AMERICAN
BANKRUPTCY
INSTITUTE

ABI/UMKC Midwestern
Bankruptcy Institute

Commercial: Issues with International Asset Sales

Sponsored by Aegis Law Group LLP

Robert J. Keach
Bernstein Shur | Portland, Maine

Brendan O'Neill
Goodmans LLP | Toronto

Michael F. Patterson
Spencer Fane LLP | Phoenix

CONCURRENT SESSION

2022

ABI MIDWESTERN BANKRUPTCY INSTITUTE

ISSUES WITH INTERNATIONAL ASSET SALES

October 7, 2022

I. CRITICAL ISSUES IN INTERNATIONAL SALES TRANSACTIONS OUTSIDE OF INSOLVENCY PROCEEDINGS

II. CROSS-BORDER SALES VIA INSOLVENCY PROCEEDINGS

   a) COORDINATING CROSS-BORDER ALL-ASSET SALES

      i. cross-border protocols
      ii. joint/simultaneous approval of bid procedures and processes
      iii. joint/simultaneous auction(s)
      iv. joint/simultaneous sale hearing(s)

   b) RECOGNITION AND ENFORCEMENT OF FOREIGN SALE ORDERS VIA CHAPTER 15 FOLLOWING *FAIRFIELD SENTRY*

III. CUTTING EDGE SALE AND RESTRUCTURING METHODS: THE REVERSE VESTING TRANSACTION

IV. CFIUS REVIEW OF BANKRUPTCY TRANSACTIONS

CFIUS REVIEW AND BANKRUPTCY TRANSACTIONS

2022 ABI Midwestern Bankruptcy Institute
October 6-7, 2022

Robert J. Keach
Bernstein Shur Sawyer & Nelson

CFIUS review of bankruptcy sales is hardly a new phenomenon. *See* In re Chateaugay Corp., 186 B.R. 561 (Bankr. S.D.N.Y. 1995) *aff'd* 198 B.R. 848 (S.D.N.Y. 1996) (providing detailed description of CFIUS process leading to withdrawal of bid of foreign buyer).

As one bankruptcy court noted:

> As appears to be undisputed, CFIUS is charged with reviewing the national security implications of particular transactions. Its members, which consist of the Secretary of the Treasury and an additional eleven other executive branch members—including, among others, the Secretary of State, the Secretary of Defense, the Secretary of Homeland Security and the President's National Security Advisor—examine the proposed transaction from the perspective of their area of competence within the government. Given the national security-related nature of the CFIUS review process, it is generally protected from disclosure to the public . . . .

In re Global Crossing Ltd., 295 B.R. 720, 722 (Bankr. S.D.N.Y. 2003) (also entering protective orders allowing presentation of CFIUS evidence in camera). *See also, generally* In re Global Crossing Ltd., 295 B.R. 726 (Bankr. S.D.N.Y. 2003) (Court permits modification of asset purchase agreement to mitigate likely CFIUS concerns).

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that oversees foreign investment in the U.S. economy. In 2018, Congress passed the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). FIRRMA expanded CFIUS jurisdiction and codified, among other things, CFIUS' preexisting jurisdiction over transactions arising from bankruptcy proceedings, such as section 363 asset sales and plan sales.

While FIRRMA expanded CFIUS' jurisdiction, CFIUS practice regarding bankruptcy sales did not materially change. CFIUS historically reviewed sales to foreign entities falling under the definition of a "covered transaction" arising in bankruptcy cases. By expressly emphasizing bankruptcy-related transactions, FIRRMA, and the regulations implementing FIRRMA, authorize CFIUS to be more proactive in bankruptcy cases.

FIRRMA:

- Codified pre-existing practice by requiring that CFIUS prescribe regulations clarifying that a covered transaction includes any transaction arising from bankruptcy proceedings that otherwise qualifies as a covered transaction;
- Expanded the definition of a covered transaction; and
- Provided CFIUS with more resources, allowing it to proactively analyze and review transactions not voluntarily filed with CFIUS for review

Consequently, debtors and transaction counterparties must analyze whether bankruptcy transactions might be covered transactions under the regulations and/or be subject to mandatory filing requirements.

The CFIUS process usually begins when the transaction parties file a declaration or notice, although CFIUS can unilaterally commence a review. The review process can take 4-6 months, aggregating all stages.

Following the total review and investigation period, CFIUS can:

- Clear the transaction;
- Insist that the parties take measures, including modifying the deal, to mitigate the national security impact of the transaction; or
- Refer the transaction to the President for decision; the President has the power to block or mitigate the transaction if the President decides it negatively impacts national security.

Debtors and transaction counterparties must consider the risks of potential sales to foreign entities, including:

- The effect of delay on the ability to complete the transaction;
- The possibility that CFIUS clearance will be denied, terminating the transaction;
- The possibility that mitigation measures may affect the value of the deal

Covered Transactions

FIRRMA's definition of covered transactions extends beyond sales to foreign entities and now also includes:

- Non-controlling transactions, including non-passive investment by a foreign person in US businesses involved in:
  - critical infrastructure; and/or
  - producing critical technologies
- Transactions involving sensitive personal data that, if exploited could threaten national security
- Foreign acquisition of real estate in sensitive locations (such as ports, airports and military installations).

On February 13, 2020, CFIUS issued two final regulations implementing most of FIRRMA. Both regulations (found at 31 C.F.R. parts 800-802) emphasize applicability to bankruptcy cases:

Note 1 to [31 C.F.R.] § 800.213: "Any transaction described in (a) through (d) of this section [defining "covered transaction"] that arises pursuant to a bankruptcy proceeding or other form of default on debt is a covered transaction."

Note 1 to [31 C.F.R.] § 802.212: "Any transaction, transfer, agreement, or arrangement described in this section [defining "covered real estate transaction"] that arises pursuant to a bankruptcy proceeding or other form of default on debt is a covered real estate transaction."

The regulations expanded the types of "covered transactions" subject to CFIUS review, including:

- "Covered control transactions" resulting in foreign control of a U.S. business, or certain U.S. real estate located in certain U.S. ports or near sensitive U.S. government installations;
- "Covered instruments," including certain non-controlling foreign investments in U.S. businesses or real estate;
- Changes in a foreign investor's rights resulting in a covered control transaction or a covered investment; or
- Transactions intended to evade or circumvent CFIUS.

Historically, parties voluntarily determined whether to notify CFIUS about a proposed covered transaction. Under FIRRMA and the regulations, parties are required to notify CFIUS about certain transactions involving certain "critical technology" investments and foreign government investments.

In certain chapter 11 cases, debtors have treated the proposed restructuring or sale as subject to CFIUS review from the outset of the chapter 11 case (or before) and notified CFIUS early on to start the review process. In other Chapter 11 cases, even in the absence of notification by debtor, the government has filed notices indicating its intent to consider whether transactions are subject to CFIUS review. (See samples with the materials).

Loans

A financing transaction may be a covered transaction and trigger CFIUS review if a foreign lender acquires:

- an interest in profits of a U.S. business;
- the right to appoint members of the board of directors of the U.S. business; or
- other comparable financial or governance rights

Note: "Golden director" provision, standing alone, not sufficient (if limited to vote to file a bankruptcy petition).

CFIUS jurisdiction may apply to lending transactions if an imminent or actual default or other conditions raise the prospect that a foreign lender may, as a result of the default or other trigger, acquire:

- control of a U.S. business; or
- an equity interest plus information access, board presence, or certain decision-making rights

Real Estate

FIRRMA expands CFIUS' jurisdiction to review acquisitions of real estate. A real estate acquisition may be a covered real estate transaction if:

- The real estate is located within an air or seaport;
- The real estate is near sensitive US government property, such as military bases; or
- The real estate is located such that it could be used to collect intelligence or conduct surveillance of sensitive US government assets.

Investments

CFIUS review is triggered when a foreign investor gains decision-making rights from investments in a US business involving any of the following:

- Critical infrastructure
- Critical technologies
- Maintenance or collection of sensitive personal data that if used may pose a threat to national security.

Takeaways

CFIUS review may be trigged when a foreign entity is:

- Taking control of a US business (including via an asset sale);
- Acquiring covered real estate; or
- Investing in a business:
  - with critical infrastructure;
  - with critical technologies;
  - creating an opportunity to use sensitive personal data in a manner threatening national security;
- Financial transactions may trigger CFIUS review, if default is imminent or has occurred and enforcement of default remedies will result in a covered transaction.

CFIUS review will occur – and notice may be mandatory – even if the transaction occurs in a bankruptcy case, via a § 363 transaction or pursuant to a plan.

Bibliography:

Camille A. Stewart, *Full Court Press: Preventing Foreign Adversaries from Exfiltrating National Security Technologies Through Bankruptcy Proceedings*, 10 JOURNAL OF NATIONAL SECURITY LAW & POLICY 277 (2019)

31 C.F.R. Part 800

31 C.F.R. Part 802

Shana A. Elberg & Michael E. Leiter, *Expert Q&A on Role of CFIUS in Bankruptcy Transactions*, PRACTICAL LAW: BANKRUPTCY & RESTRUCTURING (July 24, 2019)

Christopher L. Mann & Eric J. Kandel, *Navigating the New CFIUS Landscape*, BUS. L. TODAY, Sept. 2018, at 1.

ABI Midwest Bankruptcy Institute

Issues in International Sales Outside of Bankruptcy

Michael Patterson

Spencer Fane LLP

SpencerFane

SpencerFane

At Spencer Fane, your business leaders work with our business leaders.

- 22 Offices Nationwide
- 450+ Attorneys
- 21 Practice Groups

Michael Patterson

- International Law
- Business Transactions
- Mergers & Acquisitions
- Securities Regulation and Compliance
- Financial Services

Spencer Fane LLP | spencerfane.com

SpencerFane

What is the sale relationship?

- Direct sale of assets? Ex. M&A purchase of a US entity that has foreign operations; Maquilas (Cd. Juarez and Tijuana);

Or

- Using intermediaries:
  - True distributor? (buying goods – distributing?)
  - Manufacturer's rep? (commissioned sales, we ship?)
  - Joint venture with a local partner? (form in country entity – likely)

SpencerFane

"Dorothy we aren't in Kansas anymore" I don't take my US "system" with me

- No Uniform Commercial Code (no defaults)
- Yes, there are international codes (ex. INCOTERMS), but don't rely on that only…
- Should 'write your own "code"' (good sale or distribution agreement and for clear title of assets will need help with local counsel)
- What is missing? Rapid Dispute Resolution systems: Courts, arbitration
  - Examples: injunctions, audit rights, cease and desist and "take downs" for IP.

SpencerFane

Who am I helping at the US company? (interests in process differ)

- CFO or General Counsel – maybe greater sensitivities to hear me express legal concerns and risk
- CEO: maybe "why we are doing this" cost v. upside
- VP Sales (or other sales side) – "Mike, we need this by tomorrow because we have a big sale pending in Bogota"
- Just talk to my foreign intermediary – sign this one page authorization (see next page)…

SpencerFane

Answer for: Why are we doing this?

- Minority of sales, but can be the most profitable (margins)
- Barriers to entry a little higher, yes, investment and slower up front getting it right, yes, but upside is substantial.
- There was this woman "Malinche" – US goods image
- You are from the USA – you're lucky – we have lots of help for you that other countries don't have:
  - US Commercial Service, Gold Key, StopFakes, CBP, etc.
  - EXIM (both to finance the exports and credit guarantees)

SpencerFane

The “one pager” from Distributor or other foreign contact:

- Situation: Company has never done an international sale or never done in this jurisdiction before.
- Out of the blue, international company or distributor contacts and wants to make a relatively large purchase (this is a “found money” situation)
- “Mike, we don’t want to go into the international distribution business, we just want to make this one sale - They asked us to sign this one pager, can you look it over?”
- The one pager says, and maybe in Spanish/Chinese/Japanese ☺ : “You appoint D as your exclusive distributor with rights to import your product” (you have just crossed many lines)… see next

SpencerFane

If I do a one pager, or just make a PO prepay sale, what are my risks?

- Tax presence in local country? (“no way?” poss “yes way”)
- “Deemed” labor risk? Licensing risk? (poss “yes”)
- Inadvertent appointment of *exclusive* distributor?
- Risk to intellectual property? (in some cases the one pager says, in local language, granting right to use the name and “be you” in local country). [Web site stories]
- Risk of re-distribution to additional countries or back into the US?

SpencerFane

Doing it Right: Due Diligence

- Not like the US at all for Due Diligence
- Use:
  - the US Commercial Service!
    - International Company Profile – this is hard to find anywhere - a comprehensive background report on a specific foreign company, including: general business information, background and product information, key officials, references contacted by ITA, financial data/creditworthiness information, reputational information, a site visit and interviews with principals; information sources consulted in preparing the report; and analysis of information collected; https://www.export.gov/International-Company-Profile
    - Gold Key Service – takes you to the country and interviews with appointments.
  - Buy side Investment Banker involved running diligence?
  - Mike Patterson ☺ and local counsel to vet legally. One more time: USE LOCAL COUNSEL
- What do I want to know?
  - Litigious?
  - Solvent?
  - Experience? (can they penetrate?)
  - Relationships and reputation (in many countries it is truly who you know, your network, your family, your relationship to regime, etc.)
  - What "other" businesses and distributions do they have?

SpencerFane

The Big Issues: Hardball laws

- In many countries (ex. Costa Rica, Brazil), hardball distributor favorable laws which, *no matter what the contract says*….(or unless you carefully draft around)
  - Make it tough to terminate a distributor (Brazil: have to "make whole" which could mean, pay millions and pay them and the new distributor while you transition), ex. Used an irrevocable power to fix.
  - Deemed "exclusive" unless you draft around (Costa Rica, others)
  - Other laws: Commercial Agent laws, etc.

© Michael F. Patterson 2022

Spencer Fane LLP | spencerfane.com

The Big Issues: Exclusivity

- Draft out of hardball laws
- Think Future: you may "think" this one is all you need, but if successful there will come a day when you want to segment this distributor by territory. Guadalajara example
- Milestones/Penetration: link exclusivity to meeting milestones of penetration (D's argument is "I need exclusivity to invest/penetrate for you" ergo: if you don't penetrate, you lose exclusivity and I can hire others too
- Also: if not getting paid, I can cut exclusivity (Turkey Dist. example)
- No sideways export to other jurisdictions or back to US!

The Big Issues: Registrations

- Biggest single issue!
- D will say "I'll get them for you in my name, I'll pay!" Why?
- It is HUGE, repeat HUGE leverage at termination – real quote: "I don't care what the contract says, I've got your registrations and I'm not giving them back until you pay me USD$4 million" (another $1.7 Million)
- Answers: Careful drafting, "pocket" executed power transferring now;
- Consider intermediary: ex. EMERGO to hold the registrations but avoid your tax, labor, regulatory "presence" in country.

SpencerFane

The Big Issues: Dispute Resolution

- One lawyer: "Malpractice not to do arbitration" but then, after my questions, "well maybe not malpractice" ☺
- Carve outs for intellectual property, audit, one sided collections
- *Pena Convencional* (like liquidated damages) remedies instead of reliance on US type provisional remedies
- Saudi example – Arbitration forum that excluded lots of damages.
- Where? US? (Kansas Dorothy) – one client uses Oregon
- Or: Neutral: London, Miami
- (SW: Phx; Dallas; LA well accepted)
- Consider: Mediation? International is slow enough – timing?

SpencerFane

The Big Issues: Getting Paid

- Full payment at closing or before ship – consider less hold backs more up front? Escrows important and location of escrow.
- Consider EXIM or other credit insurance (discuss: not only for getting paid, but increasing sales by "turn")
- Shut off and set off terms in agreement and potential effect on exclusivity as leverage
- Discipline: don't get behind on international
- Letter of credit? Back up promissory note? Guaranty?
- Pricing clear (local counsel: enforceable as written?)

The Big Issues: the Customers

- Who owns them? Do I know who they are and data?
- When terminate:
  - Cannot "hold out" as distributor
  - Non-competes, but difficult to enforce
  - During the deal: can't rep others
- During the course of agreement:
  - Find ways to "support" and interact with clients (ex. Client 'surgery')
- Leave door open for future that you may want to go in country if wildly successful, tax advantage, etc.

The Big Issues: Inventory

- Dealing with:
  - Old inventory
  - New product introductions
  - Upon termination, sell off, or repurchase or sale to new distributor
  - Issues in product warnings, disclaimers, packaging in country

SpencerFane

The Big Issues: Warranty

- Don't assume risk less than US
- Assume: in a consumer litigation you are the "big bad gringo"
- Insurance!
- Need local counsel review of what warranties are required for your product type

SpencerFane

The Big Issues: Intellectual Property

- Register marks, and other IP in the country
- Limited licenses only (that are terminable) in agreement
- Monitor!
- CBP registration to watch for knock offs coming back into US market (ref: "Stop Fakes Roadshow")

SpencerFane

The Big Issues: Language

- Often English is permitted (local counsel question)
- But: in event of litigation, may need a local language "version" and could substantially slow down or strategically hinder, so maybe prepare now and agree on.
- If side-by-side or back to back, then specify which one controls (remove signature blocks from the "courtesy")

SpencerFane

The Big Issues: Taxes

- Taxes referring to any class of taxes, fees, "stamps" registrations, withholdings, etc.
- Gross up provisions – you get paid the net you contract
- Responsibility for withholdings

The Big Issues: International Shipping and Import Responsibilities

- Select your sales terms (Incoterms) ***carefully***, as they will dictate when and where delivery will occur, as well as the responsibilities of each party for:
  - Packing and loading the goods.
  - Export clearance from the seller's country.
  - Import clearance into distributor's territory (including payment of all duties, fees and taxes).
  - Insurance.
  - Transportation.

- Separately state in your written agreement when and where risk and title transfers from buyer to seller (not addressed by Incoterms).

The Big Issues: U.S. Export and Economic Sanctions Compliance

- **Incorporate U.S. export and sanctions compliance language into your written agreements:**
  - Prohibit the resale or transfer of your products to embargoed countries.
  - Prohibit the resale or transfer of your products to prohibited persons.
  - Prohibit the resale or transfer of your products for prohibited end-uses.
  - Require the distributor to screen all parties to its transactions against the US restricted parties lists.
  - DISTRIBUTOR may be required to obtain export licenses from the USG for reexports or resales.

- **If *YOU* will be exporting the goods from the U.S., ensure your compliance with all U.S. export controls and economic sanctions.**
  - Destination Control Statements placed on commercial invoices.
  - Determine export license requirements and obtain them if required.
  - Timely and accurately file the Electronic Export Information filing.
  - Maintain records of all exports for 5 years from date of export.

- **If the *DISTRIBUTOR* will be export your goods from the U.S., ensure that:**
  - Destination Control Statements placed on commercial invoices.
  - Any ***routed export*** is set up properly (i.e., goods delivered to Distributor's forwarder in the US but Distributor assumes responsibility for the export from the U.S.).
  - ***STOP*** your delivery of the goods to the Distributor if you know or have reason to know of a risk of diversion or red flag!

5 most common Incoterms

- EXW (Ex Works) Buyer responsible for everything from pick up at seller's warehouse through delivering
- DDP (Delivered Duty Paid) – Polar opposite of EXW – Seller pays all, including duties.
- FOB (Free on Board) Seller pays to deliver goods to ship of buyer's choosing and pays to load it on board, then buyer pays all from there. Only applies to sea/inland transport.
- CIF (Cost, Insurance and Freight) Seller delivers to vessel and gets loaded, but also pays ocean freight and insurance. Once at port, buyer pays unloading and from there.
- FAS (Free Alongside Ship) Seller pays to transport to a named port on seller's end, once at port, buyer pays to load and everything else from there (insurance, transport, etc.)

The Big Issues: Anti-Corruption/Anti-Bribery

- **Due diligence process for vetting prospective Distributors should include anti-corruption/anti-bribery (FCPA compliance.)Process may include:**
  - Internal Diligence Questionnaire completed by YOU based on research and background checks.
  - FCPA Compliance Questionnaire completed by DISTRIBUTOR.
  - FCPA Compliance Certification completed annually by DISTRIBUTOR

- **Distributor agreement should include specific anti-corruption language and require compliance with applicable laws, regulations <u>*AND*</u> your policy.**

- **<u>*YOUR*</u> Anti-Corruption Policy should be provided to Distributors, too!**

The Big Issues: Indemnification

- For: (confirm enforceability with local counsel)
  - Their acts
  - Their negligence or omissions
  - Their taxes
  - Their “other” business interests
- Require:
  - Insurance to back up
  - Guaranty
  - Additional insured certificates

Other tips

- Notarize and apostille documents now (at least notarize so that you can apostille in future if necessary)
- Recitation of express powers
- Consider drop down entity for international to protect “mother ship” assets in event of suit/their tax authority audit/etc.
- Consider IC-DISC and other tax strategies?
- Repatriating profits: tax treaties often treat differently: consulting, royalties, dividends, principal/interest payments – so plan the structure carefully in advance.

Michael Patterson
Spencer Fane
602-471-5170 Cell
mpatterson@spencerfane.com

SpencerFane

THE REVERSE VESTING TRANSACTION: A CANADIAN RESTRUCTURING INNOVATION

By Andrew Harmes[1]

Submission for the 2022 III Prize in International Insolvency Studies

May 31, 2022

[1] The author is an associate at Goodmans LLP in the corporate restructuring group. The author would like to thank his colleagues at Goodmans LLP for their significant contributions to the development of the reverse vesting transaction structure, and the writing of this article, in particular, Bradley Wiffen and Brendan O'Neill. The views and opinions expressed in this article are those of the author and does not necessarily reflect the position of Goodmans LLP or its lawyers or clients.

TABLE OF CONTENTS

I. INTRODUCTION

Restructurings in Canada, like in many other jurisdictions worldwide, are typically completed through one of two transaction structures: (a) a plan of arrangement or (b) an asset sale. The plan of arrangement structure is typically used to facilitate restructurings involving an acquisition of the shares of a debtor company. Conversely, asset sale transactions are typically completed by transferring assets of a debtor company to a separate legal entity, free and clear of claims and encumbrances, pursuant to a court vesting order.

In recent years, a third form of transaction has emerged in Canadian restructuring proceedings that facilitates the acquisition of the shares of a restructured debtor company: the "reverse vesting transaction". In a reverse vesting transaction, the purchaser acquires the shares of the debtor company, and unwanted assets and obligations are transferred to a newly formed entity (or entities) that becomes subject to the insolvency proceeding in place of the debtor and is subsequently wound down. The reverse vesting transaction takes place outside of a plan of arrangement – the typical structure through which the equity of a restructured debtor is acquired, and which requires a creditor vote – and is subject only to court approval in the same manner as an asset sale transaction.

The reverse vesting structure represents a new and innovative approach to completing a going concern restructuring transaction. A reverse vesting transaction can be completed more quickly than a plan of arrangement as it does not require a creditor vote. In addition, non-transferable licenses, permits, intellectual property and/or tax attributes of the debtor company can be preserved in circumstances where a plan of arrangement is impracticable from a timing, cost or structural perspective. The structure is particularly efficient for debtors operating in highly regulated industries, and in some cases, may be the only structure that preserves going-concern value and/or key tax attributes, such as net operating losses. The recent boom in reverse vesting transactions can in part be attributed to a rise in restructurings in Canada's cannabis industry, which is a highly regulated industry that has seen companies face various financial and operational challenges in the years since the legalization of recreational cannabis in 2018.[2] Reverse vesting transactions have also been implemented in many other industries, including in mining, oil and gas, education, entertainment, grain and retail, among other sectors.[3]

Not surprisingly, some important questions have been raised regarding the reverse vesting transaction structure and its impact on stakeholders.[4] This has led to the formulation in the recent case of *Harte Gold Corp.* ("***Harte***") of a new set of factors for Canadian courts to apply in

---

[2] For further information regarding the challenges facing Canada's cannabis industry and the use of reverse vesting transactions to restructure insolvent cannabis companies, see Jocelyn T. Perreault, Gabriel Faure & François Alexandre Toupin, "Reverse Vesting Transactions: An Innovative Solution to Restructure Insolvent Cannabis Companies" (2021) 10 J. Insolvency Institute Canada 10.

[3] See Appendix 1 for a summary of 25 reverse vesting transactions approved in Canadian restructuring proceedings as at the time of writing this article.

[4] See e.g., Dr. Janis Sarra, "Reverse Vesting Orders – Developing Principles and Guardrails to Inform Judicial Decisions", *Houlden & Morawetz Insolvency Newsletter* (7 February 2022) 22-6 Bankruptcy & Insolvency L. Newsletters (WL Can.).

considering whether to approve a reverse vesting transaction.[5] The development of this four-part test is indicative of a maturation of the reverse vesting structure as an accepted tool for use in Canadian restructuring proceedings.

With the *Harte* decision, now is an opportune moment to reflect on the development, purpose and future use of the reverse vesting transaction, and to introduce the reverse vesting transaction to the international restructuring community. Part II provides a background to the development of the reverse vesting transaction, including a brief overview of the Canadian insolvency and restructuring regime within which the structure developed. Part III outlines the development and evolution of the reverse vesting structure through three key phases: the unopposed period, the opposed period and the development of the *Harte* factors. Part IV offers an analysis of principal advantages of the structure, and Part V provides an outlook for future use. The paper concludes with a consideration of the broader significance of the reverse vesting structure as a restructuring tool.

II. BACKGROUND AND INTRODUCTION TO THE REVERSE VESTING TRANSACTION

A. A Brief Overview of the Canadian Insolvency and Restructuring Regime

To understand the evolution of the reverse vesting transaction, one must first understand the regime within which it developed. The reverse vesting transaction would not have developed without an accommodative legal framework.

Restructuring and insolvency law in Canada is a matter of federal jurisdiction and consists of a web of statutory and common law rules. Canada's main statutory regime is the *Companies' Creditors Arrangement Act* (the "***CCAA***"), which has become the restructuring statute of choice in Canada for larger companies or complex cases, including for corporations incorporated under Canadian law and corporations (wherever incorporated) that have assets or do business in Canada.[6]

The *CCAA* was originally enacted in 1933 amid the Great Depression to provide a framework within which debtors and creditors could effect a reorganization to avoid the many costs associated with firm failure. Although the *CCAA* was not widely used for much of its history, it has emerged

---

[5] *Harte Gold Corp. (Re),* 2022 ONSC 653 [*Harte*]. The author notes that Goodmans LLP served as counsel to FTI Restructuring Inc., the court-appointed monitor in *Harte*'s restructuring proceedings.

[6] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended [*CCAA*]. Note that insolvent corporations may alternatively file a commercial proposal under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, Part III, Division I [*BIA*]. However, the *BIA*'s proposal provisions are rarely used for larger corporations or complex filings, including because the BIA prescribes strict timelines that a debtor must meet in order to remain under court protection. For example, section 50.4(8) requires the debtor to file a proposal within 30 days, failing which it will be assigned into bankruptcy. While this 30 day time period may be extended on application to the court, extensions can only be granted for periods of up to 45 days at a time and may not be extended beyond five additional months. *CCAA* proceedings, on the other hand, can be extended by court order for as long as necessary. While this article focuses on reverse vesting transactions completed in *CCAA* proceedings, such transactions have also now been approved in *BIA* proposal proceedings. See e.g., *Junction Craft Brewing Inc., Re* (17 December 2021), Toronto, Ont. Sup. Ct. J. [Commercial List] 31-2774500 (Approval and Vesting Order), and *Ayanda Cannabis Corporation, Re* (1 March 2022), Toronto, Ont. Sup. Ct. J. [Commercial List] BK-22-02802344-0035 (Approval and Vesting Order) [*Ayanda*].

over the past approximately 40 years as the preferred statutory framework to facilitate the restructurings of large firms, including for cross-border cases.

Canadian insolvency law, including the *CCAA*, is administered by the superior court of each province or territory, rather than specialized bankruptcy courts (like in the US), although certain of such courts have separate divisions that deal with bankruptcy, insolvency, and corporate restructuring or reorganization matters.[7]

Canadian courts frequently describe the *CCAA* as being "skeletal" in nature, as opposed to a comprehensive code that sets out all that is permitted or barred. Courts have adopted a flexible approach to interpreting the *CCAA*'s provisions so as to give effect to the statute's underlying policy objective of facilitating restructurings to prevent the socioeconomic consequences that result from firm failure.[8] In particular, section 11 of the *CCAA* provides a court with a general power to make any order it considers appropriate in the circumstances.[9] The Supreme Court of Canada has recently reiterated the broad and flexible discretion of judges pursuant to section 11 of the *CCAA* to fill in the gaps of the *CCAA* and make orders that are appropriate in the circumstances absent explicit authority in the *CCAA*, and to the extent that any such order furthers the objectives and purposes of the *CCAA*.[10]

The general power granted to Canadian courts under section 11, combined with the *CCAA*'s skeletal nature, has led to many innovative case-based developments over the years as courts grant orders that respond to ever changing fact scenarios and evolving business environments. One such development is the reverse vesting transaction. As discussed further below, there is no express authority in the *CCAA* for courts to approve reverse vesting transactions. In approving the structure, courts have relied primarily on the general section 11 power to make any order that is appropriate in the circumstances, while also utilizing the analytical framework of the *CCAA* provisions that address asset sales completed outside the ordinary course of business.

B. Distressed Transactions Under the *CCAA*

Before the reverse vesting transaction was developed, Canadian restructurings and distressed transactions have typically occurred either through a plan of arrangement confirmed under section 6(1) of the *CCAA*, or an asset sale under section 36 of the *CCAA* – the latter being Canada's equivalent of section 363 sales under Chapter 11 of the U.S. Bankruptcy Code.[11]

While there is now explicit authority under section 36 of the *CCAA* for a debtor company to sell all or substantially all of its assets through a court-approved sale, this has not always been the case. The full title of the *CCAA* refers to it being "an Act to facilitate compromises and arrangements

---

[7] For example, the Ontario Superior Court established the Commercial List in 1991. Based in Toronto, Ontario, the Commercial List consists of a team of judges who have experience in complex commercial litigation and restructuring matters.

[8] See e.g., *Ted Leroy Trucking [Century Services] Ltd., Re*, 2010 SCC 60 at para. 57.

[9] *CCAA*, *supra* note 6, s. 11.

[10] *9354-9186 Québec inc. v. Callidus Capital Corp*., 2020 SCC 10 at paras. 65, 67.

[11] *CCAA*, *supra* note 6 at ss. 6(1), 36; 11 U.S. Code §363.

between companies and their creditors," and for much of the *CCAA*'s history it was principally used to provide a court-supervised framework within which financially distressed debtors could negotiate and develop a plan of arrangement with their creditors that set out various compromises on which creditors would vote as an alternative to liquidation.[12] However, some value must flow in a plan of arrangement scenario to all classes of creditors whose claims are to be compromised to incentivize such creditors to vote in favour of the proposed plan. This structure is not ideal in a situation where the value of the debtor company's assets and business would be insufficient to provide some recovery to all creditor classes and could prevent potential going concern transactions from being completed in such circumstances.

As an example of the flexibility of Canada's restructuring regime, Canadian insolvency law evolved over time to recognize that in some circumstances value can be maximized through the sale of a debtor's assets "free and clear" of its liabilities. Asset sales can take the form of a going concern sale of substantially all of the debtor's business or as a piecemeal sale as part of a business wind-down. Asset sale transactions, in either case, have come to be colloquially referred to in Canada as "liquidating *CCAA*s".[13]

Canadian courts initially approved asset sale transactions pursuant to the general power under section 11 as an exercise of judicial discretion to "fill in the gaps of legislation so as to give effect to the objects of the *CCAA*".[14] However, with courts having accepted that the jurisdiction existed under the *CCAA* for asset sale transactions to be approved and such transactions becoming more common, the *CCAA* was amended in 2009 to introduce section 36 and codify the procedures and factors for courts to consider when determining whether to approve asset sale transactions.[15] Notably, unlike the *CCAA* plan of arrangement, which requires approval by each class of affected

---

[12] See e.g., Chris Armstrong, "Where's the Plan? The Declining Role of *CCAA* Plans in the Canadian Restructuring Landscape, and When They Still May be Needed" (2021) 10 J. Insolvency Institute Canada [Armstrong, "Where's the Plan?"].

[13] As Armstrong notes, the term "liquidating *CCAA*" is a somewhat misleading term given that it describes both a piecemeal liquidation and a going concern sale of assets comprising a debtor's entire business, the latter of which can have an effect similar to that of a restructuring completed under a *CCAA* plan of arrangement. See *ibid*.

[14] See *Canadian Red Cross Society/Société canadienne de la Croix-Rouge, Re*, 1998 CarswellOnt 3346 at paras. 43-56 (Ct. J. (Gen. Div.) [Commercial List]). See also, *Nortel Networks Corp.*, *Re*, 2009 CarswellOnt 4467 (Sup. Ct. J. [Commercial List]) [*Nortel*], in which the Ontario Superior Court, in finding that a *CCAA* judge has jurisdiction to authorize a sale under the *CCAA* outside of a plan of arrangement, adopted a four-part test to determine whether approval such an asset sale was appropriate in the absence of a plan: (1) is a sale transaction warranted at this time; (2) will the sale benefit the whole "economic community"; (3) do any of the debtors' creditors have a bona fide reason to object to a sale of the business; and (4) is there a better viable alternative?

[15] Pursuant to section 36(1), a debtor company may not sell or otherwise dispose of assets outside the ordinary course of business unless granted court authorization. Pursuant to section 36(3), in deciding whether to grant approval, courts are to consider, among other things: (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances; (b) whether the court-appointed monitor approved the process leading to the proposed sale or disposition; (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy; (d) the extent to which the creditors were consulted; (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value. *CCAA*, *supra* note 6, s. 36. The section 36(3) factors largely reflect the test developed in *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (C.A.) for a sale of assets in receivership proceedings, while also reflecting some of the elements of the test set out in *Nortel*, *supra* note 14.

creditors by way of a creditor vote and sanctioning by the court if such creditor approval is obtained, the Canadian parliament in enacting section 36 chose only to require court approval.

Since section 36 of the *CCAA* was adopted, it has become relatively routine for significant asset sales to occur in *CCAA* cases. According to Renner and Forbes, between September 2009 and December 2020, plans of arrangement were filed in approximately 35% of all *CCAA* proceedings.[16] While asset sale transactions have not completely overtaken the plan of arrangement, it is clear that asset sale transactions have been accepted as a valid transaction alternative. The same is also true of restructurings in the United States. Section 363 sales were completed in 51% of all Chapter 11 cases filed in 2018 and 2019, and 39% and 40% of cases in 2020 and 2021, respectively.[17]

There are likely several reasons for the increase in asset sale transactions in *CCAA* proceedings, none of which are particularly unique to Canada. The most often-cited advantage of an asset sale, whether under the *CCAA* or under section 363 of the U.S. Bankruptcy Code, is that the transaction can be completed more quickly than a plan of arrangement reorganization.[18]

A restructuring completed through a *CCAA* plan of arrangement typically requires the development and negotiation of a plan, the completion of a claims process, court approval to convene a meeting of creditors to vote on the plan, the conduct of such creditor meeting, and court approval of the plan if creditor approval is obtained. In total, this process typically requires at least six months to complete, and requires a number of court attendances.

An asset sale transaction, on the other hand, only requires court approval and needs as few as two court attendances, being a court hearing to approve procedures for a sale process and a court hearing to seek approval of the transaction selected as the successful bid. It is also possible for a sale process to be conducted before a *CCAA* filing as courts have accepted the use of a pre-filing sales process as an appropriate market test where such pre-filing process was carried out in a manner consistent with a typical post-filing process, or contain pre- and post-filing elements.[19] In either a pre- or post-filing process, it is possible in many cases to complete a sale transaction on a relatively expedited basis, thereby minimizing the disruption to the debtor's business.[20]

---

[16] Natalie Renner & Katherine Forbes, "Are the Rumours True? Has There Been a Shift Away From the Use of Plans of Compromise and Arrangement under the *CCAA*? A Cross-Canada Look at the Use of *CCAA* Plans Over the Years" (2021) Annual Rev. Insolvency L. 10 (WL Can.).

[17] Wachtel, Lipton, Rosen & Katz LLP, "Distressed Investing, Mergers and Acquisitions: An Overview of the Legal Landscape for Acquirors and Investors" (2022), online: <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28050.22.pdf>.

[18] See e.g., Armstrong, "Where's the Plan?", *supra* note 12.

[19] See e.g., *Nelson Education Ltd., Re*, 2015 ONSC 5557 at paras. 32-33.

[20] Note that Nocilla, in analyzing 77 *CCAA* proceedings between January 1, 2012 and December 31, 2013, found that companies that sold all or substantially all of their assets spent more time in *CCAA* protection than companies that reorganized through a plan of arrangement. However, as Nocilla notes, this arguably does not reflect the speed within which asset sale transactions can be completed since many companies that complete asset sales early in a *CCAA* case remain under court protection for an extended time thereafter to complete wind-down matters, including distribution

In addition to the speed at which a sale-based restructuring can be completed, an additional advantage is the certainty that it provides as compared to a plan of arrangement by only requiring court approval. As Armstrong notes, unlike the U.S. Bankruptcy Code, which permits a Chapter 11 plan to be confirmed over the objection of a dissenting class of creditors so long as the plan does not discriminate unfairly and is fair and equitable with respect to the dissenting class, referred to as the "cramdown" clause, a *CCAA* plan of arrangement must be approved by the requisite number of creditors of each affected class to be sanctioned by the court.[21] The threshold for creditor approval under the *CCAA* is a double majority, consisting of two-thirds in value and a majority in number of affected creditors in a given class.[22] As such, depending on the creditor base, there may be uncertainty with respect to a creditor vote and a large creditor with a veto in respect of a particular class of creditors has an effective veto over the entire plan of arrangement. Although creditors are able to object to a proposed asset transaction at the hearing for court approval, it is ultimately a matter of judicial discretion as to whether the statutory test for approval is satisfied.

There are also circumstances in which it is not practical to proceed with a plan of arrangement – for example, if there is insufficient liquidity to carry a debtor through a plan process, or if there is a credit bidding secured creditor whose claim is significantly greater than the value of the business or assets of the debtor – in which the traditional transfer of assets to a separate legal entity may not be the optimal structure to implement the transaction. The reverse vesting transaction was developed to fill this void.

C. The Nuts and Bolts of the Reverse Vesting Transaction

The key feature of a reverse vesting transaction is the acquisition of the shares of a debtor company pursuant to a court order that vests out from the debtor any unwanted assets, obligations and encumbrances. This court order is referred to as a "reverse vesting order" as it reverses the normal structure of a vesting order approving an asset sale in which the purchased assets are transferred to a new acquireror entity. This is what gives rise to the "reverse vesting transaction" moniker.

The particular structure of a reverse vesting transaction will vary depending on a variety of factors. The reverse vesting transaction, in its relatively brief history, has proven to be flexible in nature and able to adapt to the particular circumstances at hand and imperatives of the transaction.[23] However, reverse vesting transactions typically include the following basic elements:

- *Definitive Agreement* – the debtor company affected by the transaction will enter into a definitive agreement with the purchaser setting out the terms of the transaction. The definitive agreement will typically specify the entity or entities whose shares will be acquired under the transaction (including, whether the shares being acquired will be the

---

to creditors of sale proceeds. See Alfonso Nocilla, "Reorganizations, Sales, and the Changing Face of Restructuring in Canada: Quantitative Outcomes of 2012 and 2013 *CCAA* Proceedings" (2019) 42:2 Dalhousie L.J. 371.

[21] Armstrong, "Where's the Plan?", *supra* note 12.

[22] *CCAA*, *supra* note 6, s. 6(1).

[23] For a detailed analysis of structuring considerations in a reverse vesting transaction, see Michelle Pickett & Linc Rogers, "The Business Side of Reverse Vesting Orders" (2021) Annual Rev. Insolvency L. 14 (WL Can.) [Pickett & Rogers, "The Business Side of Reverse Vesting Orders"]

debtor's existing shares or whether the existing shares will be cancelled and new shares issued), the assets and obligations that will be retained by the acquired entities, and the unwanted assets and obligations that will be transferred to an existing or newly-formed entity (a "**ResidualCo**") on completion of the transaction.

- *Reverse Vesting Order* – the obligations of the parties under the definitive agreement will be expressly conditioned on obtaining *CCAA* court approval of the transaction and the issuance of a reverse vesting order, an agreed form of which is typically attached to the definitive agreement. In certain circumstances, it may also be necessary and appropriate to seek an order granting certain additional powers to the court-appointed monitor in connection with the completion of the transaction and the post-closing administration of ResidualCo.

- *Approval Hearing* – once the definitive agreement is executed, the *CCAA* debtor will file a motion in the *CCAA* proceedings seeking court approval of the proposed transaction and the issuance of the reverse vesting order. Parties in interest may object to the proposed transaction.

- *Closing* – if the *CCAA* court approves the transaction and issues the reverse vesting order, the parties will work to close the transaction. On closing, the acquirer becomes the holder of the acquired entity's shares and the acquired entity emerges from the *CCAA* proceedings in its restructured form pursuant to the reverse vesting order.[24]

The effect of the reverse vesting structure is that the debtor company continues to own the retained assets free and clear of all obligations and encumbrances other than those that are expressly retained by the debtor company, with the purchaser becoming the sole shareholder of the restructured debtor company.[25] After the reverse vesting transaction closes, the *CCAA* proceedings continue in respect of ResidualCo, including efforts to realize on any excluded assets that may provide additional value for creditors.[26] Any remaining proceeds held by ResidualCo, including any cash proceeds from the reverse vesting transaction, are distributed to pre-filing creditors of the debtor company, whose relative priorities and entitlements as against the proceeds are preserved under the reverse vesting order.[27]

III. DEVELOPMENT AND EVOLUTION OF REVERSE VESTING TRANSACTIONS

Three phases can be identified in the relatively short history of the reverse vesting transaction. The first phase is the unopposed period, in which early forms of the reverse vesting structure were first

---

[24] Bradley Wiffen, "Reverse Vesting Transactions: An Innovative Approach to Restructuring" (2020) Annual Rev. Insolvency L. 4 (WL Can.) [Wiffen, "Reverse Vesting Transactions"].

[25] *Ibid.*

[26] *Ibid.*

[27] See e.g., *Wayland Group Corp., Re* (21 April 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-19-00632079-00CL (Approval and Vesting Order) at para. 9 [*Wayland* Approval and Vesting Order].

introduced and approved by courts without sustained opposition from applicable stakeholders and without the court offering detailed reasons for approval. The second phase is the contested period in which reverse vesting transactions in *Nemaska Lithium Inc.* ("***Nemaska***") and *Quest University Canada* ("***Quest***") were vigorously contested by certain opposing creditors but ultimately approved by applicable courts.[28] Both cases reached appellate courts, where leave to appeal was denied, and in *Nemaska*, further leave was denied by the Supreme Court of Canada. The third period is the development in *Harte* of an analytical framework for courts to apply when considering whether to approve a reverse vesting transaction.

A. The Unopposed Period

The unopposed period in the development and evolution of the reverse vesting structure consists first of its introduction in the 2015 *CCAA* proceedings of *Plasco Energy Group Inc.* ("***Plasco***"), and second, the use of the structure between October 2019 and September 2020 in several cases, including the first use of the reverse vesting structure to effect a going concern transaction.

(i) Plasco: The Birth of the Reverse Vesting Transaction Structure

Plasco and its affiliates operated a clean energy technology company that ultimately sought and obtained *CCAA* protection in 2015 because it was unable to raise additional financing to fund commercialization efforts.[29] *Plasco* conducted a sale process in its *CCAA* proceedings but did not generate a going concern transaction, and thus transitioned to wind down operations, including decommissioning its large-scale demonstration facility and undertaking the environmental remediation of the site on which the facility was situated.[30]

Plasco's secured creditors would not permit the demonstration facility to be dismantled and liquidated as part of the decommissioning process without an arrangement that preserved the value of *Plasco*'s intangible assets for their benefit. These intangible assets consisted primarily of *Plasco*'s intellectual property (over which the secured creditors had a security interest as collateral), trade name and significant tax losses.[31]

---

[28] *Arrangement relatif à Nemaska Lithium inc.*, 2020 QCCS 3218 [*Nemaska* Decision]; *Arrangement relatif à Nemaska Lithium inc.*, 2020 QCCA 1488 [*Nemaska* Court of Appeal Decision]; *Victor Cantore v. Nemaska Lithium Inc. (Formerly Nemaska Lithium Inc., Nemaska Lithium Whabouchi Mine Inc., Nemaska Lithium Shawinigan Transformation Inc., Nemaska Lithium P1p Inc. and Nemaska Lithium Innovation Inc.), et al.*, 2021 CarswellQue 4589 (S.C.C.); *Brian Shenker v. Nemaska Lithium Inc., et al.*, 2021 CarswellQue 5301 (S.C.C.), [*Nemaska* SCC Decision]; *Quest University Canada (Re)*, 2020 BCSC 1883 [*Quest*], leave to appeal refused, 2020 BCCA 364.

[29] *Plasco Energy Group Inc., Re* (10 February 2015), Toronto, Ont. Sup. Ct. J. [Commercial List]) CV-15-10869-00CL (Endorsement) [*Plasco* Endorsement]. The author notes that Goodmans LLP served as counsel to *Plasco* in its *CCAA* proceedings.

[30] *Plasco* had ultimate responsibility for the decommissioning of its facility and completing any required environmental remediation under its agreements with applicable governmental and regulatory authorities.

[31] *Plasco Energy Group Inc., Re* (14 July 2015), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-15-10869-00CL (Affidavit of Randall Benson at para. 35) [Benson Affidavit].

To resolve this situation, *Plasco* entered into a global settlement with its secured creditors that was implemented through a reverse vesting structure.[32] Under the transaction, the secured creditors acquired the shares of *Plasco*, the parent company of the *Plasco* group of companies. *Plasco* retained certain limited assets, including the shares of certain of its subsidiaries, its intellectual property, and books and records. All other assets and liabilities of *Plasco* and its affiliates, including the demonstration facility assets, were transferred to a newly incorporated ResidualCo that became the applicant in the *CCAA* proceedings. The ResidualCo ultimately proceeded with the decommissioning of the facility and the completion of environmental remediation activities.[33]

The global settlement and the related transactions were approved in *Plasco*'s *CCAA* proceedings. The global settlement and the reverse vesting order were premised on the concept that the ResidualCo was effectively the "mirror image" of *Plasco*, with the result being that no creditor would be prejudiced by the settlement transaction.[34] All assets of *Plasco*'s, other than those retained by the secured creditors, would transfer to the ResidualCo, and any creditor that before the transaction had a claim against any of the acquired entities would have a claim of equivalent priority against the ResidualCo and its assets.[35]

The court was satisfied that the settlement was fair and reasonable, beneficial to the debtors and their stakeholders generally, and consistent with the purpose and spirit of the *CCAA*. The court granted the reverse vesting order relying on its general authority under section 11 notwithstanding that no plan or arrangement was proposed to effect the settlement and related transactions.[36] *Plasco* lacked the resources to undertake a *CCAA* plan process, including to run a claims process and develop and negotiate a plan of arrangement to be voted on by affected creditors. The proceedings were being funded from the company's remaining cash resources and it was not feasible to obtain interim financing in the circumstances. The global settlement, and reverse vesting structure through which the transaction would be implemented, presented an efficient alternative that would enable *Plasco* to dismantle and liquidate the demonstration facility assets and complete the decommissioning and remediation of the site, while also maximizing value as the secured creditors, who were facing (and did incur) a significant shortfall, were able to efficiently realize on their intellectual property security and preserve *Plasco*'s significant tax losses for their benefit. This outcome would not have been possible without the reverse vesting structure.

---

[32] Wiffen, "Reverse Vesting Transactions", *supra* note 24.

[33] Benson Affidavit, *supra* note 31 at paras. 26 -34.

[34] Wiffen, "Reverse Vesting Transactions", *supra* note 24.

[35] Benson Affidavit, *supra* note 31 at para. 31.

[36] *Plasco* Endorsement, *supra* note 29 at pp. 3-4. The court stated as follows with respect to the approval of the settlement agreement and the reverse vesting structure: "The Global Settlement contemplates implementation of a corporate reorganization by which the shares of Plasco will be transferred to an acquisition corporation owned by [the secured creditors] and the remaining assets of the applicants will be held by a new corporation, referred to as "New Plasco", which will assume all of the liabilities and obligations of Plasco. I am satisfied that the Court has authority under section 11 of the *CCAA* to authorize such transactions notwithstanding that the applicants are not proceeding under s. 6(2) of the *CCAA* insofar as it is not contemplated that the applicants will propose a plan of arrangement or compromise. For this purpose, I consider that the Global Settlement is analogous to such a plan in the context of these particular proceedings."

(ii) Stornoway and Beyond: The Proliferation of the Reverse Vesting Transaction

Following the implementation in *Plasco* of a reverse vesting transaction, the next use of the structure came four years later in the 2019 *CCAA* proceedings of *Stornoway Diamond Corporation* (“***Stornoway***”).

Stornoway, which owned and operated a diamond mine in the Province of Québec, commenced *CCAA* proceedings in September 2019 and following a sale process entered into a share purchase agreement with certain of its secured creditors. The agreement provided for implementation of a reverse vesting transaction. With the *Plasco* case as a precedent, the aim was to enable the continued operation of *Stornoway*’s mine without the need to assign contracts, thus minimizing disruption to its business, and also to preserve certain of *Stornoway*’s tax attributes.[37]

Like *Plasco,* the *Stornoway* transaction resulted in an acquisition of shares through a reverse vesting transaction by the debtors’ secured creditors. Unlike *Plasco*, however, the acquisition of the shares was completed on a going concern basis that maintained *Stornoway*’s significant business operations.

The court-appointed monitor of *Stornoway*, in reporting to the court in respect of the proposed reverse vesting transaction, considered whether the treatment of *Stornoway*’s creditors would have been materially different had the transaction instead proceeded as an asset transaction. The monitor noted that all of the excluded liabilities transferred to the ResidualCos were subordinate to the payment in full of the outstanding secured indebtedness, and that the excluded liabilities would not have received different treatment under an asset sale transaction.[38] The monitor also was of the view that a sale in bankruptcy, which it determined to be the only alternative to the proposed reverse vesting transaction given the results of *Stornoway*’s sale process, was unlikely to result in a better outcome for the *Stornoway*’s creditors.[39]

The transaction was approved by the Québec Superior Court.[40] The Court did not issue written reasons in connection with the transaction approval.

The *Stornoway* transaction marked the beginning of a growth period for the reverse vesting structure. After the *Stornoway* reverse vesting order was issued in October 2019, the reverse vesting transaction was used in three *CCAA* cases from April to September 2020 as a tool to assist

---

[37] *Stornoway Diamond Corporation, Re* (30 September 2019), Montreal, Que. Sup. Ct. [Commercial Division] 500-11-057094-191 (Motion Seeking (i) Extension of the Stay of Proceedings; (ii) Amendment and Restatement of the Initial Order; and (iii) Leave to enter into the Participating Streamers/Diqauem Transaction with Issuance of an Approval and Vesting Order and Ancillary Relief at para. 38).

[38] *Stornoway Diamond Corporation, Re* (2 October 2019), Montreal, Que. Sup. Ct. [Commercial Division] 500-11-057094-191 (Second Report to the Court Submitted by Deloitte Restructuring Inc. in its Capacity as Monitor at para. 36).

[39] *Ibid*, at para. 39.

[40] *Stornoway Diamond Corporation, Re* (7 October 2019), Montreal, Que. Sup. Ct. [Commercial Division] 500-11-057094-191 (Approval and Vesting Order).

debtors facing obstacles to completing a traditional asset sale transaction, such as non-transferrable permits and licenses or constrained liquidity, or to preserve the debtor's tax attributes.[41]

In the *CCAA* proceedings of *Wayland Group Corp.* ("***Wayland***") and *Beleave Inc.* ("***Beleave***"), the debtors were government licenced cannabis producers. The *Cannabis Act* (Canada) and its regulations do not provide for the transfer or assignment of cannabis licences, and the government health regulator takes the position that cannabis licenses are not transferrable assets.[42] As such, transactions in *Wayland* and *Beleave* were structured as reverse vesting transactions principally to preserve government issued cannabis licences while also facilitating an acquisition by a third-party purchaser by vesting out unwanted assets and liabilities pursuant to a reverse vesting order. In each of *Wayland* and *Beleave*, there were also liquidity constraints that made implementation of a *CCAA* plan of arrangement – the traditional method by which a purchaser acquires the shares of a restructured entity in an insolvency situation – impracticable in the circumstances.[43]

In *Comark Holdings Inc*. ("**Comark**"), the debtor was an apparel retailer that utilized the reverse vesting structure to preserve significant tax attributes and complete a credit bid transaction on an expedited basis in light of significant liquidity constraints and business considerations.[44] The duration of the company's *CCAA* proceedings – from the initial filing to the closing of its reverse vesting transaction – was just over two months.[45]

---

[41] See *Wayland* Approval and Vesting Order, *supra* note 27; *Comark Holdings Inc., Re* (13 July 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-20-00642013-00CL (Approval and Vesting and CCAA Termination Order); *Beleave Inc., Re* (18 September 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-20-00642097-00CL (Approval and Vesting Order).

[42] *Cannabis Act*, S.C. 2018, c. 16. See *Pure Global Cannabis Inc.* (1 April 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV- 20-00638503-00CL (Affidavit of Michael McGuire at para. 12), at which it is stated that "it is Health Canada's position that licenses and not transferable assets."

[43] In *Wayland*, a *CCAA* plan of arrangement was determined not to be an efficient use of estate resources as the transaction proceeds would provide, at best, a marginal recovery for the first-ranking secured creditors and no value for junior secured or unsecured creditors. A plan of arrangement would have required the Wayland to conduct a claims process and undertake the procedural steps necessary to obtain creditor and court approval. During this period, the *Wayland* would have needed to fund its operations and the costs associated with the development and implementation of the plan of arrangement. *Wayland*'s DIP lender was not prepared to provide this incremental funding, and encouraged Wayland and the purchaser to implement the transaction through a reverse vesting structure as the most efficient restructuring solution. *Wayland Group Corp, Re* (15 April 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-19-00632079-00CL (Seventh Affidavit of Matthew McLeod at paras. 40-41). Similarly, in *Beleave*, the debtor had limited liquidity and did not have the necessary cash flow to fund operating costs during the time that would be required to formulate, draft, negotiate and implement a plan of arrangement, or pay professional expenses necessary to undertake such tasks. *Beleave Inc., Re* (8 September 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-20-00642097-00CL (Affidavit of Bill Panagiotakopoulos at para. 35).

[44] According to the debtor company, a plan of arrangement was not available as the delays associated with developing and conducting a claims process, holding creditor meetings and seeking court approval, would jeopardize the viability of the business. The company needed to implement the transaction and obtain exit financing as soon as possible in order to have the funds necessary to build inventory in the quantities required before the busy fall and holiday shopping season. *Comark Holdings Inc., Re* (July 7, 2020), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-20-00642013-00CL (Third Affidavit of Gerald Bachynski at paras. 12, 41-42). The author notes that Goodmans LLP served as counsel to Alvarez & Marsal Canada Inc., the court-appointed monitor in the *Comark CCAA* proceedings.

[45] *Comark* was granted *CCAA* protection on 3 June 2020 and its restructuring transaction closed on 7 August 2020.

In each of *Stornoway*, *Wayland*, *Beleave* and *Comark*, the applicable reverse vesting transactions were approved without sustained opposition from stakeholders and without courts offering detailed reasons as to why the reverse vesting structure was appropriate in the circumstances. The first challenge to a reverse vesting transaction came in *Nemaska*'s *CCAA* proceedings, and the second shortly thereafter in *Quest*'s *CCAA* proceedings.

B. The Contested Period

(i) Nemaska

Nemaska commenced *CCAA* proceedings in December 2019 as a result of liquidity issues related to the construction of its lithium mine and processing facility. After filing for *CCAA* protection and conducting a sale process, *Nemaska* accepted an offer from a consortium consisting of its principal secured creditor and two other third-party purchasers, which provided for the purchase by the consortium of all of *Nemaska*'s shares through a reverse vesting transaction. The reasons for proceeding via a reverse vesting transaction included the need to preserve *Nemaska*'s mining lease, mining claims and environmental permits, maximize various tax attributes, and to proceed in a timely manner.[46]

A creditor of *Nemaska* objected to the reverse vesting transaction arguing, among other things, that the power of a *CCAA* court to issue a vesting order is limited to circumstances where a debtor's assets are being sold, and that reverse vesting transactions sidestep the creditor approval requirements of a plan process.

The Québec Superior Court ultimately approved *Nemaska*'s proposed reverse vesting transaction in the face of the creditor opposition.[47] With respect to the legal authority for approval of a reverse vesting transaction, the court, with reference to principles set out by the Supreme Court of Canada that refer to the evolving nature of *CCAA* proceedings and the role of supervising judges in making a range of orders that can respond to the circumstances of each case, the court determined that the legal authority of courts to approve the reverse vesting structure existed through a broad interpretation of section 36, the section of the *CCAA* that permits courts to approve the sale or disposition of assets outside of the ordinary course of business.[48] According to the court, the terms "sell or otherwise dispose of assets outside of the ordinary course of business" in subsection 36(1) of the *CCAA* permit a wide range of acts and methods of disposition, including by way of the reverse vesting structure, in accordance with the wide discretionary powers afforded a supervising judge pursuant to section 11 of the *CCAA*.[49]

The Québec Superior Court did not accept the objecting creditor's argument that the reverse vesting structure robbed creditors of a fundamental right to vote under the *CCAA* as far as creditor approval is required for the usual process through which a debtor's shares can be acquired. The court was of the view that, given its finding that the authority to approve the reverse vesting

---

[46] *Nemaska* Decision, *supra* note 28 at para. 4.

[47] *Nemaska* Decision, *supra* note 28.

[48] *Nemaska* Decision, *supra* note 28 at para. 71.

[49] *Nemaska* Decision, *supra* note 28 at paras. 71, 74.

transaction and issue the reverse vesting order was grounded in section 36 of the *CCAA*, and since sales pursuant to section 36 of the *CCAA* require only court approval, there was no prejudice to *Nemaska*'s creditors in proceeding with a reverse vesting transaction outside of any plan of arrangement.[50] The Québec Court of Appeal refused a subsequent application by the creditor and certain shareholders for leave to appeal the decision.[51] Further leave was denied by the Supreme Court of Canada.[52]

(ii) Quest

In the *CCAA* proceedings of *Quest*, a private liberal arts and sciences post-secondary institution, a reverse vesting transaction was utilized to preserve the debtor's statutory license to grant post-secondary degrees. Notably, the reverse vesting structure was not the initial structure, but was utilized when it became apparent that implementation through a plan of arrangement would likely fail due to certain creditor opposition.

Quest ran a sales process in its *CCAA* proceedings and accepted an offer from a third-party purchaser for a going concern sale that, as originally proposed, provided for the purchaser to acquire substantially all of *Quest*'s assets through a traditional asset sale, and then lease such assets back to *Quest*. The transaction was conditional on, among other things, *Quest* disclaiming its leases with Southern Star Developments ("**Southern Star**"), the owner of on-campus residences and a significant creditor of *Quest*, and implementing a plan of arrangement. In this structure, *Quest*'s post-secondary degree granting license would be preserved by remaining with the same legal entity, and unwanted liabilities would be addressed by the plan of arrangement to improve *Quest*'s financial position moving forward.

The structure was problematic because Southern Star's claim that would arise from *Quest* disclaiming the leases with Southern Star would be large enough, when combined with the claims of another creditor who intended to oppose the plan, to give Southern Star a veto over plan approval.[53] Southern Star took issue with the disclaimer of its leases and once Southern Star made it clear that it would not support the proposed transaction, *Quest* and the purchaser amended the transaction to replace the combined asset sale and plan of arrangement with a reverse vesting structure. The primary effect of the change to a reverse vesting structure was that a creditor vote on the transaction would no longer be needed.[54]

---

[50] *Nemaska* Decision, *supra* note 28 at paras. 85-86. Also of note, the supervising judge concluded that the opposing creditor had objected to the reverse vesting transaction largely in an attempt to obtain leverage in negotiations, and thus questioned the legitimacy of the arguments being raised in opposition to the transaction.

[51] *Nemaska* Court of Appeal Decision, *supra* note 28. The Québec Court of Appeal agreed with the supervising judge's determination that the opposing party had been objecting to the transaction as a negotiating tactic, and found that granting leave to appeal would jeopardize the transaction to the detriment of affected parties.

[52] *Nemaska* SCC Decision, *supra* note 28.

[53] See *Quest*, *supra* note 28 at paras. 115-16.

[54] See *Quest*, *supra* note 28 at para. 121. The acquired assets were still transferred to and vested in the purchaser for leasing back to Quest in the revised transaction structure, however, there was an element of "reverse vesting" because unwanted assets and liabilities were vested out and transferred to a ResidualCo (as opposed to being addressed in a plan of arrangement).

Southern Star objected to the proposed reverse vesting transaction on several grounds, including that it unfairly negated its right to vote and that the transfer of its claims to the ResidualCo was improper.[55]

In deciding to approve the proposed transaction, the British Columbia Superior Court delivered detailed written reasons that reviewed reverse vesting transactions previously approved by Canadian courts, including those in *Plasco*, *Stornoway*, *Wayland*, *Comark* and *Nemaska*, and determined that courts have the authority under section 11 of the *CCAA* to approve reverse vesting transactions.[56] As for whether it was appropriate to approve the proposed reverse vesting transaction in the circumstances at hand, the British Columbia Superior Court found that the factors set out in section 36 of the *CCAA* applicable to an asset sale favoured approval of the transaction in this case.[57] Notably, the proposed transaction was the only viable transaction that had emerged from the *CCAA* sale process such that any alternative would be a non-going concern outcome. Further, the debtor's post-secondary degree granting license would be preserved in the proposed transaction, thereby enabling *Quest* to continue as a going concern for the benefit of a broad stakeholder group that included faculty, staff, students, secured and unsecured creditors, suppliers, landlords, and the community more generally. The British Columbia Superior Court concluded that the transaction was "unquestionably the fairest and most reasonable means by which the greatest benefit can be achieved for the overall stakeholder group" and that approval of the proposed reverse vesting transaction in such circumstances aligned with the remedial purpose of the *CCAA*.[58]

Important to the court's decision in approving the *Quest* reverse vesting transaction was its view that Southern Star and the other objecting creditor were "working actively against the goals of the *CCAA*" in opposing the proposed transaction.[59] The court stated that a reverse vesting structure would not generally be approved in a *CCAA* case simply to "rid a debtor of a recalcitrant creditor who may seek to exert leverage through its vote on a plan while furthering its own interests," but in the circumstances of this case, *Quest* was seeking the reverse vesting order in good faith in an effort to achieve the best outcome for all stakeholders.[60]

C. *Harte* and a Specific Reverse Vesting Order Test

The next step in the evolution of the reverse vesting transaction is the *Harte* decision of the Ontario Superior Court.

Harte was a publicly traded Canadian gold mining company. Facing various liquidity and operational challenges, *Harte* undertook an extensive marketing process over the course of the summer and fall of 2021, which ultimately resulted in *Harte* entering into a subscription agreement

---

[55] See *Quest*, *supra* note 28 at para. 126.

[56] See *Quest*, *supra* note 28 at paras. 127, 157.

[57] See *Quest*, *supra* note 28 at para. 178.

[58] See *Quest*, *supra* note 28 at para. 172.

[59] See *Quest*, *supra* note 28 at para. 170.

[60] See *Quest*, *supra* note 28 at paras. 171-72.

with an affiliate of Silver Lake Resources Limited (collectively, "**Silver Lake**"), an Australian gold mine company. Silver Lake had acquired *Harte*'s secured first lien debt facilities and therefore offered to acquire *Harte*'s operations by way of a credit bid transaction to be completed in a *CCAA* process. The transaction was structured as a reverse vesting transaction to preserve the various permits and licenses that *Harte* maintained in order to conduct its gold mining operations.

Harte commenced *CCAA* proceedings with the Silver Lake transaction serving as the stalking horse bid in a further court-approved sales process. Given the extensive pre-filing marketing efforts that led to the Silver Lake transaction, the deadline for binding bids to be submitted in the post-filing sales process was less than 40 days after the initial *CCAA* filing.[61] A further credit bid proposal from *Harte*'s second-ranking secured creditor containing terms superior to the Silver Lake stalking horse bid was received in the post-filing sales process, but after Silver Lake matched the superior bid, all parties agreed that the revised Silver Lake bid would be the successful bid.

The Silver Lake transaction was structured as a relatively standard credit bid reverse vesting transaction involving a publicly traded debtor company in that it involved the cancellation of all of *Harte*'s shares and the issuance of new shares to Silver Lake, and the transfer and vesting out in two ResidualCos of designated excluded assets, contracts and liabilities. There were, however, some unique features, including the payment by Silver Lake of virtually all pre- and post-filing trade amounts. The ultimate value of the consideration payable by Silver Lake under the reverse vesting transaction was estimated to be more than $160 million, significantly more than the amount of *Harte*'s pre-filing secured obligations.

With the reverse vesting transaction structure at this point having been approved by the Ontario Superior Court in several instances with little more than brief written reasons issued as guidance, and with the benefit of the Québec and British Columbia courts having delivered the *Nemaska* and *Quest* decisions, Justice Penny of the Ontario Superior Court used the opportunity in *Harte* to deliver detailed reasons addressing the use of the reverse vesting transaction as a restructuring tool.

In its decision, the court provided a detailed analysis of the statutory basis on which a *CCAA* court can approve a reverse vesting transaction and issue a reverse vesting order, setting out the history and evolution of the structure, from the first reverse vesting transaction in *Plasco* through to the *Nemaska* and *Quest* decisions.[62] Regarding jurisdiction, the court was of the view that, despite no explicit authority in the *CCAA*, courts have the power to issue a reverse vesting order under the section 11 general power, provided that doing so accords with the objects and purposes of the *CCAA*.[63] In this regard, the court emphasized that the authority of *CCAA* courts to issue reverse vesting orders is not without limits, and such transactions should be regarded as an extraordinary measure to be used in appropriate circumstances and not simply because it may be more convenient to the purchaser.[64]

---

[61] The post-filing sales process also took place over the winter holiday period.

[62] *Harte*, *supra* note 5 at paras. 18-37.

[63] *Ibid* at paras. 36-37.

[64] *Ibid* at paras. 37-38.

As for the analytical framework to be applied by courts in determining whether to issue a reverse vesting order, the court was of the view that, although section 36 of the *CCAA* was not sufficient to ground authority for courts to issue reverse vesting orders, as had been suggested in *Nemaska*, the section 36(3) factors that apply to the assessment of a typical asset sale transaction should apply when seeking approval of a reverse vesting transaction, but with modifications to account for the revised structure. In particular, in applying the section 36(3) factors, courts should also consider the following additional factors:

1. Why is the reverse vesting order necessary in this case?;
2. Does the reverse vesting structure produce an economic result at least as favourable as any other viable alternative?;
3. Is any stakeholder worse off under the reverse vesting structure than they would have been under any other viable alternative?; and
4. Does the consideration being paid for the debtor's business reflect the importance and value of the licences and permits (or other intangible assets) being preserved under the reverse vesting structure?[65]

Applying the section 36(3) factors, with reference throughout to the above referenced additional considerations, the court was satisfied that the company and the monitor had demonstrated that a reverse vesting structure was appropriate in the circumstances and approved the transaction. The court was satisfied that the reverse vesting structure was necessary in the circumstances to preserve the many permits and licenses necessary for *Harte* to conduct its gold mining operations, and that the structure produced an economic result superior to any alternatives.[66] As for whether any stakeholder was worse off as a result of the reverse vesting structure, the court noted that the reverse vesting structure was not being used to thwart creditor opposition, and as such, there were no concerns of creditor democracy being undermined.[67] Almost all creditors would be repaid in full as part of the closing of the transaction, and no creditor was being placed in a worse position because of the reverse vesting structure than they would be under a traditional asset sale structure or, under any plausible plan of compromise.[68] Finally, the court was easily satisfied that the consideration being paid reflected the importance and value of *Harte*'s licences and permits being preserved under the reverse vesting structure.[69] Silver Lake had increased the consideration at multiple stages and was paying considerably more than the value of the secured debt.

At the end of the day, the reverse vesting transaction enabled the many permits and licenses needed for *Harte* to conduct its gold mining operation to be preserved. It also facilitated continued employment for all but four of *Harte*'s approximately 280 employees and contractors, and the retention and payment in full of almost all creditor claims, which were unaffected by the transaction. In an asset sale transaction, Silver Lake would have had to apply to the various

---

[65] *Ibid* at para. 38.

[66] *Ibid* at paras. 46-49. The court was satisfied that the sale process demonstrated that the Silver Lake transaction was the highest and best offer available for *Harte*'s business and assets, and would produce a result superior than a bankruptcy.

[67] *Ibid* at para. 57.

[68] *Ibid* at para. 58.

[69] *Ibid* at para. 67.

agencies and regulatory authorities for transfer of existing licenses and permits or, if transfers were not possible, for new licenses and permits. This would have caused a significant degree of uncertainty and delay. Silver Lake, as the interim lender in addition to the proposed purchaser, was unwilling to continue to fund ongoing operations and the *CCAA* process in circumstances where it had to seek relevant government consents to transfer necessary licenses and permits or apply for newly issued versions of same, the implication being that *Harte*'s gold mine would need to be put on care and maintenance if an asset-sale was required (or if *Harte* was required to pursue a restructuring via a plan of arrangement). As such, the reverse vesting transaction was the only option available in the circumstances to facilitate a going concern sale of *Harte*'s business.

IV. BENEFITS OF A REVERSE VESTING TRANSACTION

A. Speed and Efficiency

As described above, a restructuring completed through a *CCAA* plan of arrangement, even if uncontested, is a time-consuming process. Asset sales, in comparison, can facilitate a going concern restructuring transaction more quickly.

Reverse vesting transactions can be completed on a timeline similar to a typical sale-based restructuring. After negotiating the transaction with the purchaser and other key stakeholders, the debtor company brings an application for its approval by the court. Provided that court approval is obtained, the transaction can be implemented without further creditor and stakeholder approvals, except as required pursuant to the definitive transaction agreement. As is the case with asset sale transactions, where the debtor has the financial runway, a reverse vesting transaction can serve as a stalking horse bid in a *CCAA* sale process, thus limiting the time in which the debtor is under court protection before consummating a restructuring transaction. For example, in *Harte*, the Silver Lake reverse vesting transaction closed within 60 days of obtaining court approval as the stalking horse bid.

B. Solution to Asset Transfer and Assignment Issues

Although asset sales in the insolvency context can typically be completed more quickly than the acquisition of a debtor's shares completed through a plan of arrangement, it is generally accepted that asset transactions are typically more complicated and difficult to implement as compared to a share transaction. In contrast to a share transaction, the purchaser in an asset sale is only acquiring the assets described in the transaction agreement, meaning the purchaser must describe the particular assets being acquired. Although it is common in *CCAA* asset sales to broadly describe the assets being acquired, particularly when the transaction involves the going concern acquisition of all the assets that comprise the debtor's business, there is almost always difficulties with identifying and describing the acquired assets in an asset sale scenario, particularly in a distressed situation. The reverse vesting structure solves this issue by enabling purchasers to only have to identify the particular assets and liabilities that they do not wish to assume. This significantly reduces the burden on the purchaser to identify and describe the acquired assets.

In addition, the transfer of assets in an asset transaction requires the parties to obtain any approvals and consents necessary to transfer the purchased assets from the debtor company to the purchaser. Approvals and consents may be required to transfer trade contracts, leases, government licences and permits, and other authorizations and agreements necessary for the continued operation of the business.

Although some transfers can be completed through the court approval process, other transfers require third-party consents and cannot be effected by court order. Section 11.3 of the *CCAA*, which permits the court to overrule an objection to assignment and force the assignment of an agreement, excludes post-filing agreements, "eligible financial contracts," and agreements that arise under a collective agreement.[70] Further, governmental licenses, by their nature as statutory instruments, are not typically considered to be an "agreement" that can be assigned under section 11.3.[71] The process of negotiating, obtaining and documenting these approvals can be time-consuming. In some cases, it may not be possible to transfer or assign an agreement or authorization that is vital to the continued operation of the business as a going concern. This has been the case in a number of the reverse vesting transactions implemented to date, such as in the *Wayland* and other cases involving licensed cannabis producers, where the Health Canada licences required to operate a cannabis business could not be transferred to the purchaser, and in *Harte* where the permits and licenses needed for *Harte* to conduct its gold mining operation could not be readily transferred.

The reverse vesting transaction structure addresses these asset transfer and assignment issues because the acquired assets are retained within the existing corporate entity. This means that the debtor's contracts do not have to be assigned, and government licences and permits that are issued in the name of the existing debtor company do not need to be transferred. In this way, the reverse vesting transaction replicates the effect of a *CCAA* plan of arrangement through a revised structure that addresses timing and other structuring considerations that often make plans or arrangement impracticable to pursue and implement.

C. Preservation of Tax Attributes

Not surprisingly, it is common for debtor companies facing potential insolvency or restructuring proceedings to have incurred relatively significant operating losses in the lead-up to their initiation of *CCAA* proceedings. As Canadian tax law generally permits operating losses to be applied against future income to reduce taxes payable in respect of such income, these losses can have significant value.

However, the only practical means by which a purchaser can obtain the benefit of the debtor company's tax losses is by acquiring its shares, which, in the insolvency context, has traditionally only been achievable through implementation of a *CCAA* plan of arrangement. The reverse vesting transaction structure presents another transaction option for a purchaser to acquire the shares of

---

[70] Pursuant to section 11.3(2) of the *CCAA*, a court may not make an order assigning the rights and obligations of a debtor company under any agreement that is not assignable by its nature or that arise under a post-filing contract, an eligible financial contract, or a collective agreement. The meaning of "eligible financial contract" is set out by regulation under the *CCAA* and generally includes complex financial instruments, such as swaps, forwards, and other derivative instruments.

[71] For a detailed discussion regarding the assignability of cannabis licenses, see Maria Konyukhova and Nicholas Avis, "The Crash After the High: Managing Insolvency in the Cannabis Sector", (2020) Annual Rev. Insolvency L. 14 (WL Can.).

the debtor and thus maintain the business assets and tax losses in the same corporate entity, thereby preserving and monetizing tax losses in circumstances where a plan is unavailable.[72] Preserving tax losses was a central consideration in determining to proceed with a reverse vesting transaction in each of *Plasco*, *Stornoway*, *Comark* and *Nemaska*, as well as a number of other reverse vesting transactions.[73]

The desire to preserve tax losses and other tax attributes in the debtor corporation can be a significant factor in determining transaction structure, but the value of such losses and attributes will not always be sufficient to warrant a purchaser proceeding via a plan of arrangement when an asset sale transaction would otherwise be the preferable transaction route. The reverse vesting transaction therefore provides another path to preserve tax attributes where a *CCAA* plan of arrangement is not feasible in the circumstances.

D. Ability to "Cherry Pick"

In an asset sale, the purchaser has the flexibility to determine the specific assets and obligations of the target company that it is prepared to acquire and assume. This ability to "cherry pick" assets and acquire them free and clear of liabilities and encumbrances is an important feature of asset sale transactions, which is replicated in a share sale context through the reverse vesting structure by the purchaser selecting the excluded assets and liabilities that are transferred to and vested in the ResidualCo, leaving the assets and obligations that it is prepared to acquire and assume behind with the acquired entity. This includes choosing whether to acquire the subsidiaries of a debtor company, since the shares of a subsidiary are assets of the debtor company and can be treated as either a retained asset or an excluded asset under a reverse vesting transaction. This cherry picking of assets is something which is not available to the purchaser in a standard share sale transaction outside of insolvency.

E. Ability to Obtain Broad Releases

Although the *CCAA* does not specifically set out any explicit authority or framework for the approval of releases, other than to provide at section 5(1) that a plan of arrangement may compromise pre-filing claims against a debtor's directors, broad releases are common features of plans of arrangement and have also been granted in asset sale transactions.[74] Beneficiaries of releases granted in *CCAA* proceedings include, among other parties, the debtor company, its directors, officers, and employees, the court-appointed monitor, counsel, and purchasers.

---

[72] As explained further by Pickett and Rogers, if the quantum of liabilities being transferred to the ResidualCo is greater than the debtor company's tax losses, such losses may be reduced in connection with the completion of the transaction as a result of the debt forgiveness rules of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), which generally provide that if debt is cancelled, forgiven or discharged for less than the amounts owed, the amount of the cancelled, forgiven or discharged debt might be taxable.

[73] See e.g. the reverse vesting transactions completed in the *CCAA* proceedings of *JMX Contracting Inc. et al*, *Bellatrix Exploration Ltd.*, *Dominion Diamond Mines ULC et al*, *Cirque du Soleil Canada Inc. et al*, *Salt Bush Energy Ltd et al*. For a discussion on tax considerations in reverse vesting situations, see Pickett & Rogers, "The Business Side of Reverse Vesting Orders", *supra* note 24.

[74] Releases are generally sanctioned under the general section 11 power of the *CCAA*.

Releases have also been approved in a number of reverse vesting transactions, including in the face of opposition. In connection with the approval of a reverse vesting transaction in *Green Relief Inc.*, the Ontario Superior Court approved the granting of a release in favour of the debtor company's directors, officers, employees, agents, legal counsel, and advisors, as well as the monitor and its legal counsel.[75] The release was opposed by several parties on a variety of grounds, including on the basis that the court did not have the jurisdiction to approve the proposed release because no plan of arrangement was proposed.[76] The court disagreed with this objection and held that the absence of a plan of arrangement did not deprive the court of the jurisdiction to approve a release.[77]

V. CURRENT STATE AND OUTLOOK

With at least 15 reverse vesting orders being issued by *CCAA* courts over an approximately two-year span from April 2020 to the *Harte* decision in February 2022, it is clear that reverse vesting transactions have emerged as a popular Canadian restructuring tool. The *Harte* decision is clear that reverse vesting transactions are to be considered extraordinary relief, and not the norm alongside a plan of arrangement and asset sale transaction, each of which are specifically permitted under the *CCAA*. *Harte* is indicative of a maturation of the reverse vesting structure as a useful tool in the Canadian restructuring toolkit that is to be applied in appropriate circumstances to facilitate value-maximizing transactions where certain obstacles make the traditional tools ineffective. As support for this view, at the time of writing this article, at least five reverse vesting orders have been issued in Canadian insolvency proceedings in the approximately three and a half months that have passed since *Harte*.[78]

The adoption in *Harte* of a specific legal framework that courts are to consider in determining whether to approve a reverse vesting transaction requires those parties seeking to avail themselves of the structure to demonstrate that the use of a reverse vesting transaction is appropriate in the circumstances and does not cause undue prejudice to stakeholders relative to other viable restructuring alternatives. As such, it is worthwhile to consider the circumstances in which a Canadian court might find the additional *Harte* factors to be satisfied.

(i) When is a reverse vesting order necessary?

The most obvious scenario in which a reverse vesting transaction might be considered necessary is where the debtor company operates in a highly regulated industry. The *Harte* decision builds upon earlier case law in recognizing that a principal benefit of the reverse vesting structure is the

---

[75] *Re Green Relief Inc.*, 2020 ONSC 6837.

[76] *Ibid* at para. 19.

[77] *Ibid* at paras. 23, 25.

[78] See *MediFocus Inc., Re* (8 February 2022), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-21-00669781-00CL (Re Transaction Approval, Reverse Vesting Order, Stay Extension, Monitor's Approvals, and *CCAA* Termination); *Ayanda*, *supra* note 6; *Orionis Corporation v. Ontario Graphite Ltd.* (14 March 2022), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-20-00634195-00CL (Approval and Vesting Order); *Balanced Energy Oilfield Services Inc., Re* (30 March 2022), Calgary, Alta. Ct. Q.B. 2201-02699 (Approval and Reverse Vesting Order);*., Re* (12 May 2022), Calgary, Alta. Ct. Q.B. 2001-10261 (Approval and Vesting Order).

preservation of non-transferable regulatory approvals and licenses. Where a debtor company's business depends on regulatory approvals and licenses, it is likely that a court would consider the reverse vesting structure to be necessary in circumstances where a plan of arrangement is unavailable or impracticable. A plan of arrangement may be unavailable or impractical, for example, where time pressures do not allow sufficient runway for a plan process.

For example, in the *CCAA* proceedings of *Medifocus Inc.*, a company engaged in the research, development and sale of medical device systems that deliver focused microwave-generated heat to treat diseased tissue, approval of a reverse vesting transaction was obtained shortly after the *Harte* decision was released.[79] The proposed transaction was structured as a reverse vesting transaction to preserve non-transferable approvals from the United States' Food and Drug Administration ("**FDA**") and similar approvals from relevant authorities in various foreign countries, which were a key component of value for the debtor company.[80] The debtor company's submissions to the court focused on the fact that any asset transfer would risk resulting in a loss of FDA approval and consequently the various Asian approvals that were tied to FDA approval, thereby causing the proposed credit-bidding purchaser to enter into a lengthy and costly consent or re-licensing process, effectively eliminating any going concern value.[81]

A reverse vesting transaction might also be considered necessary where it is proposed as a means of creating additional value through a debtor's corporate entity that remains following a sale-based restructuring. For example, a reverse vesting transaction involving a debtor's remaining corporate entity might be appealing to a potential purchaser if the debtor is a reporting issuer. In this scenario, where a reverse vesting order is granted after a debtor has sold substantially all of its assets, the reverse vesting structure enables the creation of value for creditors that would not be available in the absence of such structure.

Finally, a reverse vesting transaction might also be considered necessary where an asset transaction is ill-suited and time pressures mean a plan of arrangement cannot be undertaken. Distressed situations may arise where a share transaction is the preferred transaction form, but there are real timing pressures that do not allow for a plan process. In such cases, the ability to implement a transaction on an expedited timeline can preserve going concern value where it might otherwise be lost.

(ii) Demonstrating that a reverse vesting structure produces an economic result at least as favourable as any other viable alternative

The first step in determining whether a reverse vesting transaction provides an economic result at least as favourable as any other viable alternative, is to set out the other viable alternatives against which to compare the proposed reverse vesting transaction. While a plan of arrangement is one of the two traditional transaction structures used in Canadian restructuring proceedings and may be the preferred route to implementing a restructuring where a debtor company has sufficient

---

79 *MediFocus Inc., Re* (2 February 2022), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-21-00669781-00CL (Affidavit of Raymond Tong at para. 2).

80 *Ibid* at paras. 18-19.

81 *MediFocus Inc., Re* (2 February 2022), Toronto, Ont. Sup. Ct. J. [Commercial List] CV-21-00669781-00CL (Supplementary Factum of MediFocus Inc. at paras. 11-12).

liquidity, as noted above, this structure will not always be available as a viable alternative because of funding issues or timing issues applicable to the underlying business being restructured.

Wayland and *Plasco* were both examples of cases in which the secured creditors were facing a significant deficiency and the debtor companies needed to implement a share sale transaction but did not have the liquidity to advance a *CCAA* plan of arrangement. Similarly, in *Harte*, the court emphasized that the pre- and post-filing sale efforts had made clear that the only parties willing to bid for the debtor company were secured creditors, and they were only willing to bid the value of the secured debt plus carrying and process costs. *Harte* is also an example where timing pressures made a plan of arrangement ill-suited. As noted above, the purchaser, who was also providing interim financing, was unwilling to fund operations where it would need to either obtain government consents to transfer or re-apply for required licenses and permits. It is reasonable to infer that the purchaser was also unwilling to continue to fund operations through a prolonged plan process, particularly in a credit bid scenario. Accordingly, a plan process would have led to the debtor's gold mine being put on care and maintenance, thereby significantly eroding going concern value.

In cases where a plan of arrangement is not a viable alternative, the alternatives against which to compare a proposed reverse vesting transaction is an asset sale or liquidation. If an asset sale is not suited to implement the transaction given the nature of the business or assets, the comparison focuses on a liquidation. It is often the case that a going concern reverse vesting transaction will provide superior recoveries to creditors than a liquidation, as the purchaser in a going concern scenario usually is willing to pay a premium for the operational business.

(iii) Treatment of stakeholders as compared to under other viable alternatives

Similar to the second *Harte* factor, determining whether the reverse vesting structure would place any stakeholder in a worse position involves consideration of the other viable alternatives. If a plan of arrangement is not a viable alternative, this again would result in comparing the treatment of stakeholders in the reverse vesting transaction as against their treatment in an asset sale or liquidation. In *Harte* no creditor was being placed in a worse position than they would in an asset sale. In addition to the process having clearly demonstrated that unsecured creditors were out of the money, such that there would be no proceeds from any asset transaction available for distribution to unsecured creditors, the reverse vesting transaction provided for payment of all or substantially all of the debtor's pre-filing trade liabilities and any cure costs in respect of contracts. With respect to shareholders, the court in *Harte* found that they had no reasonable economic interest given the results of the extensive sale efforts, and in any event, adequate disclosure had been made to inform shareholders that they had little or no prospect of recovery.

(iv) Requirement that the consideration being paid reflects the importance and value of the licences and permits (or other intangible assets) being preserved under the RVO structure

The fourth *Harte* factor for consideration in determining whether to approve a reverse vesting transaction, is likely to be a very fact-based analysis. The concern that the court was trying to address with this factor was whether the credit bidding purchaser, in proceeding via a reverse vesting structure, was effectively "getting something" in the reverse vesting transaction – being *Harte*'s licences and permits, which were not clearly subject to Silver Lake's security – for nothing.[82] While the debtor's licenses and permits had not been valued, the court noted that such licenses and permits would likely have no value in a bankruptcy, and further, the pre- and post-filing sale efforts had clearly demonstrated that "no one else among the universe of potential purchasers of an operating gold mine in Northern Ontario was willing to pay more than Silver Lake was willing to pay."[83] On this basis, the court was satisfied that this was not a scenario where a purchaser was getting "something" for "nothing."

(v) Additional considerations regarding the appropriateness of an RVO

As the *Harte* factors present additional, but non-exhaustive, factors to be considered in the context of a reverse vesting transaction, it will be important in each case to consider whether any additional considerations are relevant. In particular, it will likely be important going forward for debtors and purchasers in reverse vesting scenarios to demonstrate that the structure is not being used as a means of circumventing the statutory protections of the *CCAA*, such as creditor voting or other relevant mechanisms. For example, in *Harte*, the purchaser's commitment to pay any cure costs in respect of the debtor's contracts demonstrated to the court that the reverse vesting structure was not being used to escape the payment of amounts that would ordinarily be payable in a typical asset sale structure.

VI. CONCLUSION

There is the well-known proverb that "necessity is the mother of invention." The reverse vesting transaction has emerged in Canada as a third form of restructuring transaction structure that facilitates going concern restructurings in circumstances where the traditional approaches – a *CCAA* plan of arrangement or a court-approved asset sale – are impracticable from a timing, cost or structural perspective. The reverse vesting structure facilitates the acquisition of the shares of a debtor company on a restructured basis where a plan of arrangement is unavailable or impracticable, and preserves valuable estate assets that may be forfeited in an asset sale transaction.

As with most innovations, there has been some growing pains along the way. But with the formation in *Harte* of a new set of factors for courts to apply when considering the appropriateness of a proposed reverse vesting transaction, there is now a framework in place to determine the circumstances in which a departure from a plan of arrangement or asset sale is appropriate. In some cases, a reverse vesting transaction may be the only viable alternative to a liquidation and thus will clearly maximize value for stakeholders, while also furthering the goals of the *CCAA* by facilitating restructurings and avoiding the social and economic costs of firm failure.

Canadian restructuring law has often been characterized as consisting of a flexible and facilitative framework under which courts and practitioners are able to craft creative solutions to address the ever-changing challenges that come before them. Going forward, the frequency with which reverse vesting transactions will be presented for court approval remains to be determined. It also remains

---

[82] *Harte*, *supra* note 5 at para. 67.

[83] *Harte*, *supra* note 5 at para. 68.

to be determined whether other jurisdictions will take note of Canada's latest restructuring innovation and the benefits that come with it.

APPENDIX 1

Summary of Reverse Vesting Transactions Approved by Courts in Canadian Restructuring Proceedings

Debtor	Jurisdiction	Proceeding Type	Monitor / Trustee	Filing Date	Date of Reverse Vesting Order	Industry	Opposed / Unopposed
Plasco Energy Group Inc.	Ontario	CCAA	EY	9-Feb-15	17-Jul-15	Waste management / energy	Unopposed
Stornoway Diamond Corporation	Quebec	CCAA	Deloitte	9-Sep-19	7-Oct-19	Mining	Unopposed
Wayland Group Corp.	Ontario	CCAA	PwC	2-Dec-19	21-Apr-20	Cannabis	Unopposed
Comark Holdings Inc.	Ontario	CCAA	A&M	3-Jun-20	13-Jul-20	Retail	Unopposed
Beleave Inc.	Ontario	CCAA	Grant Thornton	5-Jun-20	18-Sep-20	Cannabis	Unopposed
Nemaska Lithium Inc.	Quebec	CCAA	PwC	23-Dec-19	15-Oct-20	Mining	Opposed

Debtor	Jurisdiction	Proceeding Type	Monitor / Trustee	Filing Date	Date of Reverse Vesting Order	Industry	Opposed / Unopposed
JMB Crushing Systems Inc.	Alberta	CCAA	FTI	1-May-20	16-Oct-20	Manufacturing	Unopposed
Cirque du Soleil	Quebec	CCAA	EY	30-Jun-20	26-Oct-20	Media	
Green Relief Inc.	Ontario	CCAA	PwC	8-Apr-20	9-Nov-20	Cannabis	RVO unopposed, but third-party releases opposed
Quest University	British Columbia	CCAA	PwC	16-Jan-20	16-Nov-20	Education	Opposed
Tidal Health Solutions Ltd.	Quebec	NOI	PwC	29-Jul-20	20-Nov-20	Cannabis	Unopposed
Tribalscale Inc.	Ontario	CCAA	MNP	NOI - 19-May-20; CCAA - 31-Jul-20	11-Jan-21	Technology	Unopposed
JMX Group	Ontario	CCAA	Crowe Soberman	NOI - 20-Apr-20; CCAA - 29-Sep- 20	2-Feb-21	Construction	Opposed
Salt Bush Energy Ltd.	Alberta	CCAA	Deloitte	13-Jan-21	21-May-21	Oil & Gas	Unopposed

Debtor	Jurisdiction	Proceeding Type	Monitor / Trustee	Filing Date	Date of Reverse Vesting Order	Industry	Opposed / Unopposed
Vert Infrastructure Ltd.	British Columbia	Receivership	KSV	16-Jun-20	8-Jun-21	Financial Services	Unopposed
Bellatrix Exploration Ltd.	Alberta	CCAA	PwC	2-Oct-19	22-Jun-21	Oil & Gas	Unopposed
Port Capital Development (EV) Inc.	British Columbia	CCAA	EY	29-May-20	23-Jun-21	Real Estate	Unopposed
North American Lithium Inc.	Quebec	CCAA	Raymond Chabot	23-Dec-19	29-Jun-21	Mining	Opposed
Clearbeach Resources Inc.	Ontario	CCAA	MNP	NOI - 22-Jul-20; CCAA - 20/05/21	14-Jul-21	Oil & Gas	Opposed
Dominion Diamond Mines	Alberta	CCAA	FTI	23-Apr-20	16-Nov-21	Mining	Initially opposed, but the parties settled on a form of order

Debtor	Jurisdiction	Proceeding Type	Monitor / Trustee	Filing Date	Date of Reverse Vesting Order	Industry	Opposed / Unopposed
Junction Craft Brewing Inc.	Ontario	NOI	Richter	15-Oct-21	17-Dec-21	Food & Accommodation	Unopposed
Harte Gold Corp.	Ontario	CCAA	FTI	7-Dec-21	28-Jan-22	Mining	Unopposed
MediFocus Inc.	Ontario	CCAA	Spergel	NOI - 09/08/21 CCAA - 10/07/21	8-Feb-22	Biotech	Unopposed
Ayanda Cannabis Corporation	Ontario	NOI	Richter	4-Feb-22	1-Mar-22	Cannabis	Unopposed
Ontario Graphite	Ontario	CCAA	Deloitte	12-Feb-20	14-Mar-22	Mining	Unopposed
Ontario Graphite Ltd.	Ontario	CCAA	Deloitte	12-Feb-22	14-Mar-22	Mining	Unopposed
Balanced Energy Oilfield Services Inc.	Alberta	Receivership	FTI	7-Mar-22	30-Mar-22	Oil & Gas	Unopposed

Debtor	Jurisdiction	Proceeding Type	Monitor / Trustee	Filing Date	Date of Reverse Vesting Order	Industry	Opposed / Unopposed
Glenogle Energy Inc.	Alberta	CCAA	EY	NOI - 14-May-22; CCAA - 8-Sep-2020	12-May-22	Oil & Gas	Unopposed

7267710.5

RECOGNITION AND ENFORCEMENT OF FOREIGN SALES ORDERS UNDER 11 U.S.C. §1520(a)(2)

Robert J. Keach (rkeach@bernsteinshur.com)

Letson Douglass Boots (lboots@bernsteinshur.com)

Bernstein Shur

Portland, Maine

Issues with International Asset Sales

2022 ABI Midwestern Bankruptcy Institute

October 6-7, 2022

I. Introduction

Foreign courts administering foreign insolvency proceedings, whether liquidations or rescue (restructuring) proceedings, may enter orders approving sales of assets either actually or legally within the United States. Those orders may contain terms—such as free and clear language—that require enforcement; moreover, parties may want the comfort of a U.S. court order to effectuate the transfer. Parties who objected to the approval of the sale in the foreign proceeding may wish to challenge recognition and enforcement of the order in the U.S., hoping for the proverbial "second bite." Thus, fundamental questions arise as to the jurisdiction of the U.S. court, and the standard to be applied in determining whether to recognize and enforce the foreign sale order.

Chapter 15 of the Bankruptcy Code—the U.S. version of the United Nations Commission on International Trade Law ("UNCITRAL") Model Law on Cross-Border Insolvency (the "Model Law")—provides a process for U.S. courts to recognize foreign insolvency proceedings.[1] Upon recognition, the chapter 15 court may enter relief in aid of the foreign proceeding.[2] One such form of relief is an order enforcing, within the U.S. and against U.S. creditors, orders entered in the foreign proceeding. Typically, the standard employed by the U.S. chapter 15 court is whether to extend comity to the order (and whether enforcement of the order would be manifestly contrary to the public policy of the United States under section 1506), not whether U.S. law would have permitted entry of the order in the first instance.[3] Enforcement of sale orders however, under prevailing case law, may be a different story.

[1] 11 U.S.C. §§ 1515-1517.
[2] 11 U.S.C. §§ 1507, 1520, 1521.
[3] *See, e.g.*, In re Sino-Forest Corp., 501 B.R. 655 (Bankr. S.D.N.Y. 2013); In re Metcalfe & Mansfield Alt. Invs., 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

As noted, one of the key relief provisions of chapter 15 is section 1520, which provides certain automatic, mandatory relief upon the recognition by a U.S. bankruptcy court of a "foreign main proceeding"—a "foreign proceeding pending in the country where the debtor has the center of its main interests."[4] The relief provided in section 1520 occurs automatically upon recognition; the debtor need not request it, and the court lacks discretion whether to grant it.[5] In that vein, section 1520(a)(2) provides that section 363 "appl[ies] to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that [section 363] would apply to property of an estate."[6] The precise meaning of this section, and the interplay with the usually central role of comity, has been considered by courts over the past decade. At least two issues arise: (1) when is property within the territorial jurisdiction of the United States, thus triggering the application of the section; and (2) what does it mean—and what does it mean for considerations of comity—that section 363 applies "to the same extent that the section would apply to property of the estate." Decisions to date provide some answers to both questions.

II. Interpreting 11 U.S.C. § 1520(a)(2): Overview of the Case Law

Following the enactment of chapter 15 of the Bankruptcy Code in 2005, courts have explored the contours of the mandatory relief provided for in section 1520 and whether principles of comity apply to such mandatory relief.

a. In re Elpida Memory, Inc.

In In re Elpida Memory, Inc., the Bankruptcy Court for the District of Delaware considered—as a matter of first impression—"what legal standard applies in a Chapter 15 case to

[4] 11 U.S.C. § 1502(4).
[5] 11 U.S.C. § 1520(a); *see also* In re Ace Track Co., 556 B.R. 887, 915 (Bankr. N.D. Ill. 2016) (noting the mandatory nature of section 1520(a)(2)); In re Elpida Memory, Inc, No. 12-10947, 2012 WL 6090194, at *3 (Bankr. D. Del. Nov. 20, 2012). This is in contrast with section 1521, which provides additional relief that, upon recognition, a debtor can request and a court has discretion to grant or deny. *See* 11 U.S.C. § 1521(a).
[6] 11 U.S.C. § 1520(a)(2).

the transfer of assets located in the United States pursuant to a 'global' transaction previously approved by another court in a foreign main proceeding."[7] The debtor, Elpida Memory, Inc., filed a petition for commencement of corporate reorganization under the Japan Corporate Reorganization Act in Tokyo, and the Tokyo District Court appointed trustees of the debtor and an examiner.[8] Shortly thereafter, the trustees filed a petition in the bankruptcy court to commence a chapter 15 case, and the bankruptcy court subsequently entered an order recognizing the bankruptcy case as a foreign main proceeding.[9] Once the proceeding was recognized in the U.S., the trustees—recognized by the bankruptcy court as foreign representatives—filed motions pursuant to section 363 for authorization to enter into certain sale transactions that had been approved by the Tokyo District Court. In its review of those motions, the bankruptcy court considered (a) what standard should a U.S court apply to a section 363 motion in a chapter 15 case where the foreign main proceeding has been recognized by the U.S court, and (b) to what extent—if any—the principles of comity must be considered in that analysis.[10]

In its decision, the bankruptcy court looked to the plain meaning of section 1520(a) to conclude that the text of the section "clearly provides that section 363 and, by implication, its standards are applicable to the transfer of assets located in the United States by a foreign debtor in a foreign main proceeding outside of the ordinary course of business."[11] The Elpida Memory court then noted that "[t]he section 363(b) standard is well-settled" and listed the four-factor test that the Third Circuit applies to determine whether to grant a section 363 motion, explaining that "under

[7] Elpida Memory, 2012 WL 6090194, at *1.
[8] Id.
[9] Id.
[10] Id. at *3-9.
[11] Id. at *5.

the plain meaning of section 1520(a)(2), this test is applicable to [the foreign representatives' section 363 motions]."[12]

Although the inquiry could have ended there, the bankruptcy court went on to consider whether, in a chapter 15 proceeding, the "plain meaning should be subservient to legislative history or more general principles of comity."[13] Reviewing the Model Law and the legislative history for chapter 15, the bankruptcy court concluded that it would reach the same result: that the four-factor test would apply.[14]

Turning next to the issue of comity, the bankruptcy court noted that while "[d]ecisions relating to Chapter 15 routinely invoke the principle of comity . . . only two provisions in Chapter 15 actually mention comity."[15] Those two sections are section 1507—which provides that a court is authorized to grant "additional assistance" under the Bankruptcy Code and the laws of the United States, so long as it is consistent with the principles of comity—and section 1509(b)(3)—which directs a court to grant comity to the foreign representative once he or she obtains recognition.[16] Having explained that "[t]he principle of comity has never meant categorical deference to foreign proceedings,"[17] the bankruptcy court emphasized that to "require this Court to defer in all instances to [a] foreign court decision would gut section 1520."[18] Unlike other provisions of chapter 15, "Section 1520 is mandatory."[19] The court noted that section 1507 is inapplicable because "the Foreign Representatives are not seeking 'additional assistance,'" and, likewise, section 1509 is

[12] Id. (explaining that "the courts in this Circuit require that a sale satisfy four requirements (1) a sound business purpose exists for the sale; (2) the sale price is fair; (3) the debtor has provided adequate and reasonable notice; and (4) the purchaser has acted in good faith").
[13] Id.
[14] Id. at *5-7.
[15] Id. at *8.
[16] 11 U.S.C. §§ 1507, 1509(b)(3).
[17] Elpida Memory, 2012 WL 6090194, at *8 (quoting In re Treco, 240 F.3d 148, 157 (2d Cir. 2001)).
[18] Id.
[19] Id.

inapplicable because it "requires only that the court grant comity to the *foreign representative*—not the foreign court or the orders entered by such a court."[20] In its conclusion, the Elpida Memory court noted that "[w]hile this Court is cognizant of the importance of comity, especially in the context of Chapter 15, it cannot ignore the plain meaning of section 1520(a)" and held that it "must apply the well-settled standard governing a sale of assets under section 363 of the Bankruptcy Code."[21]

b. In re Fairfield Sentry Ltd.

Shortly after the Delaware bankruptcy court entered its order in Elpida Memory, the Bankruptcy Court for the Southern District of New York considered a similar issue in a chapter 15 case of a British Virgin Islands debtor—Fairfield Sentry Ltd (the "Debtor").[22] After commencement of liquidation proceedings in the BVI, the foreign representative of the Debtor and other related debtors filed a petition in the Bankruptcy Court for the Southern District of New York, seeking recognition of the BVI liquidation proceedings as foreign main proceedings, which the court granted.[23] The foreign representative then filed a motion in the chapter 15 court for the *disapproval* of a certain sale approved by the BVI court pursuant to section 363. The subject of the section 363 motion was a sale of certain claims of the Debtor under the Securities Investor Protection Act (the "SIPA Claim").[24] At issue before the bankruptcy court was whether it "should conduct a best interests of the estate review under section 363 . . . in considering disapproval of the Sale."[25]

---

[20] Id. (emphasis in original).
[21] Id. at *9.
[22] In re Fairfield Sentry Ltd., 484 B.R. 615 (Bankr. S.D.N.Y. 2013).
[23] Id. at 618-19.
[24] Id. at 619-22.
[25] Id. at 622.

The bankruptcy court in Fairfield Sentry, like the Delaware bankruptcy court in Elpida Memory, started with a review of the statutory language of section 1520(a).[26] The parties in Fairfield Sentry disputed the phrase "transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States" contained in section 1520(a)—language not analyzed in any depth in Elpida Memory.[27] The court concluded that the "Sale does not involve a Section 1520(a)(2) Transfer because the allowed SIPA Claim is not 'within the territorial jurisdiction of the United States."[28]

Section 1502(8) defines "within the territorial jurisdiction of the United States" as:

> [T]angible property property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States.

Applying New York law, the bankruptcy court evaluated whether the SIPA Claim would be considered property "within the territorial jurisdiction of the United States" for the purposes of section 1520(a)(2), and concluded that "convenience and common sense dictate that this Court find that the SIPA Claim is located with the debtor in the BVI," because the liquidator of the Debtor, which was appointed by the BVI court, "is deemed to have custody and control of all of the assets of [the Debtor] under the BVI Insolvency Order."[29] The court also found that the claim was not subject to attachment or garnishment because the stays in the BVI proceeding and under section 362 (made applicable by section 1520(a)(1)) prevented such action.[30]

[26] Id. at 623.
[27] *See* id.; *compare* Elpida Memory, 2012 WL 6090194, at *5.
[28] Fairfield Sentry, 484 B.R. at 623.
[29] Id. at 625 (internal quotations omitted).
[30] Id. at 625, n.14.

The bankruptcy court did not stop there; it reasoned that its finding was "consistent with Chapter 15's origins and its governing concept of comity."[31] Exploring the origins of comity and its incorporation into the text of chapter 15, the bankruptcy court explained that "the transaction at issue is BVI-centric for purposes of this Court's review," and as such, "comity dictates that this Court defer to the BVI Judgment."[32] Accordingly, the bankruptcy court declined to conduct a plenary section 363 review of the sale at issue.[33] The district court affirmed.

On appeal, the Second Circuit reversed. First, the Second Circuit concluded that the SIPA Claim was indeed located "within the territorial jurisdiction of the United States" as defined in section 1502(8) because:

> The SIPA Claim here is subject to attachment or garnishment and may be properly seized by an action in a Federal or State court in the United States. Under New York law, any property which could be assigned or transferred is subject to attachment and garnishment. For attachment purposes, with respect to intangible property that has as its subject a legal obligation to perform, the situs is the location of the party of whom that performance is required pursuant to that obligation. . . . Here, although [the Debtor] and the SIPA Trustee do not have a contractual relationship, the SIPA Trustee is statutorily obligated to distribute to [the Debtor] its pro rata share of the recovered assets. Therefore the situs of the SIPA Claim is the location of the SIPA Trustee, which is New York.[34]

In reaching this conclusion, the Second Circuit dismissed of the argument that the SIPA Claim could not be seized, garnished, or attached in an action in a United States court because such an action would be stayed by the BVI Court and the U.S. bankruptcy court—emphasizing that such an argument "would render the 'subject to attachment or garnishment' phrase of section 1502(8) a nullity."[35] As the Second Circuit explained, "[t]here is always an automatic stay in bankruptcy proceedings so it would make no sense if the existence of a stay could affect the

---

[31] Id. at 626.
[32] Id. at 626-28.
[33] Id. at 628.
[34] In re Fairfield Sentry Ltd., 768 F.3d 239, 244-45 (2d Cir. 2014) (internal quotations and citation omitted).
[35] Id. at 245 (quoting 11 U.S.C. § 1502(8)).

construction of the term 'interest' under section 1502(8)."[36] The Second Circuit thus held that the sale of the SIPA Claim is a transfer subject to section 1520(a)(2), and accordingly, "the bankruptcy court must apply section 363."[37]

The Second Circuit also reversed the bankruptcy court's holding regarding comity.[38] Acknowledging that comity is an important factor in chapter 15 cases, the Second Circuit noted that "Chapter 15 does impose certain requirements and considerations that act as a brake or limitation on comity"—including the "express statutory command that, in a Chapter 15 ancillary proceeding, the requirements of section 363 apply . . . *to the same extent* as in Chapter 7 or 11 proceedings."[39] Thus, like the Elpida Memory court, the Second Circuit held that "[t]he language of section 1520(a)(2) is plain; the bankruptcy court is *required* to conduct a section 363 review when the debtor seeks a transfer of an interest in property within the territorial jurisdiction of the United States."[40] Remanding the matter to the bankruptcy court to apply a section 363 analysis, the Second Circuit highlighted the need to apply the multi-factor test used in the Second Circuit to the sale of the SIPA Claim, with particular emphasis on one particular factor: "whether the asset is increasing or decreasing in value."[41]

On remand, the bankruptcy court applied the so-called "*Lionel* Factors," as instructed by the Second Circuit, to the sale transaction.[42] Starting with the question of the increased value of the transaction—as instructed by the Second Circuit—the bankruptcy court considered evidence presented that the value of the SIPA Claim has increased substantially from the purchase price

[36] Id.
[37] Id.
[38] Id. at 245-46.
[39] Id. at 245 (internal quotations omitted) (emphasis in original).
[40] Id. at 246 (emphasis in original).
[41] Id. at 246-47 (quoting In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983)).
[42] In re Fairfield Sentry Ltd., 539 B.R. 658 (Bankr. S.D.N.Y. 2015).

provided for the original transaction.[43] Accordingly, "the most important factor and the one factor the Second Circuit specifically directed this Court to consider plainly weighs against approval of the sale," and "the other relevant *Lionel* factors also favor disproval."[44] The bankruptcy court thus granted the foreign representative's motion to disapprove the sale of the SIPA Claim.[45]

The would-be purchaser appealed the bankruptcy court's order, arguing, among other things, that the order should be reversed on comity grounds.[46] On appeal, the Second Circuit affirmed.[47] Noting again section 1520(a)(2)'s requirement that section 363 be applied to certain transfers "to the same extent" as in a typical domestic bankruptcy, the Second Circuit recognized the factors listed in *Lionel* to be considered in a section 363 review:

> [A] bankruptcy judge . . . should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike. He might, for example, look to such relevant factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.[48]

In its rejection of the would-be purchaser's arguments, the Second Circuit concluded:

> Even assuming that comity can be considered in § 363 review, Farnum has not demonstrated that it obviously compels a result contrary to that reached in *Sentry I*. The post-Sale increase in the value of [the SIPA Claim] still provides a "good business reason" to disapprove the transaction, *In re Lionel Corp.*, 722 F.2d at 1071, that is not clearly outweighed by comity . . . .[49]

---

[43] Id. at 669.
[44] Id.
[45] Id. at 676. In disapproving the sale, the bankruptcy court also dispelled with the would-be purchaser's argument that section 1520(a) does not mandate that section 363 applies automatically: "The Second Circuit held that the plain language of § 1520(a)(2) mandated the automatic application of § 363 explaining that the 'bankruptcy court is *required* to conduct a section 363 review when the debtor seeks a transfer of an interest in property within the territorial jurisdiction of the United States." *See* id. at 672-73 (quoting Fairfield Sentry, 768 F.3d at 246).
[46] In re Fairfield Sentry Ltd., 690 Fed.Appx. 761, 764 (2d Cir. 2017).
[47] Id.
[48] Id. at 769 (quoting Lionel Corp., 722 F.2d at 1071).
[49] Id. at 769-70 (footnote omitted).

III. Takeaways: Assuring Recognition and Enforcement of Foreign Sales Orders Under Chapter 15 (or Challenging Same)

As detailed above, there are at least two important issues to consider when seeking recognition and enforcement of a foreign sale order in a chapter 15 case involving a foreign main proceeding: the actual or legal location of the property to be sold, and whether principles of comity—or merely the standards applicable under section 363—apply.

a. *Location of Property of the Debtor*

As highlighted above, in order for section 363 to apply—automatically and to the same extent as in a domestic bankruptcy case—to a transaction approved in a foreign main proceeding for which enforcement is sought under chapter 15, it must involve "a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States."[50] The phrase "within the territorial jurisdiction of the United States" is statutorily defined as "tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may be properly seized or garnished by an action in a Federal or State court in the United States."[51]

While it is unlikely that the location of tangible property will often be in dispute, the location of intangible property likely will, as evidenced in the Fairfield Sentry litigation. Thus, transfers of causes of action, intellectual property, contract rights and other similar assets require careful scrutiny. Determining the legal location of intangible property requires an analysis—both legal and factual—of the applicable state or federal law and its application to the facts of the

[50] 11 U.S.C. § 1520(a)(2).
[51] 11 U.S.C.§ 1502(8).

particular case. And, as emphasized by the Second Circuit in Fairfield Sentry, the fact that such property is subject to an automatic stay in a foreign bankruptcy court or the chapter 15 court does not mean that it cannot be "located within the territorial jurisdiction of the United States" for the purposes of section 1520(a)(2) based on its being subject to garnishment or attachment under applicable state or federal law. That possibility must be analyzed as well, and separate and apart from other considerations driving the legal "location" of the asset.

b. *Comity*

Although courts considering the issue have coalesced around an interpretation that principles of comity are not to be considered when reviewing a section 363 sale pursuant to section 1520(a)(2), the Second Circuit left open the possibility that it could be a factor in its final decision in the Fairfield Sentry litigation.[52]

However, the few cases decided since the conclusion of the Fairfield Sentry litigation have not entered through any window left open for the consideration of comity in section 363 sales in connection with foreign main proceedings, instead emphasizing that chapter 15 "impose[s] certain requirements and consideration that act as a break or limitation on comity."[53] Pending contrary case law, parties must prove to the chapter 15 court that the sale transaction would be approved under section 363 in accordance with the standards applicable to sales under chapter 7 or 11. Best practices would also dictate that the parties establish that comity supports approval of the sale and enforcement of the sale order as well.

[52] Fairfield Sentry, 690 Fed.Appx. at 769-70 ("Even assuming that comity can be considered in § 363 review, [purchaser] has not demonstrated that it obviously compels a result contrary to that reached in *Sentry I.*").
[53] *See, e.g.*, In re PT Bakrie Telecom Tbk, 628 B.R. 859, 880 (Bankr. S.D.N.Y. 2021) (quoting Fairfield Sentry, 768 F.3d at 245); *see also* In re Oi Brasil Holdings Cooperatief U.A., 578 B.R. 169, 213 (Bankr. S.D.N.Y. 2017) (noting that the Second Circuit "expressly rejected the notation that the bankruptcy court should defer to the foreign court's determination based on the principle of international comity") (citing Fairfield Sentry, 768 F.3d at 245-46).

Meanwhile, the application of section 363 standards by the chapter 15 court means that opponents of the sale may indeed get that second bite. Enforcement of the sale order can be challenged anew, citing a failure to meet those standards, as was the case in *Fairfield Sentry*.

Accordingly, where possible, the original sale proceedings in the foreign main proceeding should conform to U.S. standards if recognition of the sale order under chapter 15 is essential to the closing of the transaction or the efficacy of the sale. The parties should consider the requirements of notice, marketing and a competitive process where feasible. This is particularly critical when the sale is being coordinated to involve both foreign and U.S. assets, as in the case of a going concern sale of the debtor's assets.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
ONE AVIATION CORPORATION, *et al.*,	Case No. 18-12309-CSS
Debtors.	(Jointly Administered)

NOTICE OF THE UNITED STATES OF AMERICA CONCERNING THE REVIEW OF CERTAIN TRANSACTIONS BY THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

The United States of America respectfully submits this statement to address the possibility that certain transactions contemplated by the *Joint Prepackaged Chapter 11 Plan of Reorganization for One Aviation Corporation and its Debtor Affiliates* [Docket No. 13] (Plan)[1] may be subject to review by the Committee on Foreign Investment in the United States (CFIUS), which could affect the ability of the parties to complete the transactions, the timing of their completion, and/or their terms.

A. The Global Transaction and the Plan's Essential Regulatory Approvals

1. On October 10, 2018, the Debtors commenced voluntary chapter 11 cases. On the same day, the Debtors filed the Plan and associated *Disclosure Statement for the Joint Prepackaged Chapter 11 Plan of Reorganization for One Aviation Corporation and its Debtor Affiliates* [Docket No. 14] (Disclosure Statement). The Plan provides for a "reorganization pursuant to which prepetition first lien debt, now held entirely by Citiking, would be converted to equity in the reorganized Debtors." Disclosure

[1] Any capitalized term not defined herein has the meaning ascribed to it in the Plan and the Disclosure Statement.

Statement Art. IV.B.

2. The Plan and other relevant documents describe certain regulatory approvals that must be obtained. Section 8.1 of the Plan lists conditions precedent to the Effective Date. Under Section 8.1.4, in order for the Plan to become effective, "[a]ll requisite governmental authorities and third parties shall have approved or consented, or such time period to object, stay, or limit shall have expired, to the transactions contemplated by this Plan, to the extent reasonably required." The Disclosure Statement further provides that "the effectiveness of the Plan is subject to obtaining certain Governmental Approvals, except to the extent such Governmental Approvals would not, in the aggregate, reasonably be expected to result in losses, costs, liabilities or expenses to the parties to the Restructuring Support Agreement and their respective subsidiaries in excess of $5,000,000." Neither the Disclosure Statement nor the Plan specifically contemplates any clearance by CFIUS for the transactions contemplated by the Plan.

B. <u>CFIUS's Purpose and Membership</u>

3. CFIUS is an inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person in order to determine the effect of such transactions on the national security of the United States. *See* 50 U.S.C. § 4565(b)(1)(A).

4. Section 721 of the Defense Production Act of 1950, as amended (currently codified at 50 U.S.C. § 4565) (Section 4565), authorizes the President, acting through CFIUS, to review any merger, acquisition, or takeover "that could result in foreign control of any person engaged in interstate commerce in the United States." 50 U.S.C. § 4565(a)(4)(B)(i). Any such transaction with this possible effect is referred to as a

"covered transaction." *Id.* The term "person" is defined to mean any individual or entity. 31 C.F.R. § 800.221. Covered transactions could include the acquisition by a foreign person of an entity engaged in interstate commerce in the United States (a U.S. business) that is in bankruptcy, including components of a business or assets that constitute a U.S. business under the CFIUS regulations. *See* 31 C.F.R. Part 800.

5. The members of CFIUS include the Secretaries of the Treasury (chair), State, Defense, Commerce, Energy, and Homeland Security; the Attorney General; the United States Trade Representative; and the Director of the White House Office of Science and Technology Policy; the heads of any other executive department, agency, or office may participate as determined to be appropriate on a case-by-case basis. 50 U.S.C. § 4565(k)(2); Exec. Order No. 11858, § 3(b), *as amended by* Exec. Order No. 13456, 73 Fed. Reg. 4677 (Jan. 23, 2008).

C. <u>The CFIUS Process</u>

6. CFIUS review can be initiated voluntarily or involuntarily. Any party to a covered transaction can file a voluntary notice of the transaction with CFIUS, or CFIUS can unilaterally initiate review of the transaction. *See* 50 U.S.C. § 4565(b)(1)(C), (D). Following a 45-day review period, *see id.* § 4565(b)(1)(F), two principal outcomes are possible. First, CFIUS could determine not to undertake an investigation and conclude action with respect to the transaction. *See* 31 C.F.R. § 800.504. Alternatively, CFIUS may initiate a 45-day investigation into the "effects of [the] covered transaction on the national security of the United States." 50 U.S.C. § 4565(b)(2)(A).

7. Upon completion of any investigation, CFIUS may conclude action with respect to the transaction, *see* 31 C.F.R. § 800.506(d), or, if CFIUS determines that the

transaction poses national security concerns that cannot be resolved, unless the parties choose to abandon the transaction, CFIUS will send a report to the President requesting his decision on whether to take an action to suspend or prohibit the transaction, 50 U.S.C. § 4565(d)(1), which must be made within 15 days. *Id.* § 4565(d)(2). Such action taken by the President is not subject to judicial review. *Id.* § 4565(e)(1).

8. CFIUS may seek to mitigate any threat to the national security of the United States that arises as a result of a covered transaction by entering into agreements with a party or imposing conditions on the transaction. *See* 50 U.S.C. § 4565(l)(3)(A). In addition, the process could be prolonged by pre-notification informal consultations, *see* 31 C.F.R. § 800.401(f) (encouraging such discussions); withdrawal by the parties of any written notification of a transaction, 50 U.S.C. § 4565(b)(1)(C)(ii); and by informal discussions regarding possible resubmission. *Id.* § 4565(b)(1)(C)(iii).

9. In conducting its national security risk analysis, CFIUS considers issues including, for example, domestic production needed for projected national defense requirements and the capability and capacity of domestic industries to meet national defense requirements. *See id.* § 4565(f). Section 4565(f)(1)-(11) lists factors that CFIUS considers in assessing national security risk.

D. <u>Confidentiality in the CFIUS Review Process</u>

10. The CFIUS review process is subject to explicit confidentiality provisions, with limited exceptions, including for disclosure as may be relevant to any administrative or judicial action or proceeding. *See* 50 U.S.C. § 4565(c); 31 C.F.R. § 800.702. Unpermitted disclosure of certain information or material filed with CFIUS can result in criminal penalties, including fines and imprisonment. *See* 31 C.F.R. § 800.702. "[T]here

is . . . a clearly articulated intention, on the part of each of the legislative and executive branches of our government, that the CFIUS process remain confidential." *In re Global Crossing Ltd.*, 295 B.R. 720, 724–25 (Bankr. S.D.N.Y. 2003). The CFIUS statutory and regulatory confidentiality provisions apply in bankruptcy. *See id.*; *see also* Fed. R. Bankr. P. 9018 ("[T]he court may make any order which justice requires . . . to protect governmental matters that are made confidential by statute or regulation."). Nothing in the CFIUS regulatory confidentiality provisions, however, prohibits the public disclosure by a party of documentary material or information that it has filed with CFIUS. *See* 31 C.F.R. § 800.702(c).

Dated: January 17, 2019

Respectfully submitted

JOSEPH H. HUNT
Assistant Attorney General

DAVID C. WEISS
Acting United States Attorney

ELLEN SLIGHTS
Assistant United States Attorney

/s/ I-Heng Hsu
RUTH A. HARVEY
LLOYD H. RANDOLPH
DANIELLE A. PHAM (CA Bar 269915)
I-HENG HSU

Department of Justice
Commercial Litigation Branch,
Civil Division
P.O. Box 875, Ben Franklin Station
Washington, DC 20044-0875
TEL: (202) 616-3619
FAX: (202) 514-9163
Email: i-heng.hsu@usdoj.gov

ATTORNEYS FOR THE UNITED STATES

CERTIFICATE OF SERVICE

On January 17, 2019, I caused a copy of the foregoing to be served electronically through the Court's ECF system upon those who have entered an appearance in this proceeding, and through electronic mail on the parties listed below.

Dated: January 17, 2019

/s/ I-Heng Hsu
I-Heng Hsu

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: TK HOLDINGS INC., Debtors.	Chapter 11 Case No. 17-11375 (BLS)

NOTICE OF THE UNITED STATES OF AMERICA CONCERNING THE REVIEW OF CERTAIN TRANSACTIONS BY THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

The United States of America respectfully submits this statement to address the possibility that certain transactions contemplated by the *Third Amended Joint Chapter 11 Plan of Reorganization of TK Holdings Inc. and Its Affiliated Debtors* [Docket No. 1629] (Plan)[1] may be subject to review by the Committee on Foreign Investment in the United States (CFIUS), which could affect the ability of the parties to complete the transactions, the timing of their completion, and/or their terms.

A. The Global Transaction and the Plan's Essential Regulatory Approvals

1. On June 25, 2017, the Debtors commenced with this Court a voluntary chapter 11 case. On January 5, 2018, the Debtors filed the Plan and associated *Disclosure Statement for Third Amended Joint Chapter 11 Plan of Reorganization of TK Holdings Inc. and Its Affiliated Debtors* [Docket No. 1630] (Disclosure Statement). The Plan provides for a "sale of substantially all of Takata's worldwide assets unrelated to the manufacture and sale of PSAN Inflators" to the Plan Sponsor "for an aggregate purchase price of $1.588 billion." Disclosure Statement Art. I.

[1] Any capitalized term not defined herein has the meaning ascribed to it in the Plan and the Disclosure Statement.

2. The Plan and other relevant documents describe certain regulatory approvals that must be obtained. Article IX of the Plan details conditions precedent to (a) confirmation of the Plan and (b) the occurrence of the Effective Date. Section 9.2 of the Plan lists conditions precedent to the Effective Date. Under Section 9.2(o), in order for the Plan to become effective, the Debtors must obtain "all authorizations, consents, regulatory approvals, ruling[s], or documents that are necessary to implement and effectuate the Plan."

3. The Disclosure Statement contains greater specificity about the regulatory approvals contemplated by the Debtors. As relevant here, the Disclosure Statement provides that CFIUS must clear the U.S. Acquisition Agreement [Docket No. 1110-1], under which certain Takata subsidiaries will sell substantially all of their non-PSAN Assets to the Plan Sponsor. *See* Disclosure Statement §§ 1.1, 5.13(l)(xvi), 10.1(a) ("The U.S. Acquisition Agreement contains an extensive list of conditions to closing. . . . These conditions include, among others, . . . that certain consents and regulatory approvals be obtained, including CFIUS clearance . . . ."); U.S. Acquisition Agreement §§ 7.4, 9.3. It further states that failure to obtain CFIUS clearance may result in the Plan Sponsor's obligation to pay a regulatory termination fee. *See* Disclosure Statement § 5.13(g); U.S. Acquisition Agreement § 4.7(a).

B. <u>CFIUS's Purpose and Membership</u>

4. CFIUS is an inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person in order to determine the effect of such transactions on the national security of the United States. *See* 50 U.S.C. § 4565(b)(1)(A).

5. Section 721 of the Defense Production Act of 1950, as amended (currently codified at 50 U.S.C. § 4565) (Section 4565), authorizes the President, acting through CFIUS, to review any merger, acquisition, or takeover "which could result in foreign control of any person engaged in interstate commerce in the United States." 50 U.S.C. § 4565(a)(3). Any such transaction with this possible effect is referred to as a "covered transaction." *Id.* The term "person" is defined to mean any individual or entity. 31 C.F.R. § 800.221. Covered transactions could include a purchase by a foreign person of an entity engaged in interstate commerce in the United States (a U.S. business) that is in bankruptcy, including components of a business or assets that constitute a U.S. business under the CFIUS regulations. *See* 31 C.F.R. Part 800.

6. The members of CFIUS include the Secretaries of the Treasury (chair), State, Defense, Commerce, Energy, and Homeland Security; the Attorney General; the United States Trade Representative; and the Director of the White House Office of Science and Technology Policy; the heads of any other executive department, agency, or office may participate as determined to be appropriate on a case-by-case basis. 50 U.S.C. § 4565(k)(2); Exec. Order No. 11858, § 3(b), *as amended by* Exec. Order No. 13456, 73 Fed. Reg. 4677 (Jan. 23, 2008).

C. <u>The CFIUS Process</u>

7. CFIUS review can be initiated voluntarily or involuntarily. Any party to a covered transaction can file a voluntary notice of the transaction with CFIUS, or CFIUS can unilaterally initiate review of the transaction.[2] *See* 50 U.S.C. § 4565(b)(1)(C), (D).

[2] The Debtors have acknowledged their intention to voluntarily submit a written notice of the transaction to CFIUS. *See* U.S. Acquisition Agreement § 7.4(b) ("[T]he Plan Sponsor and Sellers shall use reasonable best efforts to promptly prepare and file a draft Joint Voluntary Notice for review by the CFIUS staff.").

Following a 30-day review period, *see id.* § 4565(b)(1)(E), two principal outcomes are possible. First, CFIUS could determine not to undertake an investigation and conclude action with respect to the transaction. *See* 31 C.F.R. § 800.504. Alternatively, CFIUS may initiate a 45-day investigation into the "effects of [the] covered transaction on the national security of the United States." *Id.* § 4565(b)(2)(A).

8. Upon completion of any investigation, CFIUS may conclude action with respect to the transaction, *see* 31 C.F.R. § 800.506(d), or, if CFIUS determines that the transaction poses national security concerns that cannot be resolved, unless the parties choose to abandon the transaction, CFIUS will send a report to the President requesting his decision on whether to take an action to suspend or prohibit the transaction, 50 U.S.C. § 4565(d)(1), which must be made within 15 days. *Id.* § 4565(d)(2). Such action taken by the President is not subject to judicial review. *Id.* § 4565(e).

9. CFIUS may seek to mitigate any threat to the national security of the United States that arises as a result of a covered transaction by entering into agreements with a party or imposing conditions on the transaction. *See* 50 U.S.C. § 4565(l)(1)(A). In addition, the process could be prolonged by pre-notification informal consultations, *see* 31 C.F.R. § 800.401(f) (encouraging such discussions); withdrawal by the parties of any written notification of a transaction, 50 U.S.C. § 4565(b)(1)(C)(ii); and by informal discussions regarding possible resubmission. *Id.* § 4565(b)(1)(C)(iii).

10. In conducting its national security risk analysis, CFIUS considers issues including, for example, domestic production needed for projected national defense requirements and the capability and capacity of domestic industries to meet national defense requirements. *See id.* § 4565(f). Section 4565(f)(1)-(11) lists factors that CFIUS

considers in assessing national security risk.

D. <u>Confidentiality in the CFIUS Review Process</u>

11. The CFIUS review process is subject to explicit confidentiality provisions, with a limited exception for disclosure as may be relevant to any administrative or judicial action or proceeding. *See* 50 U.S.C. § 4565(c); 31 C.F.R. § 800.702. Unpermitted disclosure of certain information or material filed with CFIUS can result in criminal penalties, including fines and imprisonment. *See* 31 C.F.R. § 800.702. "[T]here is . . . a clearly articulated intention, on the part of each of the legislative and executive branches of our government, that the CFIUS process remain confidential." *In re Glob. Crossing Ltd.*, 295 B.R. 720, 724–25 (Bankr. S.D.N.Y. 2003). The CFIUS statutory and regulatory confidentiality provisions apply in bankruptcy. *See id.*; *see also* Fed. R. Bankr. P. 9018 ("[T]he court may make any order which justice requires . . . to protect governmental matters that are made confidential by statute or regulation."). Nothing in the CFIUS regulatory confidentiality provisions, however, prohibits the public disclosure by a party of documentary material or information that it has filed with CFIUS. *See* 31 C.F.R. § 800.702(c).

Dated: February 9, 2018

Respectfully submitted,

MICHAEL S. RAAB
Acting Deputy Assistant Attorney General

/s/ *Jonathan E. Jacobson*
RUTH A. HARVEY
LLOYD H. RANDOLPH
JONATHAN E. JACOBSON

Department of Justice
Commercial Litigation Branch, Civil Division
1100 L Street, NW
Washington, DC 20005
TEL: (202) 353-7971
FAX: (202) 514-9163
EMAIL: jonathan.e.jacobson@usdoj.gov

CERTIFICATE OF SERVICE

I certify that on February 9, 2018, a copy of the attached Notice was served via the Court's CM/ECF system on all parties requesting notice.

/s/ Jonathan E. Jacobson
Jonathan E. Jacobson
U.S. Department of Justice

JOON H. KIM
Acting United States Attorney for the
Southern District of New York
By: JEAN-DAVID BARNEA
DOMINIKA TARCZYNSKA
Assistant United States Attorneys
86 Chambers Street, 3rd Floor
New York, New York 10007
Telephone: (212) 637-2679/2748
Fax: (212) 637-2686
Email: Jean-David.Barnea@usdoj.gov
Dominika.Tarczynska@usdoj.gov

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re **WESTINGHOUSE ELECTRIC COMPANY LLC, et al.,** **Debtors.**	**Chapter 11** **Case No. 17-10751 (MEW)** **(Jointly Administered)**

NOTICE OF THE UNITED STATES OF AMERICA CONCERNING THE REVIEW OF CERTAIN TRANSACTIONS BY THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

The United States of America, by its attorney Joon H. Kim, Acting United States Attorney for the Southern District of New York, respectfully submits this statement on behalf of the Committee on Foreign Investment in the United States ("CFIUS"), to address the potential that certain transactions involving the sale of Debtors or their assets could be subject to CFIUS review, which could affect the transactions' timing, terms, and ability to be completed. A description of the CFIUS review process is set forth herein.

1. CFIUS is an inter-agency committee authorized to review certain transactions that could result in control of a U.S. business by a foreign person, in order to determine the effect of such transactions on the national security of the United States. 50 U.S.C. § 4565(b)(1)(A).

2. Section 721 of the Defense Production Act of 1950, as amended ("Section 721," codified at 50 U.S.C. § 4565), authorizes the President, acting through CFIUS, to review any merger, acquisition, or takeover "which could result in foreign control of any person engaged in interstate commerce in the United States" (referred to as "covered transactions"). 50 U.S.C. § 4565(a)(3). The term "person" is defined to mean any individual or entity. 31 C.F.R. § 800.221. Covered transactions could include a purchase by a foreign person of an entity engaged in interstate commerce in the United States (a "U.S. business") that is in bankruptcy, including components of a business or assets that constitute a U.S. business under the CFIUS regulations. *See* 31 C.F.R. Part 800.

3. The members of CFIUS include the Secretaries of the Treasury (chair), State, Defense, Commerce, Energy, and Homeland Security; the Attorney General; the United States Trade Representative; the Director of the White House Office of Science and Technology Policy; and the heads of any other executive department, agency, or office, as determined to be appropriate, on a case-by-case basis. 50 U.S.C. § 4565(k); Exec. Order No. 11858 § 3(b), *as amended by* Exec. Order No. 13456, 73 Fed. Reg. 4677 (Jan. 23, 2008). The Director of National Intelligence and the Secretary of Labor are nonvoting, *ex officio* members, and officials of five White House offices are observers. *Id.*

4. After receiving notification of a covered transaction, CFIUS must complete a "review" within 30 days of accepting the notice filed by the parties. 50 U.S.C. § 4565(b)(1)(E). CFIUS may then initiate an "investigation" that may last up to 45 additional days if CFIUS

determines that it needs additional time to complete its assessment. *Id.* § 4565(b)(2)(C). If CFIUS determines that the transaction poses national security concerns that cannot be resolved, it will refer the transaction to the President, unless the parties choose to abandon the transaction. 31 C.F.R. § 800.506; Exec. Order No. 11858, *as amended,* § 6(c). The President may suspend or prohibit the transaction. 50 U.S.C. § 4565(d)(1). The President has 15 days after completion of CFIUS's investigation to make his decision, and the decision is made public. *Id.* § 4565(d)(2) The President's decision is not subject to judicial review. *Id.* § 4565(e).

5. In conducting its national security risk analysis, CFIUS assesses whether a foreign person has the capability or intention to exploit or cause harm (the "threat") and whether the nature of the U.S. business, or its relationship to a weakness or shortcoming in a system, entity, or structure, creates susceptibility to impairment of U.S. national security (the "vulnerability"). *See* U.S. Dep't of the Treasury, Office of Investment Security, *Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States*, 73 Fed. Reg. 74567 (Dec. 8, 2008). National security risk is a function of the interaction between threat and vulnerability, and the potential consequences of that interaction for U.S. national security. *See id.* Section 721(f) and the Guidance provide an illustrative list and examples of the factors that CFIUS considers in assessing national security risk.

6. Generally, parties voluntarily submit notices of transactions to CFIUS. In making their decision about whether to submit a voluntary notice to CFIUS, parties to a transaction may wish to consider whether their transaction could present national security considerations. It is also important that parties consider whether a CFIUS filing is warranted *before* completing the transaction. CFIUS has the authority, and in the past has exercised this authority, to initiate a review of covered transactions and take appropriate actions—even absent a voluntary notice, and

even after a transaction has been completed. 50 U.S.C. § 4565(b)(1)(D). Such actions could include interim measures pending final CFIUS action, mitigation measures at the conclusion of CFIUS action to resolve any national security concerns, and/or a recommendation to the President that the President suspend or prohibit the transaction. 50 U.S.C. § 4565(d)(1) and (l)(1).

7. Accordingly, CFIUS has the authority to review any acquisition by a foreign person that could result in foreign control of Debtors or of their components or assets that constitute a U.S. business. Moreover, if CFIUS identifies any national security concerns with such acquisition, CFIUS or the President could take action that affects the ability of the parties to complete the transaction, the timing of completion, and/or the terms of the transaction.

Date: New York, New York
June 5, 2017

Respectfully submitted,

JOON H. KIM
Acting United States Attorney for the
Southern District of New York
Attorney for the United States of America

By: *__/s/ Dominika Tarczynska__________*
JEAN-DAVID BARNEA
DOMINIKA TARCZYNSKA
Assistant United States Attorneys
86 Chambers Street, 3rd Floor
New York, NY 10007
Telephone: (212) 637-2679/2748
Facsimile: (212) 637-2686
E-mail: Jean-David.Barnea@usdoj.gov
Dominika.Tarczynska@usdoj.gov

Faculty

Robert J. Keach is a shareholder at Bernstein, Shur, Sawyer & Nelson, P.A. in Portland, Maine, and practices in the areas of bankruptcy, reorganization and workouts. His practice focuses on the representation of various parties in workouts and bankruptcy cases, including debtors, creditors, creditors' committees, lessors and third parties acquiring troubled companies and/or their assets. Mr. Keach has appeared before the bankruptcy courts in the Districts of Maine, Massachusetts, New Hampshire and Delaware, as well as the Northern District of California and the Southern and Eastern Districts of New York, among others. He regularly appears as a panelist on national bankruptcy, lender-liability and creditors' rights programs, and he is the author of several articles on bankruptcy and creditors' rights appearing in the *ABI Law Review*, *Commercial Law Journal* and *ABI Journal*, among other publications. Mr. Keach is admitted to practice in both state and federal courts in Maine and Massachusetts, as well as the First, Second, Seventh and Eighth Circuit Courts of Appeals and the U.S. Supreme Court. He is currently an adjunct professor at Boston College Law School, where he teaches classes on cross-border insolvency and business bankruptcy. Mr. Keach currently serves as the court-appointed fee examiner in the chapter 11 case for LTL Management, LLC pending in the District of New Jersey. He also is the fee examiner as to all professionals retained by the Financial Oversight and Management Board for Puerto Rico in connection with non-Title III services. Among other private engagements, Mr. Keach was retained by a litigation trust formed pursuant to a plan of arrangement sanctioned under Canada's Companies Creditors Arrangement Act to review, and advise the trust's board with respect to, the fees and expenses of the trustee and its counsel in prosecuting multi-billion dollar cross border fraud and fraudulent transfer litigation. He also is the estate representative, and formerly the chapter 11 trustee, in the cross-border railroad reorganization of Montreal Maine & Atlantic Railway, Ltd. Mr. Keach has, *inter alia*, represented ad hoc committees in the *Homebanc Mortgage*, *New Century TRS Holdings* and *Nortel Networks* cases in Delaware, as well as a public utilities commission in the *FairPoint Communications* case in the Southern District of New York. He also represents international private-equity funds in distressed company acquisitions throughout the U.S. both in and outside of chapter 11 cases. Mr. Keach received ABI's Lifetime Achievement Award in 2021 and served on ABI's Commission to Study the Reform of Chapter 11. he also is a Fellow in the American College of Bankruptcy and sits on its board of directors. Mr. Keach received his J.D. in 1980 from the University of Maine.

Brendan O'Neill is a partner in the Restructuring Group, a head of the Restructuring Group, and a member of the Executive Committee at Goodmans LLP in Toronto. He has experience leading domestic, cross-border and transnational corporate restructuring transactions and refinancings, including CCAA and CBCA corporate restructurings, as well as other forms of cross-border restructurings, out-of-court restructurings and workouts, mass tort restructurings, strategic bankruptcy-based acquisitions, bankruptcy-based litigation and near-insolvency investing scenarios. Mr. O'Neill regularly leads or co-leads the firm's representation of debtor companies, secured and unsecured lenders, bondholders and creditors, official and unofficial creditors' committees, key shareholders and leading private-equity firms and other strategic investors focused on distressed situations. He joined Goodmans in 2005 from the Bankruptcy and Corporate Reorganization Department of Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York, where he practiced U.S. bankruptcy and restructuring law for several years. Mr. O'Neill is an active member of the International Insolvency Institute, Insolvency Institute of Canada, ABI, Law Society of Ontario, INSOL International, Turnaround management Association and the Ontario Bar Association's Insolvency Section. He received his B.A. with honors from Queen's University and his LL.B. from the University of Toronto.

Michael F. Patterson is a partner with Spencer Fane LLP in Phoenix and helps businesses navigate corporate, compliance and securities matters. He has extensive experience in domestic and international mergers and acquisitions, joint ventures, strategic alliances, equity and debt offerings, foreign direct investment, distribution, agency and licensing matters, and market entry strategies. He also regularly advises U.S. and foreign clients in connection with the establishment, structuring and compliance for international operations, including the establishment of international distribution networks. Mr. Patterson spent a decade living and working in Central America, and he reads, writes, speaks and negotiates in Spanish. He also has done legal work for clients in Canada, Asia, Europe, the Middle East, Africa, Latin America and the Caribbean. Mr. Patterson has been listed in the 2019-23 editions of *The Best Lawyers in America* and has been involved with the Governor's Arizona-Mexico Commission and the Governor's Solar Energy Advisory Task Force. He received his B.A. *summa cum laude* in 1984 from Arizona State University and his J.D. *cum laude* in 1995 from Arizona State University Sandra Day O'Connor College of Law.