Restructuring of Canada’s $32 Billion Market in Asset-Backed Commercial Paper Completed Through a CCAA Plan of Compromise and Arrangement

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Introduction

In January 2009, a group of creditors known as the “Pan-Canadian Investors Committee” completed a restructuring of Canada’s $32 billion market in third-party asset-backed commercial paper (“ABCP”) through a reorganization proceeding effected under Canada’s Companies’ Creditors Arrangement Act (the “CCAA”). The restructuring was the largest corporate restructuring in Canadian history and the only restructuring of an entire market in a single CCAA proceeding. Prior to implementation of the CCAA plan - (the “Plan”), American Lawyer magazine commented that: “The plan represents the largest and by far the most complex restructuring in Canadian history. If successful, it would be the only privately negotiated workout of an entire market anywhere in the world.”

The Plan involved the restructuring of over $32 billion of ABCP issued by 20 separate special purpose trust vehicles under 47 separate series of notes. The Plan included restructuring of the terms of the ABCP notes, as well as restructuring of the assets that “backed” those notes - a dizzying array of complex derivative transactions.

With this backdrop, there were many interesting aspects of the restructuring, not all of which can be meaningfully discussed and considered within a single article. Instead, this article will focus on the basic, key elements of the restructuring and the Plan, and on certain key aspects of the approach taken to the CCAA proceedings that gave effect to the largely pre-negotiated Plan, a process which moved from the time of commencement of the CCAA proceedings to Court sanction of the Plan in a mere 78 days. In the course of that discussion, the article touches on the unique impact that credit default swaps and special purpose investment vehicles (namely, the debtor trusts and trustees through which the ABCP was issued) had on the restructuring. Finally, the article briefly discusses the state of the law in Canada on third party releases, a central component of the ABCP restructuring, as settled in the appellate decisions of the Ontario Court of Appeal and the Supreme Court of Canada that followed the approval of the ABCP Plan by the CCAA Court.

Background

In the week of August 13, 2007, the market for third-party asset-backed commercial paper (ABCP) in Canada froze. Troubled by news about defaults in U.S. sub-prime mortgages and concerned about the level of sub-prime exposure underlying ABCP, investors stopped buying ABCP and existing holders stopped “rolling” their maturing ABCP into new ABCP. Within days, more than $32 billion in ABCP, held largely by major Canadian Crown corporations, financial institutions and pension funds, but also by a wide variety of other smaller corporations and individuals, became an illiquid, frozen investment.

ABCP is a short-term debt instrument backed by a variety of financial assets or other asset interests. A special-purpose entity (typically a trust) called a “Conduit” issues ABCP to finance the acquisition of cash flow-generating assets, and uses the cash flow from those assets to pay the interest and administrative costs of the ABCP. A “Sponsor” sets up the Conduit and typically acts as administrative agent of the Conduit, coordinating the acquisition of assets underlying the notes and the issuance and servicing of the ABCP.

ABCP programs were typically used to fund the acquisition of long-term assets, such as mortgages, auto loans, cash collateralized debt obligations and credit default swaps (“CDS”). As a result, ABCP issuers faced an inherent timing mismatch between cash generated by these underlying long-term assets and the cash needed to repay maturing short-term ABCP, which was typically 30-day paper (that paid slightly higher interest rates than government or bank paper). Typically, this timing mismatch was met through the sale of new ABCP or the “rolling” of maturing ABCP. However, when fears about the product emerged and investment and rolling stopped, there was not enough cash available from the cash-outflow of the long-term assets to repay the matured short-term ABCP.

Moreover, the assets held in the ABCP Conduits fell into two broad categories: (i) traditional securitized assets, in which the Conduit held an interest in a pool of cash flow producing assets such as credit card receivables or auto loans and leases or (ii) synthetic assets, in which the Conduit had obtained credit exposure to a portfolio of fixed income assets (without owning those assets) through the use of credit default swaps. Under a credit default swap, the credit protection seller (the Conduit) receives periodic cash

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payments in exchange for agreeing to assume a specified risk of loss on specific assets. This protection is guaranteed by posting low-risk, liquid assets as collateral. In the ABCP case, the Conduits had acted as credit protection sellers, posting part or all of the proceeds from the issuance of ABCP as collateral and using the periodic cash payments received to fund the interest and costs on the ABCP. In addition, in a synthetic asset, the credit exposure could be fully funded or levered, meaning that the collateral posted by the credit protection seller (the Conduit) is less than the amount of the credit exposure assumed. Because the posted collateral in a leveraged transaction is less than the credit risk assumed by the credit protection seller, the counterparty to the credit default swap assumes a “gap risk”. To manage this gap risk, the CDS will include events of default called “triggers” and, if the trigger is reached, the credit protection seller (the Conduit) is required to increase the amount of collateral posted or, if the credit protection seller (the Conduit) is unable to provide additional collateral, the trade is unwound and the counterparty can realize on the posted collateral, which is often held directly by the credit protection buyer, the CDS counterparty. More than 2/3 of the assets in the ABCP Conduits were synthetic and more than 55% were leveraged, many more than ten times levered and some as high as forty times levered. The higher the leverage, the higher the credit protection payment to be made to the ABCP Conduit, and, in turn, the higher the risk for the Conduit that it will be required to post a massive amount of collateral if the trigger is breached. The ABCP Conduits, most of which had minimal assets of their own (that is, that weren’t pledged to the CDS counterparties as credit protection), were not in a position to post additional collateral without issuing new ABCP, which clearly was not an option in the circumstances that arose in August 2007.

The Fundamental Problem

Against this backdrop, the fundamental problem faced by the restructuring arose. Because of the loss of market confidence in the ABCP product, Canada’s market in ABCP froze almost overnight. With the market frozen, the ABCP Sponsors and Conduits had no means of raising new money to repay short-term ABCP at maturity (typically 30 days), meaning that the notes quickly then fell into actual default. For ABCP holders, this scenario was a potential disaster as an event of default under the ABCP notes essentially triggered an event of default under the underlying CDS contracts, entitling the CDS counterparties to utilize the posted collateral in satisfaction of the credit protection seller’s (the Conduit’s) obligations under the CDS contracts. In most cases, the leverage in the credit default swaps meant that the ABCP holders would have been left with little or no recovery after the CDS counterparties had collected on their collateral. Moreover, this enforcement by the CDS counterparties could not be stayed by means of a voluntary or involuntary bankruptcy filing as the CDS contracts were “eligible financial contracts” exempted from any stay of proceedings¹, not to mention that many of the issuers of the ABCP (the trust-based Conduits) were special purpose trust entities that were not properly “debtor companies” eligible to file for protection under the CCAA in any event.

The Pre-Filing Period

As is likely abundantly clear from the above, the holders of the $32 billion in ABCP found themselves in a difficult position. Fortunately for the restructuring, within days of the crisis emerging certain large Canadian holders of ABCP banded together and immediately began to work on a solution under what came to be known as the “Montréal Accord”. Under this Accord, certain key ABCP holders such as the Caisse de Dépôt et Placement du Québec and National Bank Financial managed to secure an informal “standstill” with certain of the large CDS counterparties. With this informal standstill in place, by September 2007, the holders that initiated the Montréal Accord, together with a number of other large holders, rapidly formed the Pan-Canadian Investors Committee (the “Committee”), appointed prominent Canadian businessman Purdy Crawford, Q.C., O.C. as chair of the Committee, retained Goodmans LLP as legal counsel, and retained Ernst & Young Inc. as advisor to, among other things, contact and communicate with the thousands of holders of ABCP across Canada. By October 2007, the informal standstill had been supplemented and formalized by “Extraordinary Resolutions”, passed by 66 2/3% of the holders of notes in each of the 47 series of ABCP, under which the indenture trustees for the notes were formally directed to stand still and not to declare any events of default. These Extraordinary Resolutions went a long way toward contributing to the “breathing room” necessary to formulate a restructuring plan given that, at this stage, (i) there was no Court-ordered stay of proceedings under any insolvency proceedings, (ii) such a stay would have been ineffective vis-a-vis the CDS counterparties in any event, and (iii) the indenture trustees were, absent a formal direction from the note holders to stand still (as provided by the Extraordinary Resolutions), nervously facing $32 billion worth of undeclared defaults.

Having created this breathing room through the standstill of the Montréal Accord and the Extraordinary Resolutions, the seventeen members of the Committee, the financial advisor for the Committee, JPMorgan, the nine main CDS counterparties, the six Sponsors for the twenty Conduits, the issuer trustees for the 20 Conduits, the four indenture trustees for the 47 series of ABCP notes, an ad hoc committee of other noteholders represented by Miller Thomson LLP and PriceWaterhouseCoopers Inc., and Ernst & Young Inc. got to work on a plan.

The Plan

The restructuring plan that was ultimately developed and presented to the Court at the commencement of the CCAA proceedings in March 2008 had not changed much from the plan that the parties sketched out during the early days of the Committee’s existence, and that was further formalized under the “Framework Agreement” signed by the parties in December 2007. The basic elements were, and remained, as follows.

Under the Plan, all of the old ABCP issued by the Conduits was replaced by new notes with maturity dates and interest rates that matched the underlying assets, thereby eliminating the maturity mismatch inherent in the original notes. For the

¹ Under the CCAA, as under the U.S. Bankruptcy Code, “eligible financial contracts” are not subject to the stay.
ABCP based on credit default swaps (the majority of the ABCP), the triggers for those derivatives were renegotiated with the CDS counterparties to more remote and objective levels that would reduce the risk of future trigger defaults. In addition, to further reduce the risk of default, additional collateral was made available through the pooling and cross-collateralization of all of the original ABCP assets into new “Master Asset Vehicles” or “MAVs” that would house the assets in a limited number of common places, rather than 20 separate trust entities. These larger pools of assets housed in the MAVs were then made available to support the new Plan Notes to be issued by each of the three (rather than twenty) new MAVs. Finally, multi-billion dollar “Margin Funding Facilities” were put in place with funds made available from the CDS counterparties, Canada’s Schedule I Banks, certain large members of the Committee and, ultimately, through additional contributions from certain governments of Canada granted during the global credit crisis of fall 2008. These new multi-billion dollar Margin Funding Facilities are now available to inject additional collateral into the CDS trades underlying the new Plan Notes in the event that any of those trades trip their revised triggers before maturity and require additional margin support to avoid default.

**The CCAA Orders**

Having developed this comprehensive Plan to restructure the old ABCP, and prepared a 400-page Information Statement to describe it to the other holders of ABCP, it became time for the Committee to commence the CCAA proceedings, schedule a vote of creditors and, if successful at the vote, request the approval of the CCAA Court for the Plan. As an initial matter, however, the restructuring faced several further technical challenges arising from the nature of an ABCP investment in the first instance.

(1) **Identifying Debtor “Companies”**

One challenge was that ABCP was issued by a Conduit, which was a special purpose trust vehicle where the majority of the issuer trustees were trust entities. Under the CCAA, however, only “debtor companies” (a definition that does not include trusts) are permitted to avail themselves of the statute’s protections and process. The technical solution to this problem was to consider the issuer trustees of the Conduits, which were technically liable for the obligations of the Conduits (albeit only to the extent of the assets of the Conduits), as the debtors and, as necessary, replace the issuer trustee trust entities with newly-formed corporations on the eve of the commencement of the CCAA proceedings. That done, the replacement corporations for the Conduit trustees could then be filed as the “debtor companies” for purposes of the CCAA proceedings. While the logistics of changing the trustees for the ABCP notes on the eve of the filing were daunting, this step was considered necessary and appropriate by the Court under the circumstances in order to allow the restructuring effort to proceed under the CCAA, as was required in order to give binding effect to the Plan. Given the increasing complexity and ingenuity of modern investment vehicles (consider SIVs, for example), this is likely not the last case in which a court may have to consider the particular or proper nature of the debtor before it. In the ABCP restructuring however, the CCAA Court took a functional and pragmatic approach to the set of circumstances before it and, with full disclosure of the pre-filing arrangements having been made to the Court, was in turn comfortable making the CCAA available to this particular form of debtor company.

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(2) Procedural Consolidation among unrelated Debtors
As noted above, one of the fundamental elements of the ABPC Plan was its ability to deal with all of the ABPC within a single proceeding, notwithstanding the fact that the ABPC had been issued by a variety of unrelated debtors. Here, again, the CCAA Court took a pragmatic view of the situation and noted that these debtors were not opposed to (and indeed supported) the procedural consolidation of their proceedings under a single CCAA plan. Moreover, the Court noted that given the interconnectedness of the proposed restructuring plan – which sought to fix an entire market – the alternative of having 20 separate plans (one for each issuer), each of which would have been conditional on approval of the other, was not practical.

(3) Classification
Similar to its approach to procedural consolidation, the Court also accepted the Committee’s proposal for a single class of creditors for the vote, notwithstanding the fact that the ABPC obligations were issued by many unrelated Conduits and that the obligations’ only significant commonalities were their fundamental nature and the creditors that held them. Here, the Committee made a simple proposal that was accepted by the Court: to proceed with a single class, but also to tabulate the voting by Series of ABPC. If it turned out that the creditors of any particular Series did not approve the plan by the requisite majorities, then there would be a creditor classification issue to consider. If, however, the tabulations showed that the noteholders in each Series had approved the Plan by the requisite majorities, then there would be no classification issue to be concerned about. By accepting this pragmatic suggestion the Court did not unnecessarily delay the restructuring for potential classification disputes and the results of voting quickly supported that approach: holders in each Series approved the Plan by the requisite majorities required under the CCAA and in the aggregate the Plan was supported by 96% of the ABPC noteholders in dollar value and amount.

Any of these initial issues, such as the nature of investment vehicle involved (a trust to which the CCAA did not technically apply) or the admittedly unrelated nature of the debtors to one another (as an initial procedural matter or as a voting and classification matter) could potentially have stopped the ABPC restructuring in its tracks. Fortunately, however, on each issue, the CCAA Court took a pragmatic and purposive approach to the meaning and terms of the statute and applied the CCAA accordingly. The approach was distinctly enabling. It allowed an admittedly massive and far-reaching restructuing plan access to the CCAA and efficient passage through the CCAA process, thereby giving legal effect to a CCAA Plan that, while challenging in nature, was the plan that was overwhelmingly supported by the creditors in the $32 billion market for Canadian ABPC. Not including the appeal discussed below on the limited and singular point of the third party releases contained in the Plan, the CCAA proceeding for the ABPC Plan moved from the initial filing by the Committee, through the creditor vote organized by the Monitor, to Court approval in 78 days. For the largest and most complex restructuring in Canada’s history, that is a considerably efficient process.

The Appeals
Following the overwhelming approval of the Plan at the meeting of creditors, and sanction of the Plan by the CCAA Court, certain holders of ABPC appealed the approval of the Plan on the basis that the broad third party releases contained therein were not valid as a matter of Canadian law. This is, in essence, the only aspect of the restructuring Plan that was ever challenged.

The appeal was heard by the Ontario Court of Appeal in June 2008 and, in a decision released in August 2008, the Court of Appeal unanimously supported the approval of the Plan by the CCAA Court and the validity of the third party releases contained therein. The Ontario Court of Appeal’s favourable decision was then appealed by a small group of ABPC holders to the Supreme Court of Canada which, in September 2008, denied leave to appeal. Following a tumultuous final closing period during the massive market and credit crisis of fall 2008, which required certain further funding commitments to be obtained from the plan participants and certain governments of Canada, the Plan was finalized and implemented in January 2009 and $32 billion of restructured Plan Notes were issued to the holders of old ABPC.

Through the Ontario Court of Appeal’s lengthy and well-reasoned decision, and the Supreme Court’s denial of leave to appeal that decision, third party releases have been confirmed as a valid part of a Canadian CCAA plan, under the appropriate circumstances. In essence, where the Court is convinced on the evidence that the releases are an essential and, in the circumstances, fair and reasonable part of the restructuring, third party releases can be offered and are a valid component of a CCAA plan. By comparison, this is now seemingly more settled law in Canada than in the U.S., which has differing views between the Circuits on the validity or propriety of third party releases in a Chapter 11 plan and which does not have a Supreme Court decision on point to resolve any of those differences.

In any event, it is an important development in Canada that third party releases have been confirmed as another element of a restructuring in appropriate circumstances. Given the increasingly difficult and multi-party environment of modern-day restructurings, the availability of this tool will surely be relevant in other restructurings to follow.

Conclusion
Through the co-operation and diligence of the many parties involved in the ABPC restructuring, and the support and flexibility of the Canadian judiciary and the enabling Canadian reorganization statute, the CCAA, Canada is fortunate to have been able to complete a restructuring of this entire troubled market within a single proceeding. In doing so, the parties demonstrated the ability of Canada’s reorganization regime to efficiently and fairly handle a restructuring of unprecedented size and complexity, under very challenging circumstances.