



Court Sanctions Plan To Restructure \$32 Billion ABCP Market

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In August 2007, a liquidity crisis seized the \$32 billion Canadian market of non-bank sponsored asset-backed commercial paper (“**ABCP**”). The crisis was triggered primarily by a loss of confidence among investors stemming from the news of widespread defaults on sub-prime mortgages in the United States. In response to the liquidity crisis, a group of investors filed an application under the *Companies’ Creditors Arrangement Act (Canada)* (the “**CCAA**”) in respect of a plan of compromise and arrangement that sought to restructure ABCP into longer-term notes. The court sanctioned the plan in August 2008 and the plan is currently being implemented.

Background

ABCP is a form of short-term investment that typically matures within 30 to 90 days. The notes are “asset-backed” because the cash used to purchase the notes is converted into a portfolio of financial assets that, in turn, provide security for the repayment of the notes. The assets are generally long-term assets such as residential mortgages, credit card receivables or auto loans, as well as derivative instruments such as credit default swaps. Because of their long-term nature, there is an inherent timing mismatch between the cash generated by the assets and the cash needed to repay maturing ABCP notes. As holders of ABCP (the “**Noteholders**”) lost confidence and declined to roll over maturing notes, no cash was available to redeem notes that had matured, resulting in an absence of liquidity.

During the week of August 13, 2007, numerous ABCP market participants agreed to a standstill arrangement – known as the Montreal Protocol – committing themselves to restructuring the ABCP market with a view to preserving the value of the assets and the notes. The work of implementing the restructuring fell to the Pan-Canadian Investors Committee (the “**Committee**”), comprised of 17 financial and investment institutions, all of whom were Noteholders and who collectively held approximately two-thirds of the value of the ABCP being restructured. The Committee engaged in extensive negotiations over a number of months to obtain concessions and the support of financial institutions for a restructuring plan (the “**Plan**”).

The Plan and Sanction by the Ontario Superior Court of Justice

In March 2008, the Committee filed an application to the Ontario Superior Court of Justice (the “**Superior Court**”) under the CCAA requesting that the Superior Court call a meeting of Noteholders to vote on the Plan to restructure the trusts holding assets affecting the ABCP. Under the CCAA, approval of the Plan was required by the Noteholders and by the Superior Court. The Noteholders needed to approve the Plan by a majority in number representing two-thirds of the value of the affected notes. The Superior Court then needed to conclude the Plan was legal and that it was “fair and reasonable” to the affected parties. If both the Noteholders and the Superior Court approved, then all affected Noteholders were to be bound by the Plan, including those who voted against it.

The Plan proposed to restructure the frozen and illiquid notes into longer-term securities wherein the ABCP, initially intended as a low-risk and short-term debt, would be exchanged for new replacements notes or debentures (the “**New Notes**”) that would not mature for years while earning interest originating from the underlying assets. The Plan addressed the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on the New Notes. The Plan also aimed to improve transparency by providing Noteholders with detailed information about the assets supporting their ABCP. The Committee’s hope is that a strong secondary market for the New Notes will emerge over time.

In what would become the most contentious aspect of the Plan, the Plan also called for the release of virtually all participants in the Canadian ABCP market from any liability associated with the ABCP, with the exception of certain narrow claims relating to fraud. These included actions in negligence, misrepresentation and breach of fiduciary duty.

On a meeting held on April 25, 2008, 96% of ABCP holders (by number and value) voted in favour of the Plan and Justice Colin Campbell of the Superior Court approved and sanctioned the plan on June 5, 2008.

Court of Appeal Decision

The Noteholders that opposed the Plan (the “**Appellants**”) appealed the Superior Court decision

on the basis that (1) the Superior Court had no legal authority to sanction a plan that imposed an obligation on creditors to give release to third parties, and (2) the Plan was not fair and reasonable. The aggregate value of the ABCP holdings of the Appellants was slightly more than \$1 billion. On August 18, 2008, the Ontario Court of Appeal (the “**Court of Appeal**”) dismissed the appeal and affirmed the approval order sanctioned by the Superior Court.

CCAA Plan May Include Releases if Reasonably Connected to Proposed Restructuring

Regarding the legality of the releases, the Court of Appeal concluded that the CCAA permits the inclusion of third-party releases in a plan of compromise or arrangement to be sanctioned by the court where those releases are reasonably connected to the proposed restructuring.

The Court of Appeal came to its conclusion after consideration and discussion of the following principles: (1) the open-ended, flexible character of the CCAA, (2) the broad notions of “compromise” and “arrangement” which establish a framework within which the parties may work to put forward a restructuring plan, and (3) the express statutory effect of the “double-majority” vote of affected creditors and court sanction as “fair and reasonable” which renders the plan binding on all creditors, including those unwilling to accept certain portions of it.

The Court of Appeal was satisfied that the requirement of reasonable connection was met in this case because the parties who were to have claims against them released were contributing in a tangible and realistic way to the Plan and were not willing to make those contributions unless a release was provided in return.

The Plan is “Fair and Reasonable”

The Court of Appeal upheld the Superior Court’s finding that the Plan was fair and reasonable. The Court of Appeal noted that the application judge was required to consider and balance the interests of all Noteholders, not just the interests of the Appellants, whose notes represented about 3% of the notes, and was to consider the circumstances of the restructuring as a whole. The Court of Appeal found that the Superior Court had correctly considered the importance of resolving the ABCP liquidity crisis in the context of restoring confidence in the Canadian financial system and in considering the reality that many of the financial institutions involved were not only acting as dealers or brokers of the ABCP (with the impugned releases mostly relating to the financial institutions in these capacities), but also as asset and

liquidity providers (with the financial institutions making significant contributions to the Plan in these capacities).

Leave to Appeal – Supreme Court of Canada

On September 19, 2008, the Supreme Court of Canada dismissed a request of the Appellants for leave to appeal the Court of Appeal’s decision.

Implementation

On November 25, 2008, the Committee issued a news release stating that it would not meet its November 30, 2008 deadline for completing the implementation of the Plan. The Committee stated that the delay was principally due to the complexity of the restructuring, the large number of participants involved in the process and current market conditions. On November 28, 2008, the Superior Court granted the Committee a stay of proceedings until December 19, 2008, however the Committee has not set a deadline for completion of the restructuring.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

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