APRIL 30, 2021

Top Court Denies Leave to Appeal in Contested Application for a Reverse Vesting Order in Nemaska Restructuring Proceedings

Authors: Gabriel Lavery Lepage, Christian Lachance, Denis Ferland and Alexandra Ghelerter

The Supreme Court of Canada (SCC) has denied leave to appeal in the proceedings of Nemaska Lithium Inc. and its subsidiaries (collectively, Nemaska) under the *Companies' Creditors Arrangement Act* (CCAA). In November 2020, the Québec Court of Appeal (QCA) dismissed leave applications from the decision of the Superior Court of Québec (SCQ). In this decision, the SCQ granted, for the first time after a contested hearing, a "reverse vesting order" (RVO).

Unlike a standard vesting order, which consists of the transfer of the purchased assets out of the insolvent entity, free and clear of creditors' rights and claims, an RVO consists of the sale of the shares of the insolvent entity but excluding certain unwanted assets and liabilities. In an RVO transaction, under a pre-closing reorganization authorized by the RVO, the unwanted assets and liabilities are transferred, assigned and vested out of the existing entity to a newly incorporated entity. The formerly insolvent entity, unburdened by these assets and liabilities, is then purchased and its operations continued.

One of the most significant advantages of an RVO over a traditional vesting order is that purchasing the insolvent entity itself (rather than its assets) allows existing permits, licences, authorizations and essential contracts to stay intact, and the use of existing tax attributes to be maximized. As a result, this innovative structure is especially useful for distressed companies operating in highly regulated industries or owning assets that may be difficult or impossible to transfer.

Although the RVO structure has been approved without any opposition in a number of previous insolvency proceedings, including the restructurings of Stornoway Diamond, Plasco Energy, Wayland Group, Comark Holdings and Beleave Inc., the RVO granted in Nemaska was, for the first time, rendered after a contested hearing. As a result of its formal recognition in the Nemaska proceedings, the RVO structure is likely to become an increasingly common feature in the Canadian restructuring landscape.

Background

Nemaska was a publicly traded company that intended to become a producer of lithium hydroxide, primarily for the growing lithium battery market, which is driven by demand for electric vehicles, energy storage and mobile electronics. Nemaska was developing one of the largest spodumene deposits in the world, both in terms of volume and grade.

On December 23, 2019, Nemaska sought and obtained protection under the CCAA. Following an SCQ-approved sale or investment solicitation process (SISP), Nemaska accepted a credit bid submitted by a group comprised of The Pallinghurst Group,[1] Investissement Québec and Orion. The bid was conditional upon the issuance of an RVO.

This is the context in which the SCQ considered the application for the issuance of an RVO. The application was opposed by an alleged creditor and by certain shareholders of Nemaska. Numerous arguments were raised by the alleged creditor and the shareholders, including that the SCQ did not have jurisdiction under the CCAA to issue an RVO since the RVO did not involve a "sale or disposition of assets" and would allow Nemaska to restructure under and emerge from the CCAA without having to propose a plan of arrangement.

Decision

The SCQ noted that contemporary economic problems require innovative solutions, such as RVOs. To the extent that these solutions meet the fundamental objectives and spirit of the CCAA – benefiting all stakeholders – they should be endorsed. The SCQ added that the CCAA gives the supervising judge the flexibility to issue appropriate orders that facilitate the restructuring of an insolvent company, relying on the Supreme Court of Canada's recent decision in *9354-9186 Québec Inc. v Callidus Capital Corp.*, 2020 SCC 10.

The SCQ went on to note that section 36 of the CCAA provides authority to grant an RVO even though the RVO does not involve the "sale or disposition of assets." The SCQ considered whether the criteria applicable to a sale or disposition of assets were satisfied – namely, whether sufficient efforts were made to get the best price and whether the parties acted providently, an assessment of the efficiency and integrity of the process, whether the interests of the parties were considered and whether any unfairness resulted from the process.

The SCQ noted that all reasonable efforts were made by Nemaska to find the best offer in the circumstances and this was done through a rigorous, efficient, equitable and transparent process, in accordance with the SISP. The SCQ concluded that there was no doubt that the proposed transaction was fair and reasonable and should be approved for the benefit of all stakeholders.

The SCQ also considered the alternatives available to Nemaska – namely, permitting secured creditors to enforce on their security, suspending the business to later attempt another SISP at a significant cost and in uncertain market conditions, or bankruptcy. The SCQ noted that none of these options would provide a more favourable outcome for Nemaska's stakeholders.

The SCQ went on to state that it was in a case such as this one – in which the SCQ was satisfied that the factors to be considered under section 36 of the CCAA were met and that the benefits of the proposed transaction were obvious – the judge overseeing the restructuring and the interests of all must exercise discretion wisely and allow the proposed transaction to proceed, no matter how novel or unprecedented.

Applications for leave to appeal were filed with the QCA by the alleged creditor and the group of shareholders. In seeking leave to appeal to the QCA, they argued that debtor companies must not be permitted to emerge from CCAA protection free and clear of their pre-filing debts in the absence of a plan of compromise or arrangement. They also argued that the SCQ erred in granting certain releases in favour of the directors and officers in the context of the proposed RVO. The QCA dismissed the applications for leave to appeal on November 11, 2020. On April 29, 2021, the SCC also denied leave to appeal.

Conclusion

RVOs can be an extremely valuable tool in the insolvency practitioner's toolbox, as they allow for the preservation, among other things, of the permits and tax attributes of the insolvent company and offer an alternative to a plan of arrangement. As a result of its formal recognition after a contested hearing, RVOs are likely to become an increasingly prevalent feature of the Canadian restructuring landscape.

[1] Davies is acting for The Pallinghurst Group.

Key Contacts: Denis Ferland, Christian Lachance, Gabriel Lavery Lepage, Melanie A. Shishler and Natasha MacParland