

The restructuring landscape

Thanks to a number of factors, the pace of restructuring in Canada is not likely to be brisk for the next few years

If you read newspaper headlines or watch TV news, you may be barraged by stories about the economic troubles in Europe, the US and generally worldwide. You might think these problems would translate into a significant amount of work for restructuring specialists. However, this is not the case. Most restructuring specialists are not working 12-hour days; they are working on lowering their golf handicaps.

The Insolvency Institute of Canada recently held a conference on where and when the next round of Canadian restructurings will happen. As a starting point to what is happening in the restructuring industry today, filings under the Companies' Creditors Arrangement Act (CCAA) were considered.

Over the past decade, the CCAA has been the restructuring vehicle of choice. A CCAA filing initiates a debtor-

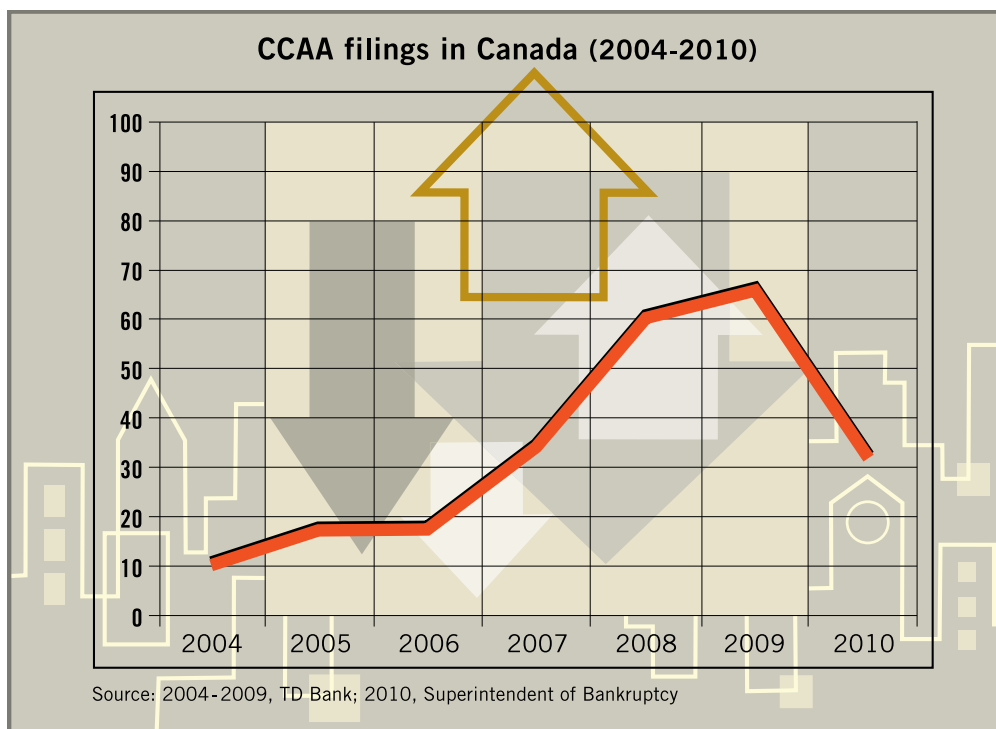
in-possession (DIP) process; thus, it does not expose third parties, such as lenders, to statutory obligations such as environmental and successor employer claims. The lender does not take possession nor operate the business. The CCAA has also proven to provide more flexibility than other restructuring statutes, in larger cases.

The graph below represents CCAA filings in Canada for the period 2004 to 2010.

The sharp increase in CCAA filings in 2007 and 2008 was no doubt a result of the global economic meltdown. It appears that CCAA filings peaked in 2009 with 65 filings whereas there were only 32 in 2010. Will this downward trend continue?

Perhaps restructurings have moved away from the CCAA to other statutes.

The number of business bankruptcies and proposal filings under the Bankruptcy and Insolvency Act (BIA) were also reviewed at the conference. They have declined



steadily in the past years as indicated by the graph on page 44.

The decline in filings seems to be countrywide, with a slight decline, as a percentage, in the West, and an increase in Quebec. Ontario and the Atlantic provinces, as a percentage of filings, remained roughly the same. Put another way, Quebec, in absolute terms, had roughly the same number of filings while the rest of the country decreased.

In a PricewaterhouseCoopers presentation at the Insolvency Institute's conference, it was pointed out that on a regional basis, real estate and construction sectors were a big source of work for restructuring specialists in the West, in Ontario it was the automotive sector, and in Quebec and BC it was the forestry industry. By now, the feeling was that most candidates in these industries have been identified and restructured.

What about size? Since Canwest Global Communications Corp., there have been a limited number of major restructurings in Canada. Almost all filings have been in the midmarket sector, which makes sense given that Canada is largely a midmarket economy. The question is whether there has been a hollowing-out of Canadian industry whereby in the future a significant restructuring may not be initiated in Canada but at a foreign corporate head office.

With enactment of Part IV of the CCAA, it is now easier to have a nonplenary filing (the recognition by Canada of a court order from a foreign jurisdiction whereby that court's orders

are enforced) in Canada. Couple this ease of obtaining foreign recognition orders with the recent controversial Ontario Court of Appeal decision in the Indalex Ltd. case (the Ontario Court of Appeal gave certain pension-deficiency claims a priority claim over a previously court-approved DIP loan obtained in conjunction with a CCAA filing) and it is easy to sense that it will be hard to justify a plenary filing in Canada if there is an opportunity to do one, say, in the US.

It also seems that while Toronto used to be the Delaware of Canada, in that most large CCAA filings were initiated in Toronto, this has changed with major filings in Montreal (Abitibi and Quebecor) and in Calgary (Calpine and Trident). So it seems that four locales can now be the recipient of major Canadian filings, once Vancouver is added to the mix. In 2010 these four cities represented approximately 73% of all CCAA filings. So certainly filings in Toronto will be down.

What is happening on the lending side? Major trends, according to the BMO Capital Markets' conference presentation, include:

- asset values have largely recovered from the depths of 2008-2009, allowing for new lending opportunities;
- there is unprecedented debt-market liquidity in the North American market. On an annualized basis, 2011 is shaping up for issuance of more high-yield debt than ever before;
- interest rates are low, stimulating refinancing activity, thus

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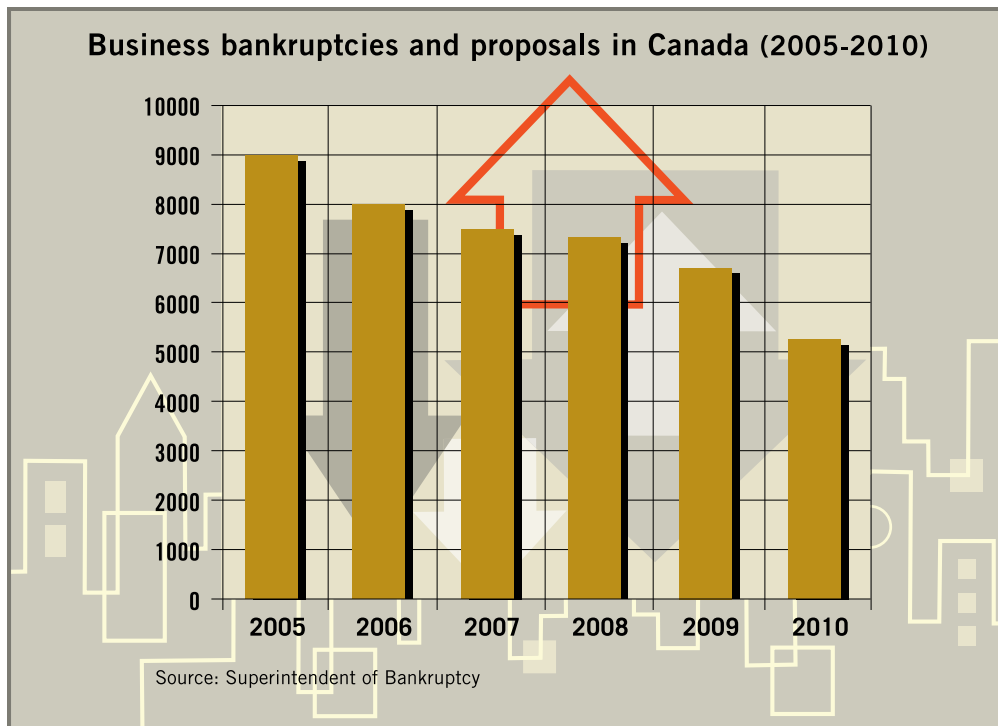
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helping to deal with the US “maturity wall” expected in 2014 through 2017;

- “covenant-light” loans are back with current covenant packages similar to those in 2006-2007; and
- asset-based lending is very much in vogue and on the rise.

So where does this leave the Canadian restructuring landscape? Some broad conclusions were drawn at the conference.

- As long as interest rates are low and companies do not have negative cash flow, lenders will adopt, amend and extend strategies with troubled borrowers. This strategy can work only until interest rates go up. Interest rates are not likely to significantly rise in the foreseeable future given the state of the Canadian and world economies. As well, the impact of an interest rate increase on the Canadian dollar will be taken into consideration by the Bank of Canada. The strength of the Canadian dollar can make businesses big winners or big losers; distributors/importers love it, but manufacturers/exporters hate it.
- Input costs (energy and raw materials) will play a big role in determining whether manufacturers can flourish or even survive. If costs continue to go up at recent rates, then one can anticipate a fallout in the manufacturing sector, especially of companies that are on the margin. The question is how much of Canada’s manufacturing base can survive or will Canada become polarized into a service and commodity-based economy?
- There is a trend to informal work-outs as compared to formal filings. This is largely driven by the cost and time of a CCAA filing. These factors loom especially large in midmarket situations. Nontraditional lenders also are a factor here as companies have a longer time frame to execute a turnaround using a nontraditional lender.

- With the powers and protections now afforded to a “national” receiver (Secs. 14.06 and 243 provisions of the BIA), there may be a shift away from CCAA filings to more receiverships. These sections protect a receiver from becoming responsible for pre-filing employee claims. This concern became an issue as a result of the TCT Logistics case (*GMAC Commercial Credit Corp. of Canada v. T.C.T. Logistics Inc.*, 2004 CANLII 11415, where the Ontario Court of Appeal granted leave to a union to proceed to the Ontario Labour Relations Board as to whether or not a court-appointed receiver is a successor employer). With changes to legislation to address this issue, lenders are no longer beholden to directors to cooperate by filing for CCAA. In a receivership, lenders do not necessarily have to bear the cost of directors’ charges and retention bonuses and promise to pay all government payables and the cost of a CCAA filing.

- It is likely Canada will see the rise of more foreign-recognition orders as opposed to plenary proceedings being commenced in Canada. That is, the main restructuring action will be conducted outside Canada. Until the risk to lenders that lend into distressed situations is resolved by the Supreme Court of Canada as a result of the Indalex decision, given the choice, companies will not want to file in Canada.

So what is the future pace of restructurings? It’s not likely to be brisk for the next couple of years until the current lending activity motivates startups and increased interest rates and input costs separate the successful companies from those just hanging on.

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