High-Yield Debt

Contributing editors
Arthur D Robinson, Mark Brod and David Azarkh

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GETTING THE DEAL THROUGH

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CONTENTS

Canada

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Market overview

1 Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

There are advantages and disadvantages to these two financing options from both a lender's or investor's perspective and a borrower's or issuer's perspective. The main differences between high-yield debt securities and bank loans for borrowers or issuers in Canada are that high-yield securities need to comply with Canadian provincial securities legislation; offer longer tenor (for non-investment grade borrowers or issuers); are more difficult to amend or obtain waivers in respect of (and therefore need more flexible terms); and generally cannot be repaid early without penalty.

Financing options need to be considered case by case, including the details of the covenant package and pricing and whether or not the debt will be secured. While high-yield debt securities may be secured by second lien security, many high-yield debt securities are unsecured. Most loans obtained by non-investment grade borrowers will be secured and, if bank debt is in place, the security will need to be limited to subordinate second liens. From a lender's or an investor's perspective, a second lien loan has effective priority over trade creditors and other unsecured creditors, up to the value of its interest in the collateral. A creditor is always better off with a second lien rather than being unsecured. From a borrower's or issuer's perspective, there are costs associated with providing collateral to the holders of its junior debt in terms of covenants and restrictions on its flexibility in future financing. However, a borrower should get better pricing on a second lien financing than it would by incurring unsecured debt on substantially the same terms.

2 Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

There are no particular existing or proposed Canadian regulations specifically affecting high-yield debt securities or second lien loans per se. However, as a function of Canada's G20 commitments pertaining to prudential and other financial institution regulations following the 2008 financial crisis, Canadian banks and other institutional investor sectors are undergoing significant regulatory change. These changes are impacting the nature and mix of assets and liabilities institutions are willing and able to hold. To the extent that the Canadian high-yield debt securities and second lien loan markets are cross-border markets with a significant proportion of US investors, regulatory changes in the US have an impact in Canada.

3 Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

The market for placing high-yield debt securities in Canada is relatively new. When the market developed in the US in the 1980s, it did not initially take hold in Canada. Canadian issuers who wished to issue these types of securities typically placed the majority of the issue in the US market. Even after the Canadian market became receptive to high-yield debt securities starting in 2009, certain Canadian issuers have continued to proceed with US-directed placements rather than focusing on the Canadian market. Current market activity is relatively slow due to global equity and bond market trends as well as various market uncertainties, particularly in industries that typically access the high-yield debt market (eg, healthcare, media, airlines, oil and gas). As a result, the Canadian high-yield debt market has been less active since 2013/14, but still represents a potentially attractive method of financing for companies in capital-intensive industries.

Canadian high-yield deals have tended to follow the US model. This uses debt structures in the US and other jurisdictions, such as second lien secured debt. A typical high-yield covenant package includes limitations on debt, liens, making restricted payments and investments, transactions with affiliates, asset sales and mergers. An issuer's subsidiaries guaranteeing other material debt of the issuer are typically expected to guarantee the high-yield debt. However, payment-in-kind provisions have generally not been adopted in Canadian-directed offerings.

High-yield debt can be an attractive investment for certain types of lenders, such as hedge and credit funds, as securities or loan financings. The debt has attractive pricing and the investors may receive the benefit of collateral. Therefore, companies may be able to obtain second lien financing while complying with the terms of first lien secured bank debt and unsecured indentures. There is a tension between holders of second lien debt and unsecured high-yield bonds in the layering of issuers' or borrowers' capital structure that can lead to complex restructurings as the debt matures.

4 Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The issuer and the underwriters responsible for marketing the offering for the issuer are key parties in a high-yield debt financing. The lead underwriter represents the group of underwriters (in a syndicated deal) in designing and negotiating the covenant package and in guiding the company through the negotiation, documentation and securities offering process. These underwriters receive a commission that is a percentage of the securities issue price. Underwriting commissions are commonly differentiated depending on whether marketing to 'retail' investors is contemplated. Rating agencies are involved in high-yield debt financings by providing a rating on the proposed high-yield debt security, which is critical for execution of the deal and the sale of the securities to investors.

Finally, a trust company will act as the indenture trustee representing the bondholders. It will execute the indenture and facilitate the issuance and closing settlement of the bonds and any future payments to, communications with, and any consents, waivers or modifications whether or not these involve a bondholders' meeting or voting procedures. In the case of secured high-yield bonds, a collateral agent, which is often a role played by the same trust company that is acting as the indenture trustee, will hold the collateral and be party to an intercreditor agreement with the senior lien secured creditors, on behalf of the bondholders and other secured creditors.

5 Describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

See questions 3 and 10.

Documentation terms

6 How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

A trust company will act as the indenture trustee representing the bondholders. The indenture functions as the principal operative legal document

in a high-yield bond transaction under which the bonds are constituted and issued. It contains the terms and conditions of the bonds and details pertaining to payments, presentment and documentation. The indenture will also contain the covenant package applying to the company until maturity of the bonds, whereby the benefit of the covenants is held by the indenture trustee on behalf of the bondholders. Default triggers, remedies and how the trustee is expected to exercise these discretions on behalf of the bondholders are included in the document. A communications and voting procedure will outline the circumstances in which the trustee is expected to obtain a bondholder direction before taking certain key actions or decisions. Given the nature of the indenture trustee business, the indenture will also contain a set of extensive protections and indemnities for the trustee.

With secured high-yield bonds, the same trust company typically plays the role of a collateral agent and indenture trustee. This agent holds the collateral and is party to an intercreditor agreement with the senior lien secured creditors, on behalf of the bondholders and other secured creditors. The intercreditor agreement is a key operative transaction document in secured high-yield bond transactions, containing the relative priorities between the high-yield debt and the senior creditors and the rules for the enforcement of the creditors' respective collateral. The relevant collateral will be documented through customary security documents governed by appropriate relevant laws.

High-yield debt securities offerings in Canada are either made by way of an offering to the public using a prospectus, or pursuant to a private placement exemption under applicable securities legislation in Canada using an offering memorandum. The offering document describes the business and financial statements of the company, the terms and conditions of the securities, and the covenant package being offered to investors. It also outlines key risk factors and any required securities laws disclosures and selling restrictions.

Most bank underwriters and their counsel refer to precedent documents used in previous transactions. They are considered 'market standard', which are then customised for each transaction. To the extent that an issuer is a 'first time' high-yield issuer, typically, the deal team will look at recent market precedents and the terms of the issuer's principal bank credit facilities as the starting point.

7 What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

High-yield debt securities tend to have a five, seven or ten-year maturity, with ten-year maturities being rare in current market conditions. Generally, high-yield debt securities are not redeemable at the option of the issuer for a specified number of years to permit investors locking-in an interest rate for a significant period. Redemption provisions containing a 'make-whole' clause allow issuers to call the securities during the non-call period. The ability of an issuer to redeem a portion of the securities (usually 35 per cent) with the proceeds of an equity offering during the three years after the issuance date is another typical exception.

8 How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The lead underwriter will represent the group of underwriters (in a syndicated deal) in guiding the company through the negotiation, documentation and securities offering process. An offering is launched by the distribution of the preliminary offering memorandum or prospectus, typically accompanied by a press release. This leads to the 'roadshow' during which the issuer and underwriter may meet with investors to 'build the book'. The building period varies but is typically one or two weeks. The bankers determine the length of the roadshow and will set a deadline (usually on the last day of the roadshow) for submitting an order for the security. Once books close, the bankers will schedule a pricing call with the issuer and on that call, the bankers and the issuer will agree to the terms of the deal.

Most high-yield debt securities are issued at a fixed coupon, determined as a result of investor demand, the general market, the health and stability of the issuer, the issuer's industry, the covenant package, the financial performance of the issuer, the issuer's performance during the roadshow, etc.

After the pricing call, a pricing term sheet is sent to investors to confirm sales and the underwriting agreement is signed between the issuer and the underwriters. The offering memorandum or prospectus will be finalised by the completion of pricing information and dates and with any other necessary changes. The final offering memorandum or prospectus is then distributed to investors. Once a securities transaction is priced, the securities begin trading. As part of the pricing terms, the parties will also schedule a closing date, which is typically done on a T+3 basis. Therefore, three business days after pricing, the securities offering will close. In the case of frequent or 'repeat' issuers, the above process may be abridged.

9 Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

While high-yield securities covenants are standardised, they are also carefully negotiated and tailored to the specific business needs of the issuer. High-yield covenants seek to regulate the behaviour of the issuer and its 'restricted subsidiaries' that could increase the risk profile of the company issuing the high-yield debt securities, impacting its ability to service its debt. Additionally, the covenant package must preserve the issuer's ability to run its business without undue restrictions and without the need to consult the investors for amendments or waivers in the normal course of business.

The most standard covenants place limitations on issuers ability to:

- incur additional debt;
- grant liens on assets;
- make certain investments, dividends, distributions and purchases of equity or junior debt (known as 'restricted payments');
- sell assets; and
- enter into transactions with affiliates. The high-yield covenant package is flexible in permitting transactions between the issuer and restricted subsidiaries.

The high-yield debt securities covenant package is mainly intended to ensure that the company does not become overextended. The covenants requiring guarantees from existing or future restricted subsidiaries are designed to limit 'structural subordination' by making sure that if a subsidiary of the issuer is guaranteeing other debt, the high-yield debt security holders get the benefit of the same guarantee package. The debt covenant limits the ability to incur more debt unless the issuer has sufficient cashflow to service the debt, and also further limits 'structural subordination' by restricting how much debt non-guarantor restricted subsidiaries may incur. Reporting covenants ensure that there is a flow of information so that the investors can monitor the performance of the company and compliance with the covenants.

The covenant package restricts the amount of cash or assets that leave the 'restricted subsidiaries ring-fence', namely the issuer and all of its subsidiaries that are guarantors or otherwise subject to the covenants – to preserve the issuer's cash and assets that are available to repay the securities. The asset sales covenants of high-yield debt securities establish guidelines that must be followed in any asset sale requiring the issuer to use the proceeds within a prescribed period to reinvest in the business or to prepay debt ranking higher than or equal to the high-yield debt securities in the capital structure. The restrictions on transactions with affiliates are designed to prevent value leakage to insiders ahead of the repayment of bonds.

10 Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

Canadian covenants tend to provide greater protection for investors when compared with US equivalents. Owing to the smaller size of some Canadian high-yield debt transactions than in the US without a pricing penalty (eg, a $75 million deal without pricing penalty), the transactions may involve fewer investors. This may allow some issuers to negotiate covenants less traditional and more tailored to individual needs. Moody's Investors Service reported in 2014 that Canadian high-yield bond covenants had deteriorated over the previous four years, such that the gap between Canadian and US bond covenant protection was narrowing for investors. However, in that study, Canadian high-yield bonds sold domestically still scored stronger from an investor perspective than Canadian bonds sold to US investors ('Moody's: Canadian high-yield bond covenants

deteriorate; trend closer to US bond covenant quality', Moody's Investors Service Announcement, Global Credit Research, 2 December 2014).

11 Are there particular covenants that are looser or tighter, based on a particular industry sector?

The covenant package restrictions are usually related to the credit standing of the issuer, not the industry in which it operates. However, some customisation is necessary for certain industries to ensure that the covenant package aligns with the normal methods of the covenant package in which the industries operate. These industries include the oil and gas and mining, where companies typically operate through joint ventures or co-ownership arrangements.

12 Do changes of control, asset sales or similar transactions typically trigger any prepayment requirements?

Typically, a change of control requires the issuer to offer to prepay the bonds at 101 per cent plus accrued interest. In circumstances where the change of control results in an increase in the trading price of the bonds above 101 per cent or if a redemption by the issuer's new parent at a premium is foreseeable, then holders will most likely elect not to put. Asset sales only trigger a prepayment obligation at par plus accrued interest if the issuer does not use the asset sale proceeds in a manner permitted by the asset sale covenant (ie, use the proceeds to reinvest in the business or pay down debt) within a specified period, which only rarely occurs.

13 Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

The 'double trigger' test (ie, investment grade debt to contain an obligation on the issuer to make an offer to repay at 101 per cent upon a change of control, only if there is both a change of control and a ratings downgrade from one or more rating agencies within a specified period following the announcement of a change of control) has not migrated materially into high-yield debt offerings directed at the Canadian market, although we understand there have been examples in the US.

14 Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

No standard 'crossover' covenant package has evolved in Canada. However, the Canadian market generally permits the suspension of the key restrictive covenants if the securities achieve an investment grade rating post-issuance, but only so long as the investment-grade rating is maintained.

Regulation

15 Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

Each province of Canada has its own securities legislation and enforces compliance with securities legislation through a securities commission or equivalent regulatory body. The provincial bodies coordinate regulatory requirements through the Canadian Securities Administrators (CSA), resulting in the same rules throughout Canada and the reduction of separate regulation by multiple jurisdictions, subject to limited exceptions.

As mentioned above, high-yield debt securities offerings in Canada are made either by way of an offering to the public by a prospectus or pursuant to a private placement exemption using an offering memorandum. By making an offering by prospectus the issuer becomes a reporting issuer under Canadian securities legislation and, therefore, subject to the ongoing continuous disclosure requirements applicable to public companies under Canadian securities legislation. The legislation requires 'reporting issuers' to promptly report publicly any material changes in their affairs, and to prepare and make publicly available quarterly interim and comparative annual financial statements, management discussion, and analysis of financial condition and results of operations and an annual information form.

Accordingly, a company that is not already a reporting issuer will prefer to proceed by way of a private placement. However, many reporting issuers that are already subject to the continuous disclosure obligations will still choose the private placement route because it eliminates the need for prior securities commission review of the offering document and can thereby reduce the time to market. The main disadvantage of a private placement offering is that under the 'closed system' of securities regulation in Canada, the first trade in securities issued in reliance on a prospectus exemption must generally be made under a prospectus, pursuant to a further prospectus exemption or in compliance with the relevant resale restrictions of provincial securities legislation. In contrast, when securities are distributed by way of a prospectus, they are thereafter freely tradeable, unless they form part of a control block.

When the offering is made by prospectus, Canadian provincial securities legislation provides detailed rules prescribing information that must be made available to investors to ensure they have adequate information available when making investment decisions. None of the Canadian provinces have specific prospectus disclosure rules for high-yield debt securities; the general rules for securities issuers apply.

The 'accredited investor' exemption is the most commonly relied on exemption from the prospectus requirement for the private placement of securities. It permits the securities to be placed with sophisticated investors who meet specific criteria – such as institutional investors (eg, financial institutions, insurance companies, pension funds). While a private placement transaction does not require any filing of the disclosure document with Canadian securities regulators at the time of issuing the securities and is not subject to prospectus disclosure requirements, in practice, disclosure is substantially similar to what would be provided in a public offering by prospectus. Nonetheless, because a securities regulator is not required to review private placement offering documents, there is greater flexibility on the timing and procedures for closing and the degree of detailed disclosure as compared with a public offering.

Whether the offering is made by prospectus or offering memorandum, the issuer will have statutory liability (damages or rescission) for any misrepresentation made in the offering document. Technically, the statutory liability will not apply to private placements to offerees in certain provinces, but market practice is for the issuer to offer the same remedies to investors in those provinces contractually.

High-yield debt securities issued by Canadian issuers are often sold or structured and documented with the flexibility to be sold to US investors in either the public market or the 144A market. US securities laws and market practices pertaining to disclosure are relevant as are US broker-registration requirements. High-yield debt securities issued by US based issuers can also be placed in Canada pursuant to the prospectus exemption for accredited investors or pursuant to the multi-jurisdictional disclosure system in place between Canada and the US, but broker-registration issues in Canada require careful attention.

16 Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

No. Whether the securities are being offered publicly in a prospectus offering or by way of private placement, there will be a section in the offering document describing the use of proceeds.

17 On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Preclusions will arise if the offering of high-yield securities is being made in reliance on a prospectus exemption, in which case the types of investors that may be eligible to purchase the securities in the primary offering or in secondary trading may be limited – for example, the investor may need to qualify as an accredited investor within the meaning of relevant Canadian securities laws.

18 Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

Closing mechanics for high-yield debt securities are fairly uniform – the principal transaction documents will all be executed on an agreed closing date and any registrations of security interests in collateral will be made on that date. For settlement, high-yield debt securities (whether issued by way of public offering or private placement) are typically settled and cleared as dematerialised book-entry-only securities through Canada's principal clearing, depositary and settlements firm, the Canadian Depositary for Securities, Ltd (CDS). To the extent that there is a simultaneous offering to US investors, settlement may involve additional steps. However, CDS offers customers two channels to seamlessly effect Canada-US cross-border transactions that interface with the principal US clearing and settlement services firm, the Depository Trust Company (DTC). CDS also interfaces with the European clearing and settlements firm, Euroclear.

Therefore, cross-border offerings can occur on a real-time, trade-for-trade basis; in fact, almost one-quarter of CDS's total trade-processing volume involves the US.

Guarantees and security

19 Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

The subsidiaries of an issuer typically provide upstream guarantees. The guarantee structure will be designed to provide the high-yield investors with the same package as provided to the senior secured creditors. The 2013 dismissal by the Supreme Court of Canada of the guarantor's leave to appeal application in the case of *Royal Bank of Canada v Samson Management & Solutions* provides comfort that the case law protecting the validity and enforceability of continuing guarantees to future liabilities remains intact.

In general, guarantees are limited by Canadian bankruptcy laws in narrow circumstances and, in very few cases, by Canadian corporate laws pertaining to financial assistance. Bankruptcy rules could have an impact on the enforceability of a guarantee but the validity of an intercorporate guarantee is less likely to be successfully challenged under bankruptcy, fraudulent conveyance or preference legislation in Canada than in the US.

Most Canadian corporate laws now permit a corporation to give financial assistance by way of guarantee or otherwise to any person for any purpose, provided it discloses material financial assistance to its shareholders after such assistance is given. However, the corporate laws in a few maritime provinces and in the territories continue to prohibit financial assistance to members of an intercompany group if there are reasonable grounds to believe that the corporation would be unable to meet prescribed solvency tests after giving the assistance, subject to specified exceptions. Also, in certain limited circumstances, granting a guarantee in a manner that disregards the interest of creditors or minority shareholders could be challenged under the oppression provisions of certain Canadian provinces' corporate legislation. Therefore, these issues need to be considered case by case.

20 What is the typical collateral package for high-yield debt securities in your jurisdiction?

The precise collateral package and structure of collateral is determined and negotiated for each transaction and is driven by the nature of the business, the capital structure of the company, the expectations of the noteholders and the expectations of the other creditors. In most secured high-yield transactions, high-yield investors will share in the same collateral package as the senior lenders, on a second lien basis.

The creation of security interests is governed by the law of the province where the property is located or the province where the issuer is organised or has its chief executive office in the case of intangible property and certain other types of property. The creation of security interests in most types of personal property is governed in most provinces by the Personal Property Security Act (PPSA), which is modelled on the US Uniform Commercial Code (UCC). Security interests in both real and personal property can be granted pursuant to a single security document and perfected, subject to certain exceptions, with respect to personal property by the filing of financial statements describing the collateral in the jurisdiction of organisation of the party granting the security interest and with respect to real property by filing at the applicable land registry.

In provinces other than Quebec, while security is granted by means of a written agreement, no particular document formalities need be followed. In Quebec, a Quebec law hypothec document must be used and formalities pertaining to the granting of a hypothec must be followed. Where security is taken in bank accounts, the method for taking security depends on the type of account and the transaction structure.

21 Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

No. However, there are a small number of generally applicable limitations (eg, Crown debts – the right to receive payments from the government – cannot generally be assigned as security).

22 Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

The precise collateral package and structure of collateral is determined and negotiated for each transaction and is driven by the nature of the business, the capital structure of the company, the expectations of the noteholders and the expectations of the other creditors. To date, complex 'crossing lien' or 'split collateral' structures that we understand are sometimes common in the US have not been popular in Canada. It is most common in Canadian high-yield securities transactions that, if the bonds are secured, the bonds get a second lien on the same collateral as the collateral on which the banking syndicate holds a first lien.

23 Who typically bears the costs of legal expenses related to security interests?

The issuer typically pays for the legal expenses.

24 How are security interests recorded? Is there a public register?

In provinces other than Quebec, security interests in personal property (including receivables and bank accounts) attach when value is given and the grantor has signed a security agreement in which the description is sufficient for the collateral to be identified, and are perfected by registering a financing statement in the PPSA registry under each province's PPSA. In Quebec, registration of the hypothec is required. In addition, there are specific statutes, such as the Bills of Exchange Act and the Securities Transfer Act of most provinces, which govern the perfection of assignments and security interests in specific types of assets. Relevancy will depend on the transaction structure and the types and location of assets over which security is being granted. Security interests in certain types of personal property may require the holder of the security interest to take possession or control of the asset.

A security interest in real property (including a mortgage) is perfected by registering the interest in the applicable provincial land titles registry system, although Alberta has a system for registering floating charges affecting real property interests (such as oil and gas leases and extraction licenses) at the same central registry where PPSA financing statements are filed.

25 How are security interests typically enforced in the high-yield context?

The PPSAs in provinces other than Quebec, and the Civil Code of Quebec, contain comprehensive rules dealing with the rights and remedies of creditors following default by their debtors. The rights of a secured party include, but are not limited to, the right to take possession of the collateral, the right to retain the collateral or the right to dispose of the collateral. The PPSAs also enumerate the rights and remedies of the debtor. These include, but are not limited to, the right to redeem the collateral or a right to reinstate the security agreement, and the right to receive notice of the creditors' intentions upon default. Each PPSA also specifies that, in addition to the rights and remedies enumerated in the PPSA, the principles of law and equity continue to apply, unless they are inconsistent with the express provisions of the legislation. Despite the differences in terminology, practices and procedures between Quebec and the PPSA provinces, in most cases, substantially the same or similar rights and remedies are available to creditors in Quebec as those that apply in PPSA jurisdictions. The registration and enforcement of security interests in land are governed by mortgage and land titles legislation in each province and territory.

The indenture trustee or collateral trustee or agent (depending on the structure of the particular high-yield debt securities transaction) would enforce any security interests that it holds on behalf of the holders of the securities in this manner pursuant to the provisions of the relevant PPSAs and mortgage and land titles legislation. A secured party that enforces on collateral outside of an insolvency process generally takes that collateral subject to any other potential liabilities against which the collateral is subject and subject to any priorities in any intercreditor agreement or arising by operation of law pursuant to the relevant PPSAs and mortgage and land titles legislation.

Federal bankruptcy legislation, comprising the Bankruptcy Insolvency Act and the Companies' Creditors Arrangement Act, expressly recognises the rights of secured creditors under provincial laws, but may alter unsecured creditors' priorities from the pre-bankruptcy status. Bankruptcy legislation also sets out provisions regarding preferential or reviewable transactions, and the ability of a creditor to reverse such transactions.

Debt seniority and intercreditor arrangements

26 How does high-yield debt rank in relation to other creditor interests?

The precise ranking of high-yield debt is commercially negotiated and depends on the overall capital structure of the company. In general, the high-yield debt securities rank equally in right of payment with any existing and future senior debt, but the high-yield debt securities holders' liens are effectively subordinated to all senior debt liens. High-yield debt securities are typically senior in right of payment to any existing and future subordinated debt.

27 Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The precise ranking of high-yield debt, including voting and control of key decisions and events, is commercially negotiated and depends on the overall capital structure of the company. The relationship among the creditors will typically be governed by an intercreditor agreement, in which each tranche of debt has a representative and the high-yield debt securities holders will be represented by the indenture trustee. In the vast majority of cases, the party that holds the most senior debt tranche will control any key decisions and will be entitled to enforce a standstill period against junior secured parties.

Tax considerations

28 May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

In Canada, interest expense is generally deductible for tax purposes if it is incurred for the purpose of earning income from a business or property as long as the amount of the interest expense is reasonable in the circumstances. Deductibility generally follows the legal form of the arrangement and (except in the case of interest payments to certain non-resident shareholders) there are no debt-to-equity ratios that affect the deductibility of interest. In addition, interest payments paid to non-residents of Canada who deal at arm's length with the issuer can generally be made free from withholding tax.

29 Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No.

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