment held that if the liquidation phase in a specific procedure does not meet these criteria, employees remain protected under the Transfer of Undertaking Directive[4] meaning that the workforce cannot be rightsized using the pre-pack to complete an effective restructuring.

To facilitate the pre-pack procedure, the Insolvency Law Proposal contains some further relevant provisions:

A. Member States are required to make available to a debtor in (the vicinity of) insolvency a stay on enforcement actions if such stay facilitates the seamless and effective roll-out of the pre-pack procedure.

B. Member States are obliged to facilitate the appointment of a 'monitor' at the debtors request during the preparation phase, whose main task is to find a buyer for the distressed company while safeguarding the competitiveness, fairness, and transparency of the sale process. This monitor might be appointed as 'insolvency practitioner' in the liquidation phase.

3 European Court of Justice 28 April 2022, C-237/20, ECLI:EU:C:2022:321 (*Heiploeg*), International Restructuring Newswire 2021 Q4, '***Recent activity points to the welcome revival of pre-packs in the Netherlands'*** by Prof. Omar Salah and Koen Durlinger, International Restructuring Newswire 2022 Q3, '*The pre-pack in the Netherlands may very shortly revive!*' by Prof. Omar Salah, Koen Durlinger and Rik van der Laan.

4 Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

C. Member States should ensure that the acquirer should receive the enterprise, in principle, free of debt or other liabilities, with the exception that executory contracts relating to the debtor may be assigned to the buyer.

D. Priming is allowed under the Insolvency Law Proposal, which means that providers of rescue financing may rank super senior to the existing lenders.

E. The ability to frustrate the sale is limited under the Insolvency Law Proposal. Appealing court approval of the sale in the liquidation phase will oblige the appealing party to provide adequate security for any damages following the delay caused by its appeal.

6. Mandatory bankruptcy filing

The Insolvency Law Proposal stipulates that directors of a legal entity – who are deemed best positioned to realise when the company is nearing or in insolvency – are obliged to submit a request for the opening of insolvency proceedings with the court within three months after the directors become aware or can reasonably be expected to become aware that the entity is insolvent. Further, the Insolvency Law Proposal stipulates that the Member States shall ensure that directors failing to comply with this obligation are liable for damages to creditors, but also permits the Member States to adopt stricter liability rules for failure to comply with this obligation. The rationale behind this proposal is to maximise recovery by avoiding the potential loss of asset value if insolvent companies continue trading.

That all said, the Insolvency Law Proposal lacks clear and explicit definitions of 'director', 'insolvency proceeding', and 'insolvent.' It appears that, in absence of such definitions, the harmonising effect of the Insolvency Law Proposal may be limited. After all, if each Member State applies a different definition, the way the laws work in each Member State may vary significantly. The explanatory memorandum to the Insolvency Law Proposal does set out that the term 'director' is to be understood broadly, referring to those persons charged with making, or who in fact are making or who ought to be making key decisions with respect to the management of a company.

However, there is no such guidance or definition of 'insolvency' nor as to when a legal entity is deemed to be insolvent. While this may be understandable in light of discrepancies between different Member States on these matters, it raises the question whether this aspect of the Proposal will be effective in harmonising insolvency law in the EU.

7. The creditors' committee

Another area in which the Insolvency Law Proposal seeks harmonisation between Member States is the introduction of a creditors' committee. The idea behind the creditors' committee, which is only installed pursuant on agreement of the general meeting of creditors, is to strengthen the position of creditors in insolvency proceedings in ways that individual creditors who would otherwise not participate in the proceedings due to limited resources or geographical distance are represented. This will enable creditors to become more involved in the proceedings and, where necessary, give direction to the proceedings. Creditors' committees can help cross-border creditors in particular to better exercise their rights and ensure their equitable treatment.

Member States are allowed to exclude the establishment of a creditors' committee in insolvency proceedings when the cost of setting up and operating such a committee is not commensurate to the value it may generate. This may be the case where there are too few creditors, where the vast majority of creditors have a small share in the overall claims against the debtor, or where the expected recovery from the estate is significantly lower than the costs of the set-up and operation of the committee (e.g. where the debtor is a micro-enterprise).

The Insolvency Law Proposal provides rules on key aspects of the creditors' committee such as the appointment of committee members and their composition, working methods, the function of the committee, and the personal liability of its members. The Insolvency Law Proposal also indicates that the creditors' committee is independent from and should supervise the insolvency practitioner (although it is not spelled out that the insolvency practitioner should actually be accountable to the creditors' committee).

In addition, the Insolvency Law Proposal provides that the creditors' committee be granted certain rights and duties such as the right to be heard in court, the right to seek external advice and to be informed and consulted on matters in which creditors have an interest (e.g. the sale of assets outside the ordinary course of business), and the duty to provide information to the creditors represented by the creditors' committee as well as the right to receive information from those creditors.

The Insolvency Law Proposal aims at strengthening the position of creditors in cross-border insolvencies, which is advanced by the proposals regarding creditors' committees. The scheme is well delineated in that Member States can still make their own interpretation to an extent. However, a further improvement could be realised if the Proposal not only provided for the rights, powers, and obligations of the creditors' committee as a collective, but also contained provisions on the rights of the individual creditors if a creditors' committee has not been established.

8. The introduction of the key information fact sheet

Another significant aspect of the Insolvency Proposal concerns the introduction of the 'key information fact sheet', which is envisaged to set forth the various essential elements of the national insolvency laws across Member States for cross-border investors engaging with these diverse legal jurisdictions. Its introduction is aimed at not only strengthening, but also streamlining the distribution of cross-border investments within the EU.

The key information includes, among other things, information relating to the conditions triggering the commencement of insolvency proceedings within each Member State, the rules governing the claims and the obligations involved in such proceedings, the mechanisms for the priority and the ranking of creditors' claims, and the subsequent distribution of proceeds following the completion of insolvency proceedings. Additionally, it will provide statistical insights into the average duration of national insolvency proceedings in individual Member States. The information is promised to be carefully established and presented in clear language avoiding any discrepancies relating to different interpretations, thus ensuring its comprehensibility across a broad spectrum of stakeholders, particularly catering to cross-border investors.

Ultimately, the key information fact sheet strives to empower cross-border investors with indispensable insights into the insolvency frameworks of various Member States. Its goal is to increase transparency regarding the discrepancies that exist between Member States in order to enable informed decision-making and to facilitate cross-border investments within the EU.

9. Concluding observations

The Insolvency Law Proposal is part of a broader push within the EU to further develop, harmonise, and enhance insolvency laws across continental Europe. It has been the latest in a stream of legislative efforts – including most notably the Recast Insolvency Regulation and the Preventive Restructuring Directive – to contribute to the development and cohesion of international insolvency law across the EU. Whilst the objective of the Insolvency Law Proposal was applauded, its execution has also been received with some criticism. In particular, the (albeit minimum) harmonisation on certain topics, such as the rules for mandatory bankruptcy filing and directors' liability, do not necessarily create a set of legal rules that have broad support across the European jurisdictions. It may have been partially due to these various concerns and others mentioned above that over a year after its publication the Insolvency Law Proposal has not gained much traction and seemingly has ended up in the drawer. That will, however, certainly not be the end of it given that the project is still ongoing at the level of the European Commission. Stay tuned for further developments out of the EU on these efforts.

Prof. Omar Salah is a partner, Koen Durlinger is counsel, and Rik van der Laan, Bas van Hooijdonk, Enes Altintop, Jan de Wit, Alexander Govers and Martijn Knigge are associates in our Amsterdam office. All are members of the firm's global restructuring group.

Chinese property developer Sunac receives Chapter 15 recognition

Julie Goodrich Harrison

In what is believed to be a first – a United States Bankruptcy Court in November 2023 recognized, as a "foreign main proceeding", the Hong Kong scheme of arrangement for a holding company whose subsidiary's operations were all in mainland China. After some hesitation, the US Bankruptcy Court took a deep dive into the foreign debtor's center of main interests ("COMI"), alleged to be in Hong Kong but with extensive property development and investment projects in mainland China. This article examines the US Bankruptcy Court's consideration of the debtor's COMI and ultimate recognition of the scheme of arrangement sanctioned by the Hong Kong Court.

Sunac files for judicial restructuring in Hong Kong

Sunac, officially known as Sunac China Holdings Limited, is a Cayman Island-incorporated company, which maintains a principal place of business in Hong Kong and is listed on the Hong Kong Stock Exchange. Sunac consists of a group of companies involved in property development and investments focused on property development of integrated residential and commercial properties in China (including over 890 property development projects in China), property management services, and cultural and tourism operations (including development and operation of theme parks, hotels, ski resorts, and other entertainment venues). Sunac describes its group of companies as "committed to providing wonderful living environment and services for Chinese families through high-quality products and services and integration of high-quality resources."[1]

As the parent holding company, Sunac has numerous subsidiaries operating projects in mainland China. Sunac itself, however, conducts its operations exclusively *outside* of mainland China and, in that respect, is situated quite differently than its subsidiaries for purposes of Chapter 15 recognition, as discussed below.

Facing liquidity pressures as a result of the distressed Chinese property development and capital markets, Sunac engaged legal and financial advisors to formulate restructuring plans. In the first part of 2023, Sunac entered into an agreement with some of its creditors to implement a restructuring via a scheme of arrangement, through the court in Hong Kong and a Chapter 15 case in the US.

The proposed scheme of arrangement generally provided for a restructuring of Sunac's existing debt through an exchange for new debt and/or equity – the "restructuring consideration." The restructuring consideration includes:

- US $1 billion convertible nine-year bonds;
- If elected by the creditor, up to US $2.75 billion mandatory convertible bonds;
- If elected by the creditor, up to 449 million shares, or up to approximately 14.7% of the currently issued shares of Sunac's subsidiary, Sunac Services Holdings Limited, which are listed on the Hong Kong Stock Exchange; and
- Up to eight tranches of new notes to be issued by Sunac in an aggregate principal amount equal to the sum of the creditors' claims minus (i) the aggregate amount of the convertible bonds, (ii) the aggregate amount of the mandatory convertible bonds, and (iii) the aggregate amount of existing debt to be exchanged for the Sunac Services' shares.

Sunac's scheme of arrangement proposed to cancel all existing debt and release all guarantees in connection with the existing debt, as well as require creditors to provide additional releases of certain parties involved in the proposed restructuring.

In July 2023, the Hong Kong court authorized Sunac to convene a meeting of its creditors to consider and approve the proposed scheme of arrangement. In order for the Hong Kong court to approve the scheme of arrangement, Sunac had to demonstrate that it had obtained approval of the scheme by a majority in number, representing at least 75%

1 https://www.sunac.com.cn/en/about.aspx

in value, of the creditors voting at the scheme meeting. Sunac did so easily, receiving overwhelming approval from its creditors. In October 2023, the Hong Kong court entered an order sanctioning the scheme of arrangement, with a proposed effective date of no later than December 31, 2023.

The foreign representative requests US recognition

As an international property development and investment company, Sunac's debt is comprised of, in part, senior notes governed under US (specifically, New York) law. To deal with these US-related issues, Sunac initiated a Chapter 15 case in the US Bankruptcy Court for the Southern District of New York in September 2023. Sunac asserted that it was essential for the scheme of arrangement and the Hong Kong court's orders to be binding and enforceable in the US, in order to prevent creditors from taking any actions in the US that may interrupt Sunac's restructuring.

As part of its recognition request, and in order to obtain the automatic stay and other relief provided by Chapter 15 of the US Bankruptcy Code to "foreign main proceedings," Sunac alleged that its COMI was in Hong Kong. It asked the US Bankruptcy Court to make that finding after considering a variety of factors, including:

- The location of Sunac's headquarters;
- The location of those who actually manage Sunac;
- The location of Sunac's primary assets;
- The location of the majority of Sunac's creditors or of a majority of creditors who would be affected by the case; and
- The jurisdiction whose law would apply to most disputes

In applying the factors, Sunac claimed that (i) it is registered on the Hong Kong Register, despite being incorporated in the Cayman Islands, (ii) it has its principal place of business in Hong Kong, and (iii) its shares have been listed on the main board of Hong Kong Stock Exchange since October 2010. Moreover, Sunac asserted that Hong Kong is the primary location of the individuals who actually manage Sunac. For example, Sunac's operations are conducted in large part in Hong Kong, it has multiple directors in Hong Kong, its Chief Financial Officer/Company Secretary lives in Hong Kong, and the entire board of Sunac has been focused on monitoring and coordinating Sunac's affairs in connection with the Hong Kong restructuring.

Sunac also noted for the US Bankruptcy Court that over 60% of the creditors who agreed to the restructuring support agreement for the scheme of arrangement in Hong Kong have registered Hong Kong addresses, and both the creditors' advisors and Sunac's advisors are based in Hong Kong. Sunac further urged the US Bankruptcy Court to defer to the creditors' acquiescence in, or support of, Sunac's center of main interests being located in Hong Kong, due to the large number (over 99%) of creditors voting in favor of the scheme of arrangement.

Lastly, Sunac argued that Hong Kong law would apply to most disputes involving Sunac because it maintains its principal place of business in Hong Kong and thus must submit to Hong Kong law, it is subject to the jurisdiction of the Hong Kong Securities and Futures Commission, and the majority of its debt (and the restructuring agreement it entered into in connection with that debt) is governed by Hong Kong law.

For all of those reasons, Sunac asked the US Bankruptcy Court to find that Sunac's COMI was located in Hong Kong, and not in mainland China - the location of the group's principal operations and assets.

The US Bankruptcy Court grants recognition

The US Bankruptcy Court set an initial hearing to consider recognition of the Hong Kong scheme of arrangement for October 31, 2023. At that initial hearing, the US Bankruptcy Court questioned Sunac's connection to Hong Kong and asked that Sunac provide further evidence that its COMI was in Hong Kong. The US Bankruptcy Court was particularly concerned about where Sunac's management was actually located and where board meetings were taking place. The US Bankruptcy Court also found that the existing evidence was insufficient to establish that the "locus of decision making" was in Hong Kong, rather than mainland China. Given the US Bankruptcy Court's concerns, the initial recognition hearing was rescheduled for an additional 15 days, to allow Sunac additional time to provide information to the US Bankruptcy Court regarding its COMI.

Prior to the rescheduled recognition hearing, Sunac filed updated papers with the US Bankruptcy Court, including a supplemental declaration providing additional evidence in support of Hong Kong as the location of Sunac's COMI. The declaration stated that *none* of Sunac's four principal business activities (the restructuring, the listing of its equity securities on the Hong Kong Stock Exchange, the issuance of new debt, and the holdings of its subsidiaries and certain investments) are based in mainland China. Sunac further emphasized that it does not have any business licenses in mainland China, it is not registered to do business in mainland China, and it does not file any tax returns in mainland China.

As far as management activities, Sunac explained that, from 2010 to 2019, all of the meetings of its board of directors were physically held in Hong Kong, and since 2019, board activity has taken the form of written resolutions or virtual meetings rather than in person meetings. Sunac also reoriented the US Bankruptcy Court on its organizational structure, explaining that although certain individuals may conduct business activities in mainland China, those individuals and activities relate to the operations of Sunac's subsidiaries, not of Sunac itself.

Sunac also emphasized that all preparation and company approval of the scheme of arrangement, restructuring support agreement, and the reorganization activities in general took place in Hong Kong—including activities related to the issuance of the existing debt, investor calls and roadshows, and the physical locations of investment banks, other financial institutions, and professional advisors and service providers involved with the existing debt and restructuring.[2]

At the rescheduled recognition hearing, the US Bankruptcy Court was satisfied with Sunac's additional evidence—noting that the evidence showing that Sunac's headquarters was located in Hong Kong was the most important factor he considered—and entered an order in November 2023 finding that Hong Kong is Sunac's COMI and that the Hong Kong judicial restructuring is entitled to recognition as "foreign main proceeding" by the US Bankruptcy Court under Chapter 15 of the US Bankruptcy Code. As a result of that recognition, Sunac's creditors were permanently enjoined from commencing or continuing any action or proceeding in the US inconsistent with Sunac's scheme of arrangement.

The importance of establishing center of main interests in Chapter 15 proceedings

The issues raised by the US Bankruptcy Court in Sunac's Chapter 15 proceeding highlight the importance of setting forth adequate evidence of a foreign debtor's COMI from the outset. While the US Bankruptcy Court could have instead found that Sunac had only an "establishment" in Hong Kong, this finding would not have resulted in the automatic protections against creditors seeking relief in the US against Sunac. Those protections are available only in "foreign main proceedings," which requires a finding that the foreign insolvency proceeding is pending in the debtor's COMI. Thus, Sunac's supplemental declaration (with additional facts regarding Sunac's relationship with Hong Kong) was critical to convincing the US Bankruptcy Court that Hong Kong was Sunac's COMI and that the Hong Kong scheme proceeding was a "foreign main proceeding" entitling Sunac to automatic relief under Chapter 11 in the US during the pendency of its scheme of arrangement.

Particularly with an entity like Sunac, a Hong Kong-based holding company with subsidiary operating companies whose primary operations are in mainland China, establishing factors to support the corporate separateness and the holding company's interactions with Hong Kong were integral in achieving US recognition of the Hong Kong proceeding as a main proceeding. As noted by the US Bankruptcy Court, Sunac's recognition could set precedent for future companies that operate in mainland China but otherwise have significant ties to and restructure in Hong Kong. Stay tuned for further developments as restructurings of other Chinese property development companies percolate through the system and eventually land in US Chapter 15 cases.

Postscript: In fact in January 2024, Chinese real estate developer China Aoyuan Group Limited was granted Chapter 15 recognition of a Hong Kong proceeding by the US Bankruptcy Court in New York. The Aouyan debtors are holding companies who proposed Hong Kong schemes of arrangement to implement a holistic financial structuring of their existing debt, in conjunction with parallel inter-conditional proceedings in the Cayman Islands and the British Virgin Islands. The debtors, citing to the recent decision in *Sunac*, successfully established that their COMI existed in Hong Kong, despite their subsidiaries' primary operations being focused in China.

Julie Goodrich Harrison is a partner in our Houston office in the firm's global restructuring group.

2 Sunac did not rely on an argument that the reorganization and scheme had shifted COMI to Hong Kong, arguing that COMI existed generally in Hong Kong for many years. That said, Sunac did note that if COMI had shifted to Hong Kong, it was not in bad faith.

English High Court confirms validity of Galapagos SA out of court restructuring

Gemma Long; Helen Coverdale

Overview

The long running saga in relation to the 2019 Galapagos SA out of court restructuring appears to have reached its conclusion. The disputed elements of the restructuring included a share security enforcement and utilisation of distressed disposal release mechanics to release subordinated debt. Following litigation and attempted insolvency proceedings in multiple jurisdictions, the English High Court held in July 2023[1] that the distressed disposal and enforcement and release was indeed valid. The decision is important because it is the latest in a long line of English cases[2] to reinforce the efficacy and practical utility of distressed disposal release provisions commonly included in European intercreditor agreements and commonly utilised in out of court restructuring transactions. Although this article focuses on the recent English decision, we also outline the broader cross-border context and jurisdictional disputes.

Background to the English High Court's decision

In October 2019, the Galapagos group attempted an out of court restructuring of its financial indebtedness. Prior to the restructuring, Galapagos SA (**GSA**), a Luxembourg company whose principal business was the manufacture of heat exchangers, was the borrower of group debt under a secured revolving credit facility (**RCF**), a secured bank guarantee facility, and senior secured notes. It was also the guarantor of high yield secured notes issued by its immediate parent, Galapagos Holding SA (**Holding**). Under an English law intercreditor agreement dated 30 May 2014 (**ICA**), the debt claims were ranked as follows:

1. First, claims of lenders under the RCF and bank guarantee facility
2. Second, senior secured noteholders
3. Third, high yield noteholders

As part of the restructuring, GSA sold its shares in the wholly owned subsidiary, Galapagos Bidco S.A.R.L (**Bidco**), to Mangrove IV Luxco SARL (**Mangrove**). The ultimate owners of GSA were private equity funds managed by Triton Investment Management Limited (**Triton**). Mangrove was also a subsidiary of Triton pursuant to a Loan Market Association style ICA distressed disposal provision.

The proceeds of the sale discharged 100% of the amounts due under the RCF and bank guarantee facility and 90% of the liabilities under the senior secured notes. However, the restructuring left approximately EUR33.35 million owed to the senior secured noteholders and approximately EUR250 million owed under the guarantee of the high yield notes. There was also a liability under an intercompany loan owed to Bidco.

Several junior creditors, including Signal Credit Opportunities (Lux) Investco II SARL (**Signal**), objected to the restructuring on the basis that it was in breach of the existing ICA, and legal proceedings were commenced in various jurisdictions, namely England, the United States, Germany, and Luxembourg. Signal was a high yield noteholder who held approximately 29% of the notes.

1 *Galapagos Bidco S.A.R.L V Dr Frank Kebekus and others* [2023] EWHC 1931 (Ch)

2 See, for example, the case of European Directories (*HHY Luxembourg SARL v Barclays Bank Plc & Ors* [2010] EWCA Civ 1248)

Cross-border proceedings

As highlighted above, the focus of this article is on the English proceedings. However, it is helpful to understand the broader cross-border challenges to appreciate the full context of the English proceedings.

In August 2019, when the United Kingdom was still part of the European Union, the Dusseldorf court granted a preliminary insolvency order appointing Dr. Kebekus as German insolvency administrator in respect of GSA. The proceedings were designated as main proceedings for the purposes of the Recast EU Insolvency Regulation (EU Regulation). Four days previously, GSA's English director had applied for an English administration order. That director was then removed by the high yield noteholders and a German director was appointed in their place. The new director opposed an English administration, and the English administration proceedings were stayed.

The English proceedings in relation to the restructuring were commenced the following month in September 2019, prior to the restructuring being completed. At that time, Bidco sought various declarations from the English court that the restructuring complied with the terms of the ICA and in particular the distressed disposal provisions. Signal and the German insolvency administrator challenged the English court's jurisdiction (which the English court subsequently rejected). Shortly afterwards, proceedings were commenced in New York by Signal where Signal similarly argued that the restructuring did not comply with the ICA. The New York proceedings were eventually stayed in July 2020 pending the outcome of the English proceedings.

Following the October 2019 restructuring, the German insolvency administrator commenced proceedings in December 2019 in Luxembourg against Bidco and Mangrove, arguing that the restructuring constituted a fraud and seeking a recission of the share transfer.

In September 2020, the German insolvency administrator commenced a clawback action in the German courts in Dusseldorf against Mangrove seeking an order that Mangrove transfer its shares in Bidco back to GSA pursuant to Germany insolvency law. In March 2022, those proceedings were referred to the Court of Justice of the European Union (ECJ) with the ECJ concluding that the Dusseldorf court did not have jurisdiction to open insolvency proceedings in respect of GSA where an application was pending before the English court to commence insolvency proceedings in England (i.e. the stayed administration proceeding).

The Dusseldorf court eventually dismissed the clawback proceedings.

Bidco and the senior secured noteholders wanted the English administration to proceed. However, Signal opposed this. Finally, in April 2022, the stay in respect of the English administration application was lifted, and the administration application was converted into a winding up application. A winding up order was made in June 2022, in which the English court concluded that the German proceedings were not in fact the main proceedings under the EU Regulation. Instead, the English court was satisfied that GSA's centre of main interests (COMI) was in England. An appeal against the winding-up order was dismissed in January 2023, with the English court refusing to recognise the status of the

German insolvency administrator. The result was competing insolvency proceedings in England and Germany, a phenomenon that would not have been possible prior to the UK's departure from the European Union.

The English proceedings

Focusing in on the proceedings before the English court, once the restructuring had been completed in October 2019, the English proceedings were amended to seek declarations that, amongst other things, the Security Agent had effectively released the liabilities of GSA and its subsidiaries and the disposal was in accordance with the distressed disposal provisions of the ICA. Signal also sought opposing declarations that the restructuring was ineffective.

The ICA was governed by English law, and the courts of England had exclusive jurisdiction over any dispute arising in connection with it. It contained a standard distressed disposal release provision. The sale of GSA's shareholding in Bidco to Mangrove amounted to a distressed disposal, and on the same day that the disposal occurred, the Security Agent executed a deed of release purporting to release the transaction security and all claims of the Primary Creditors.[3] The main dispute in the litigation was around whether certain conditions to the distressed disposal were satisfied. It was common ground that the sale of GSA's shareholding in Bidco amounted to a 'distressed disposal' under the documentation and that a Financial Advisers' Opinion had been obtained prior to the distressed disposal occurring (concluding, amongst other matters, that the consideration for the proposed sale was fair and was in accordance with the Enforcement Principles, as defined in the ICA). However, there was dispute over whether two other conditions were met.

The key questions for the English court were:

1. Whether a material part of the sale consideration being satisfied by way of set-off (against new loans made by certain Primary Lenders to the purchaser Mangrove) amounted to the consideration being paid "in cash (or substantially in cash)."
2. Whether an unconditional release of the transaction security and Primary Creditors' claims occurred given that a number of entities that qualified as Primary Creditors were also creditors of the purchaser group.

Whether a material part of the sale consideration being satisfied by way of set-off (against new loans made by certain Primary Lenders to the purchaser Mangrove) amounted to the consideration being paid "in cash (or substantially in cash)"

The SPA stated that the consideration was payable in cash, which was to be paid to the Security Agent for application in accordance with the ICA waterfall. The payment by way of set-off (approximately €275m out of the total circa €425m sale proceeds) occurred because some of the Primary Creditors who were entitled to receive a share of the sale proceeds of the distressed disposal agreed to provide new lending to the Mangrove entities for the purpose of funding the purchaser group. The judge, Mr Justice Trower, was of the view that the fact that certain Primary Creditors essentially chose to reinvest their share of the sale proceeds in providing new notes post completion to the restructured group did not mean that the new notes were consideration for the distressed disposal: the new notes were merely another aspect of the restructuring. The sale proceeds themselves constituted cash consideration, notwithstanding any subsequent reinvestment in new notes and notwithstanding set-off being applied to the sale proceeds. The structure simply cut out the round tripping of cash from the purchaser to the Security Agent and back to the purchaser.

In addition, following previous authorities that regarded set-off as payment in cash, it was held that the fact that set-off was applied did not mean that the sale proceeds were not in cash. Therefore, there was no requirement for the completion payments to be structured so that the full amount of the sale proceeds must be received by the Security Agent and then certain amounts transferred back on behalf of the re-subscribing note holders.

More broadly, this indicates that parties can continue to use set-off as a practical and commercial way of settling parties' payment obligations.

Whether an unconditional release of the transaction security and Primary Creditors' claims occurred given that a number of entities that qualified as Primary Creditors were also creditors of the purchaser group

3 The so-called Primary Creditors were those holding security in respect of the group's original debt and whose rights were governed by the ICA

The deed of release released all claims of the Primary Creditors (in their capacity as Primary Creditors). Signal submitted that, given that certain Primary Creditors had entered into the new note financing provided to the purchaser group, an unconditional release did not occur and that the commercial reality was that the claims of the Primary Creditors continued.

The English Court held that the fact that new notes were documented (under new documents on new terms) and provided by certain Primary Creditors to the purchaser group did not limit the effect of the releases given pursuant to the deed of release. Therefore, the distressed disposal conditions were met, and the disposal of Bidco's shares to Mangrove was in accordance with the ICA. Had Signal been successful with its submission, this would have created uncertainty as to whether (and the precise timing at which) an existing lender would have been able to provide new funding to the purchasing group.

The judge considered that such uncertainty would be a "wholly uncommercial consequence" and "would remove from the potential pool of refinancing lenders those who are most likely to have an appetite to continue to support the Group with new finance" [at para 155].

As a result, existing lenders may continue to provide new funding to the purchasers of distressed disposals without prejudicing the effect of a previous security release.

Bidco's fallback position

As a back up position, against Signal's objections to the distressed disposal, Bidco argued that the distressed disposal conditions may be disregarded because the high yield noteholders were out of the money.

Bidco submitted that, on a true construction of the ICA, the conditions stipulated in the distressed disposal clause did not have to be satisfied if the holders of the high yield notes had no economic interest in the high yield shared debt security and would receive no return should the distressed disposal not occur. The judge disagreed that it was legitimate to simply disregard the distressed disposal conditions on the basis that the high yield noteholders were out of the money. He was not prepared to hold that the conditions could be disregarded since the opening wording of the distressed disposal conditions – "at any time" – were inconsistent with Bidco's interpretation.[4]

Taking all of the above determinations together, the English court's conclusion was that the restructuring was valid and effective.

The end of the matter?

It is understood that the German insolvency administrator opted not to appeal the German Regional Court of Dusseldorf's decisions. With respect to the German proceedings, as there are no other assets available in the insolvency proceedings, the position is now final.

In November 2023, the parties agreed to discontinue the New York proceedings in the light of the English High Court's decision.

With regards to the English proceedings, permission to appeal was refused by the trial judge, and at the time of writing, no appeal to the Court of Appeal is listed, suggesting that the matter is now settled in England.

Ultimately the English court's decision will be welcomed by senior creditors who often look to the distressed disposal provisions to facilitate a restructuring transaction (usually out of Court).

Gemma Long is counsel in our London office in the firm's global restructuring group. Helen Coverdale is a Senior Knowledge Lawyer in our London office.

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4 In case the judge was wrong on that point, the question of whether the high yield noteholders were actually 'out of the money' was considered. The judge concluded that the high yield noteholders were indeed out of the money at the time of the October 2019 restructuring and that, if the restructuring had not occurred, it was likely that an immediate liquidation would follow.

CCAA Court's jurisdiction to suspend contractual restrictive covenants in the context of a sale process

Arad Mojtahedi

Introduction

It has long been recognized that under Canada's *Companies' Creditors Arrangement Act* (CCAA), supervising courts have the discretion to set aside restrictive covenants in connection with the court's approval of a sale of assets or other M&A transactions in a CCAA case. Less certain was whether such restrictive covenants could be effectively set aside at the outset of a Sale and Investment Solicitation Process (SISP). In a case of first impression, the Superior Court of Québec has taken this step – staying the exercise and effect of restrictive covenants at the launch of a SISP.

The Canadian Supreme Court decisions in *Canada North* and *Callidus* remind us that the most important feature of the CCAA is the broad discretionary power it vests in the supervising court. Indeed, Section 11 of the CCAA provides the supervising court with the jurisdiction to "make any order that it considers appropriate in the circumstances," limited only by the restrictions set within the CCAA and by the requirement that the order made be appropriate to the case.

In Canadian jurisprudence, the discretionary power of the supervising court to stay contractual rights of third parties can be traced back to the 1988 decision of *Norcen*. In this formative decision, the Alberta Court of King's Bench ruled that "s. 11 of the CCAA can validly be used to interfere with some other contractual relationships in circumstances which threaten a company's existence… such interference in the interest of fairness to all parties should be effective only for a relatively short period of time."[1] The *Norcen* case prompted a series of decisions which have since recognized the powers of the supervising court to interfere with third party contractual rights under the CCAA.

Subsequent case law has further expanded the court's discretion. In *Protiva*, the Court of Appeal for British Columbia held that the discretion to interfere with third party contractual rights must be exercised according to fairness and must balance competing stakeholder interests by taking into account the extent of the adverse impact as well as the beneficial effects upon the company and its stakeholders[2].

Furthermore, the Court ruled that it is not necessary that a proponent of an arrangement be *in extremis* or otherwise show a public interest justification before third party contractual rights can be affected[3].

Thus, the CCAA courts have the necessary power to approve transactions without complying with restrictive covenants, in exceptional circumstances where the equities and the best interests of the debtors' stakeholders in general favour such an order. In the matters of *Bear Hills and Quest*, the Courts in Saskatchewan and British Columbia also took into consideration the welfare of the business carried on by the corporations and the necessity to avoid an "economic dislocation which a liquidation or winding up would involve"[4] in their decisions when vesting off the rights of first refusal.

In the recent Québec Superior Court ruling of *Xebec*, Justice Immer notes that two different approaches have been used by courts when asked to extinguish third party rights. The first approach is the one taken in *Third Eye*, where the court must first assess the nature and strength of the interest that is proposed to be extinguished, and then consider whether the parties have consented to the vesting of the interest at some point. In case of ambiguity or inconclusiveness in these factors, the Court then determines the appropriate order with consideration of the equities. The second approach is the one taken in *Quest*, where the Court uses a balancing of equities to see whom it favours, while taking into account the parties' conduct, the rights of first refusal terms, the prejudice

1 *Norcen Energy Resources Ltd.* v. *Oakwood Petroleums Ltd.*, 1988 CanLII 3560 (AB KB) at para 52.

2 *Protiva Biotherapeutics Inc. v. Inex Pharmaceuticals Corp.*, 2007 BCCA 161 at paras 18.

3 Idem, at para 21.

4 *Bear Hills Pork Producers Ltd. v. Bank of Montreal*, 2004 SKQB 213 at para 9; Quest University Canada (Re), 2020 BCSC 1883 at paras 60-67.

and the monitor's opinion. The *Quest* approach seems to be increasingly used by the courts. In any case, Justice Immer explains that a "SISP is fundamentally incompatible with a right of first refusal.... To recognize such pre-emption rights is completely destructive of the SISP's aims."[5]

Similarly, such discretionary power was also recognized in U.S. chapter 11 courts, and in many instances these courts found the restrictive covenants such as rights of first refusal unenforceable because of their "chilling effect" on bids in the context of a SISP, as well as their thwarting of "the fundamental policy of maximizing estate assets for the benefit of all creditors."[6] This "chilling effect", first explained in the case of *Re Mr. Grocer, Inc.*, was further developed in the case of *Adelphia*, where restrictive covenants were rendered unenforceable at the initiation of the SISP.

Yet, the question always remained open in Canada as to whether the CCAA court had jurisdiction to pre-emptively stay rights of first refusal and other restrictive covenants at the initiation of a SISP. With the *Groupe Sélection inc.* case, the Superior Court of Québec confirmed for the first time that this broad discretionary power also exists in a Canadian CCAA Court.

Groupe Sélection Inc. decision

The *Re Groupe Sélection Inc.* case before the Superior Court of Québec began when the Monitor submitted an Application to the Court on March 10, 2023, advising that it was ready to launch the SISP and seeking approval of the sale process and procedures. This SISP approval was challenged by the debtor Groupe Sélection Inc. (**GS**) and several of GS's secured creditors and business partners, who held controlling interests primarily in real estate assets and were intent on capitalizing on their minority interests.

Apart from three GS business partners who objected to GS's rights in specific contracts included in the SISP assets, there were no other objections to the overall implementation of the SISP. Instead, the concerns centred around the terms and conditions set by the Monitor, which led to several interventions and objections from the affected stakeholders.

Specifically, GS's business partners contested the marketing of GS's rights in certain contracts with the business partners. Their argument was based on the assertion that these contracts were *intuitu personae*, and as a result, GS's rights in them could not be sold or transferred to a third party without

5 *Re Xebec Adsorption Inc. et al.,* 2023 QCCS 466, at para 78.

6 *Re Adelphia Communications Corp.*, 359 B.R. 65 (Bankr. S.D. N.Y., 2007) at 86-87.

obtaining approval from the business partners themselves as counterparties. There was also concern that the partners would be forced without consent to accept a new partner replacing GS.

The Québec Superior Court stated that the interventions made by these business partners were hypothetical and premature, as it was uncertain whether these potentially non-transferable contractual rights would be of any interest to a potential buyer. The Court clarified that these partners would have the opportunity to restate their positions and arguments at a later stage of the SISP if the disputed contractual rights indeed became the subject of a binding letter of intent from a potential purchaser. Therefore, if a binding offer was to be received that would violate the restrictive covenants, the Court would allow the contesting parties to challenge the legality of any resulting transaction.

The Court concluded that at this stage, the purpose of the SISP is to monetize GS's assets, but also to assess the market interest in these assets and determine their market value. The Court ordered and declared that the contractual rights and remedies of third parties restricting the disposal of assets and/or any part of the Debtors' business, including the restrictive covenants (rights of first refusal, rights of first offer, rights to match an offer, options purchase or others) are stayed and unenforceable in the context of the SISP.

Takeaway

Whereas similar orders were previously rendered at the stage of sale approval in rulings such as *Quest* and *Norcen*, the *Groupe Sélection* decision appears to be the first ruling of a Canadian court to suspend restrictive covenants upon the initiation of a SISP. In the Superior Court's reasoning, the financial survival of the company and the legal chaos that would ensue from the liquidation of the company because of its complex situation were considerations that were taken into account. In general, Canadian courts look into the following non-exhaustive factors, which when met, militate in favour of the Court setting aside restrictive covenants:

i. A bundle of assets are sold together instead of individually;

ii. There is evidence that a sale without restrictive covenants would generate greater recoveries, would maximize value for the stakeholders and that the transaction is in the best interests of the creditors at large;

iii. Restrictive Sale Provisions would have a chilling effect on the SISP;

iv. The interest of the beneficiaries of the restrictive covenants is taken into account and the beneficiaries do not suffer material prejudice.

Maximization of the debtors' assets is one of the overarching purposes of modern CCAA restructurings. It follows that Canadian courts will not hesitate to defend an open and transparent SISP where participants are encouraged and protected to perform their due diligence and submit their bids. This includes, in appropriate circumstances, staying restrictive sale provisions which may be used to thwart or delay the SISP.

Arad Mojtahedi is a senior associate in our Montréal office in the firm's global restructuring group.

The author gratefully acknowledges the assistance of Nima Shareghi, a student at law in the firm's Montréal office, for his assistance in preparing this article.

For more information, please contact

Howard Seife
Global Co-Head of Restructuring
New York, NY
+1 (212) 408 5361
howard.seife@nortonrosefulbright.com

Scott Atkins
Global Co-Head of Restructuring
Sydney
+61 2 9330 8015
scott.atkins@nortonrosefulbright.com

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