

focus

on

Insolvency Law

September, 2008

The logo for Fraser Milner Casgrain LLP, consisting of the letters 'FMC' in white on a blue square background.

FRASER MILNER CASGRAIN LLP

CONTROVERSIAL RELEASES ACCEPTABLE IN ASSET BACKED COMMERCIAL PAPER CCAA PLAN OF ARRANGEMENT

The Ontario Court of Appeal has confirmed the asset backed commercial paper CCAA Plan of Arrangement (2008 CaswellOnt 4811 (C.A.)). The reasoning of the Ontario Superior Court approving the Plan of Arrangement was reviewed in previous editions of this Newsletter.

Certain creditors who opposed the plan were granted leave to appeal the decision of the Ontario Superior Court. The primary focus on the appeal was whether the Court could sanction a plan that requires creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company. The Appellants also argued that the Judge erred in finding that the plan was fair and reasonable and therefore sanctionable under the CCAA.

At the outset the Court observed that although the asset backed commercial paper market involved many different players and many different kinds of assets, each with their own challenges, the affected parties elected to reorganize their affairs pursuant to a single CCAA Plan. There was evidence before the Court that "all of the asset backed commercial paper suffers from common problems that is best addressed by a common solution". The Plan, in essence, would convert note holder's paper - which had been frozen and therefore was effectively worthless - into new, long term notes that would trade freely, but with a discounted face value. It was hoped and anticipated that a strong secondary markets for these notes would emerge in the long run.

The Plan also aimed to improve transparency by providing investors with detailed information about the assets supporting their asset backed commercial paper notes. It also addressed

the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on new notes. Additionally, the plan adjusted some of the underlying credit default swap contracts by increasing the thresholds for default triggering events. As a result, the likelihood of a forced liquidation flowing from the credit default swap holders prior security was reduced and, in turn, the risk faced by asset backed commercial paper investors was decreased.

As stated above, the focus on appeal was the controversial releases. The plan called for a release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants from any liability associated with the asset backed commercial paper, with the exception of certain narrow claims related to fraud. There was evidence before the Court that the releases applied to "virtually all participants in the Canadian Asset backed commercial paper market".

The releases, generally speaking, were designed to compensate various participants in the market for the contributions they made to the restructuring. Those contributions under the plan included:

- (a) Asset Providers assumed an increased risk in their credit default swap contracts, disclosed certain proprietary information in relation to the assets, and provided below cost financing for margin funding facilities that were designed to make the notes more secure;
- (b) Sponsors gave up their existing contracts;
- (c) Canadian banks provided low cost financing for the margin funding facility, and
- (d) Other parties who had made a contribution under the plan.

The Appellants argued that the Court had no jurisdiction to sanction a CCAA plan that imposes an obligation on creditors to release third parties, other than directors of the debtor company. They argued (1) the CCAA does not permit such releases, (2) the Court is not entitled to “fill in the gaps” or rely upon its inherent jurisdiction to create such authority, because to do so would be contrary to the principal that Parliament does not intend to interfere with private property rights or rights of action in the absence of clear statutory language to that effect, and (3) the releases constitute an unconstitutional confiscation of the property.

The Court of Appeal rejected all of these arguments, holding, commencing at paragraph 43:

On a proper interpretation, in my view, the CCAA permits the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the Court where those release are reasonably connected to the proposed restructuring. I am led to this conclusion by a combination of (a) the open-ended, flexible character of the CCAA itself, (b) the broad nature of the term “compromise or arrangement” as used in the Act, and (c) the express statutory effect of the “double-majority” vote and court sanction which render the plan binding on all creditors, including those unwilling to accept certain portion of it. The first of these signals a flexible approach to the application of the Act in new and evolving situations, an active judicial role in its application and interpretation, and a liberal approach to that interpretation. The second provides the entrée to negotiations between the parties affected in the restructuring and furnishes them with the ability to apply the broad scope of their ingenuity in fashioning the proposal. The latter afford necessary protection to unwilling creditors who may be deprived of certain of their civil and property rights as a result of the process.

The CCAA is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme. The scope of the Act and the powers of the court under it are not limitless. It is beyond controversy, however, that the CCAA is remedial legislation to be liberally construed in accordance with the modern purposive approach to statutory interpretation. It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy: *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]). As Farley J. noted in *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), at 111, “[t]he history of CCAA law has been an evolution of judicial interpretation.”

And specifically dealing with the issue of the releases, the Court states at paragraph 63:

There is nothing to prevent a debtor and a creditor from including in a contract between them a term providing that the creditor release a third party. The term is binding as between the debtor and creditor. In the CCAA context, therefore, a plan of compromise or arrangement may propose that creditors agree to compromise claims against the debtor and to release third parties, just as any debtor and creditor might agree to such a term in a contract between them. Once the statutory mechanism regarding voter approval and court sanctioning has been complied with, the plan -- including the provision for releases -- becomes binding on all creditors (including the dissenting minority).

The appeal was dismissed and the Order of the Ontario Superior Court was upheld.

For further information please contact David Mann at 403 268-7097 or David LeGeyt at 403 268-3075, or visit our **website** www.fmc-law.com/insolvency.