

# International Corporate Rescue



*Published by:*

Chase Cambria Company (Publishing) Ltd  
4 Winifred Close  
Barnet, Arkley  
Hertfordshire EN5 3LR  
United Kingdom

[www.chasecambria.com](http://www.chasecambria.com)

*Annual Subscriptions:*

Subscription prices 2012 (6 issues)

Print or electronic access:

EUR 695.00 / USD 845.00 / GBP 495.00

VAT will be charged on online subscriptions.

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*International Corporate Rescue* is published bimonthly.

ISSN: 1572-4638

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## There's Gold in Them Thar Claims: Funding Cross-Border Litigation in Crystallex's Cross-Border Insolvency

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The sale of distressed businesses or business assets at auction is a regular feature of insolvency practice in commercially sophisticated jurisdictions around the world. Somewhat less common (and particular mainly to those jurisdictions with strong corporate rescue cultures) is the practice of financing the continued operations of distressed firms while those firms reorganise under court supervision. Rarer still is the notion that such financing should, like a sale, be put out for bid at the best terms.

Yet that is precisely what Canadian gold mining concern Crystallex International Corp. achieved recently in a Canadian insolvency proceeding, with concurrent recognition from the US Bankruptcy Court in Delaware in an ancillary Chapter 15 proceeding.

The Crystallex matter offers an interesting – and very creative – approach to monetising what might otherwise be a highly illiquid, speculative, and potentially inaccessible asset held by a troubled company: Significant arbitration claims.

### The company and its claim

Crystallex filed for protection under Canada's Companies' Creditors Arrangement Act (CCAA) on 23 December 2011. The company operates an open pit mine in Uruguay and three gold mines in Venezuela.

Among its Venezuelan projects is the 9,600-acre *Las Cristinas* mine. Court papers filed in Crystallex's case said the site's untapped gold deposits are among the largest in the world, containing an estimated 20 million ounces of gold. Crystallex filed for Chapter 15 bankruptcy protection in Delaware on the same date to protect its US assets while seeking a Canadian restructuring. Delaware Bankruptcy Judge Peter Walsh granted recognition on 20 January.

Crystallex's financial troubles allegedly stem from the Venezuelan government's threatened revocation of Crystallex's operating agreement for the *Las Cristinas* project as a result of the company's failure to obtain an environmental permit. Crystallex blames this failure on the Venezuelan government's own continued failure to grant the permit.

The company continues to operate, but appears to be staking its restructuring hopes primarily on arbitration claims for CAD 3.8 billion in alleged losses suffered in connection with the *Las Cristinas* agreement. Crystallex said it has invested more than CAD 500 million in the uncompleted *Las Cristinas* project. The company believes an arbitration award will provide sufficient funds to pay all its creditors in full while leaving value for the company's shareholders.

Those creditors include secured lenders China Railway Resources Group (owed CAD 2.5 million) and Venezolano Bank about (owed CAD 1 million). They also include CAD 104.14 million in 9.34% senior unsecured notes issued on 23 December 2004. Crystallex's CCAA filing and its concurrent Chapter 15 petition were filed on the same date its notes matured.

### The auctioned post-petition financing

Once under the protection of Canadian and US Courts, the company sought to alleviate its immediate liquidity concerns by means of a debtor-in-possession (DIP) facility. Such financing facilities are a common feature of both US and Canadian practice. Specifically, Crystallex sought a debtor-in-possession loan of CAD 35 million, convertible into an 'exit facility'.

What was unusual about the company's approach to DIP financing was its proposal to open the facility to competitive bidding. Crystallex reported to both the Ontario Superior Court of Justice and the US Bankruptcy Court that it was in receipt of multiple expressions of interest in such a facility. Meanwhile, pending the completion of due diligence and approval of such a facility by the Canadian Court, Crystallex sought recognition of a much smaller CAD 3.125 million 'bridge facility' from Tenor Special Situations Fund, L.P., which the Canadian Court approved on 20 January.

Even the smaller 'bridge facility' was the subject of competing offers. Holders of Crystallex's 9.34% senior unsecured notes proposed a rival CAD 3 million bridge loan, which was to mature on 15 April and accrue 1% per annum interest and therefore be far cheaper for the debtor than the 10% per annum offered by Tenor. Nevertheless, Justice Frank J.C. Newbould

granted Crystallex permission to use Tenor's facility after hearing all of the information presented in the case, including Crystallex's argument that despite its lower pricing, 'countervailing' factors involved with taking a loan from the company's note holders that might impact the debtor in the long run.

The bridge facility was set to expire on 16 April, and required US Bankruptcy Court approval by 20 February. Judge Walsh provided that approval at a mid-February hearing.

## The bid procedures

As outlined for Judge Walsh, the proposed bidding procedures included the following:

- Timely delivery of a 'Participation Package' (defined in the bidding procedures as including an executed non-disclosure agreement, proposed financier's financials, and disclosure of sufficient information to permit Crystallex to determine whether the proposed financier held an 'Adverse Interest' as defined in the bidding procedures).
- Agreement to comply with additional, 'reasonable' due diligence requests by Crystallex.
- 'Qualified Bidders' access to due diligence, interviews with management and with Crystallex's arbitration counsel.
- Access to a separate litigation assessment report regarding the arbitration for those Qualified Bidders who clear conflicts and sign an engagement letter with the firm tasked with preparing the report.
- Provisions for a designated 'Successful Bid' and 'Next Best Bid', both of which are to remain open until one or the other is closed, and both of which must make provision for (i) a CAD 35 million credit facility; (ii) conversion of unused amounts into an 'exit facility;' and (iii) permitted subordinate financing.

The selection of bidders was completely within Crystallex's discretion: 'Crystallex reserves the right to, after consultation with the Monitor, among other things: (i) determine which bidders are Qualified Bidders; (ii) determine which bids are Qualified Bids; (iii) determine which Qualified Bid is the Successful Bid and which is the Next Best

Bid; (iv) reject any bid that is (a) inadequate or insufficient, (b) not in conformity with the requirements of the Bid Procedures or applicable law, or (c) contrary to the best interests of Crystallex and its stakeholders; (v) abandon the Bid Process at any time; (vi) decide not to accept.'

As to interest on the proposed credit facility, the Bidding Procedures note that: 'While the Credit Facility may provide for either current-pay interest or interest paid-in-kind, or provide Crystallex an election right during the term of the Credit Facility between current-pay or paid-in-kind interest, in all cases subject to any limits otherwise provided [in the bidding procedures], Crystallex will consider favourably a Qualified Bid that provides for paid-in-kind interest from closing until maturity.'

- Prohibitions against the taking of equity or trading in claims against Crystallex prior to the Canadian Court's sanctioning of a scheme of arrangement and the US Bankruptcy Court's closure of Crystallex's Chapter 15 case.
- Prohibitions against any break-up fee or expense reimbursement, other than those specifically available to the designated 'Next Best Bidder' (i.e., 4% of the proposed facility and reimbursement of up to USD 250,000 in fees and expenses in consideration for keeping the 'Next Best Bid' open).
- Prohibitions against any economic consideration other than interest on the obligation or the 'Lender Back-End Entitlement'<sup>1</sup> set forth in the bidding procedures.
- 'Discouraged' terms included:
  - 'A paid-in-kind interest rate in excess of 10% or a current-pay interest rate in excess of 5% on the outstanding principal under the Credit Facility.'
  - '[C]ompounding of interest on obligations outstanding under the Credit Facility.'
  - Covenants imposing 'unduly restrictive' budgetary restrictions.
  - Provisions seeking to alter materially the priority of charges in Crystallex's Canadian proceeding.
  - Control rights with respect to the arbitration or Crystallex's reorganisation, or rights to appoint or control Crystallex's board of directors

## Notes

- 1 The 'Lender Back-End Entitlement' is defined in Crystallex's bidding procedures as: 'consideration (in addition to repayment of principal and interest) paid to the Lender in the form of: (i) a payment obligation of Crystallex contingent upon the value of the Net Arbitration Proceeds; (ii) an equity interest in Crystallex; or (iii) a right to convert amounts outstanding under the Financing to an equity interest in Crystallex.' This 'Entitlement' is subject to Canadian usury requirements and other applicable law. Moreover, '[i]n no circumstance shall the Lender Back-End Entitlement involve, or contemplate directly or indirectly, either (i) an acquisition of control of Crystallex, (ii) an acquisition of any interest in the Arbitration Proceeding, or (iii) a receipt of value exceeding a minority of the Net Arbitration Proceeds.'

outside those normally available to lenders under applicable Canadian law.

- A ‘closed bid’ procedure, subject to Crystallex’s ability to hold an auction: ‘Unless Crystallex determines otherwise in its sole discretion (and with consent of the Monitor), no auction shall be conducted following the identification of the Successful Bidder and the Next Best Bidder, absent unanticipated circumstances. However, if an auction is held, Crystallex will supplement these Bid Procedures with auction rules in advance of the proposed date of the auction.’
- Complete cessation of bidding in favour of one favoured ‘preemptive’ bidder: ‘Crystallex may (with consent of the Monitor) abandon the Bid Process and accept a Qualified Bid as the Best Bid (the ‘Preemptive Bid’) provided that: (i) such Qualified Bid is submitted by a Qualified Bidder prior to the Bid Deadline; and (ii) Crystallex believes (after

consultation with the Company Advisors and with the approval of the Monitor) that such bid (a) provides favourable terms, including certainty of closing and timing of funding, and (b) in the informed judgment of Crystallex is not likely to be matched in the Bid Process.’

As of the date of this writing, a US-based recognition hearing on Crystallex’s final DIP facility had been calendared for 16 March.

As noted above, the Crystallex matter offers an interesting and creative approach to funding claims litigation in the corporate rescue context. In addition, Crystallex’s employment of a private monitor in its Canadian proceeding as the initial arbiter of the fairness and reasonableness of management’s discretion under the bidding procedures stands in contrast to common US practice, where management is frequently under more direct judicial supervision, and subject to more direct input from creditors in open court.

## **International Corporate Rescue**

*International Corporate Rescue* addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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