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CCAA: THE USE OF CREDIT BIDS AT AN AUCTION IS SCRUTINIZED BY QUEBEC COURTS

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IN A RECENT DECISION OF THE COURT OF APPEAL, THE HONOURABLE PIERRE J. DALPHOND CONFIRMED THAT A SECURED CREDITOR MAY USE ITS DEBT TO ACQUIRE THE ASSETS WHICH ARE CHARGED WITH ITS SECURITY INTERESTS IN THE CONTEXT OF A SALE PROCESS MONITORED BY THE COURT UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT ("CCAA").

BACKGROUND

On February 24, 2010, White Birch Paper Inc. and several of its subsidiaries (collectively, the "**White Birch Group**") obtained an initial order under the CCAA. The White Birch Group is active in the pulp and paper industry. It employs approximately 1,200 people and operates plants mainly in Quebec (Stadacona, Papiers Masson, F.F. Soucy, Scierie Leduc) but also in Virginia (Bear Island). Following a process for marketing the assets of the White Birch Group that was monitored by the Court, which included the approval of a process for the solicitation of offers, the acceptance of a stalking horse bidder and the issuance of bidding procedures for the auction, two potential purchasers were invited to participate in an auction held in New York on September 21, 2010.

The first group of purchasers ("**Black Diamond**") was composed of entities which, collectively, represented the majority of the lenders under a syndicated loan secured by first charge security interests on the long-term assets of White Birch Group (the "**Loan**"). Black Diamond was the court-approved stalking horse.

The second group of purchasers ("**Sixth Ave**") was composed of entities which, collectively, represented a minority of the lenders that made the Loan.

The auction rules provided that a secured creditor could use the amount of its secured debt to purchase the charged assets, a procedure known as "credit bidding", as opposed to using cash to bid at the auction.

Both purchasers made offers at the auction, basically on the following terms:

- ▶ Black Diamond offered a cash amount of \$90 million to acquire the current assets of the White Birch Group (free from any encumbrances, except for the one created by the court to secure the repayment of the interim loan, in exactly the same amount of \$90 million) and a credit bid for the long-term assets, for an amount which was increased as the bidding progressed.
- ▶ Sixth Ave offered a cash amount, which was increased as the bidding progressed, to acquire all the assets of the White Birch Group. The cash was allocated entirely to the current assets, up to their value in the context of a continuing business, the balance being allocated to the long-term assets.

At the conclusion of the auction, the offer of Black Diamond was declared the best offer (the "**Winning Bid**"). It included the following components: \$90 million in cash for the current assets and \$82.5 million for the long-term assets, that is, \$4.5 million in cash (to secure payment to the holders of construction legal hypothecs) and \$78 million in the form of a credit bid related to the Loan, for a total of \$172.5 million. That offer was deemed superior to the last offer of the minority group of lenders, which was \$172 million in cash.

DISPUTE

Three days after the auction, on September 24, 2010, the White Birch Group filed an application for the approval of the sale of all of its assets to Black Diamond in accordance with the Winning Bid. Obviously, the motion was supported by Black Diamond but it was contested by Sixth Ave. The issues raised by the debate included the following:

- ▶ Is it possible to use credit bidding as part of the sale process under the CCAA, particularly in Quebec?
- ▶ Should a credit bid be considered as having the same value as a cash bid?
- ▶ Did Sixth Ave have standing that enabled it to contest the approval of the sale or was it only a "bitter bidder" not having the required legal standing?
- ▶ Was the Winning Bid to be approved by the court in accordance with the criteria set out in section 36 of the CCAA?

DECISION IN THE FIRST INSTANCE

The Honourable Robert Mongeon, J.S.C., seized of the case from the outset, approved the sale of the assets of the White Birch Group to Black Diamond for the reasons he delivered orally at the September 24, 2010, hearing. Those reasons were transcribed on October 15, 2010.

Mr. Justice Mongeon concluded that the use of credit bidding was provided for in the documents which had been approved by the Court in previous orders, particularly in the bidding procedures for the auction, and that Sixth Ave could not claim to be surprised to see it used by Black Diamond in the context of the auction. Furthermore, Mr. Justice Mongeon confirmed that Quebec law allows the use of credit bidding in the context of a sale. Indeed, article 689 of the *Code of Civil Procedure* allows a secured creditor who purchases an asset charged with his security to retain the purchase money up to the amount of his security interest. Accordingly, Mr. Justice Mongeon considered that the use of credit bidding was no stranger to Quebec law.

Mr. Justice Mongeon also confirmed that a credit bid of \$1 is equal to a cash bid of \$1. Contrary to what Sixth Ave maintained, the value of a credit bid is not limited to the fair market value of the assets charged with the security interests; such value is rather the same as the secured claim, up to the amount of the security.

Mr. Justice Mongeon was also of the view that he did not have to rule on whether Sixth Ave had standing to contest the sale of the assets. In fact, Sixth Ave could have the required standing in its capacity as a creditor of the White Birch Group, while it would not have such a standing as a bitter bidder. However, Mr. Justice Mongeon stated that he was impressed by the comments of his colleague, the Honourable Clément Gascon, J.S.C., who clearly decided, in the case of *AbitibiBowater*, that a bitter bidder does not have the required legal standing.

Lastly, Mr. Justice Mongeon analyzed the criteria in section 36 of the CCAA and concluded that they had been met in the case under review. Such criteria in section 36 of the CCAA are not limitative and it is not necessary to meet them all. He further stated that the proposed transaction must be considered in its entirety and that it is therefore not necessary that a sale generate benefits for each category of creditors in order for it to be approved by the court under the CCAA.

DECISION OF THE COURT OF APPEAL

Sixth Ave's motion for leave to appeal was heard on October 25, 2010, by the Honourable Pierre J. Dalphond, J.C.A. After referring to the four criteria established by the case law to determine whether leave to appeal from a decision issued under the CCAA should be granted, he concluded that leave should be denied since the appeal was not, *prima facie*, well founded and would hinder the reorganization process of the White Birch Group.

In its motion for leave to appeal, Sixth Ave had argued that its offer should not be compared to Black Diamond's because the latter offer included a significant credit bid component (\$78 million) while its own was a cash offer. Sixth Ave argued that the long-term assets were worthless and therefore the \$78 million credit bid allocated to those assets could not be compared to cash.

Mr. Justice Dalphond noted that the use of credit bidding was part of the process approved by the parties. To address the issue again would be tantamount to changing the rules of the game after it had been played. Nobody had ever raised the argument that a dollar in credit bid should not be equal to a dollar in cash. Moreover, Mr. Justice Dalphond noted that no evidence had been produced to the effect that the long-term assets were worthless (Sixth Ave had even made a US\$35,300,000 offer for those assets).

Mr. Justice Dalphond emphasized in particular that the entities which formed Sixth Ave were unsecured creditors of the White Birch Group only to the extent that the whole amount of the Loan had not been used as a credit bid at the auction. In this capacity, Sixth Ave was not the kind of unsecured creditor that the law seeks to protect. In the circumstances, he concluded that the dissatisfaction of the minority creditors in a syndicated loan should not be allowed to interfere in the context of a reorganization process under the CCAA.

CONCLUSION

While the use of credit bidding is well established in the United States (it is expressly provided for in sales under section 363 (k) of the *U.S. Bankruptcy Code*), it is rather exceptional in Canada.

Although it has been mentioned in certain uncontested cases (*Brainhunter, Eddie Bauer and Maax Corporation*), the White Birch Group matter is the first contested case in which the courts have been called upon to review the issue of credit bidding. The White Birch Group case is therefore a significant precedent.

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