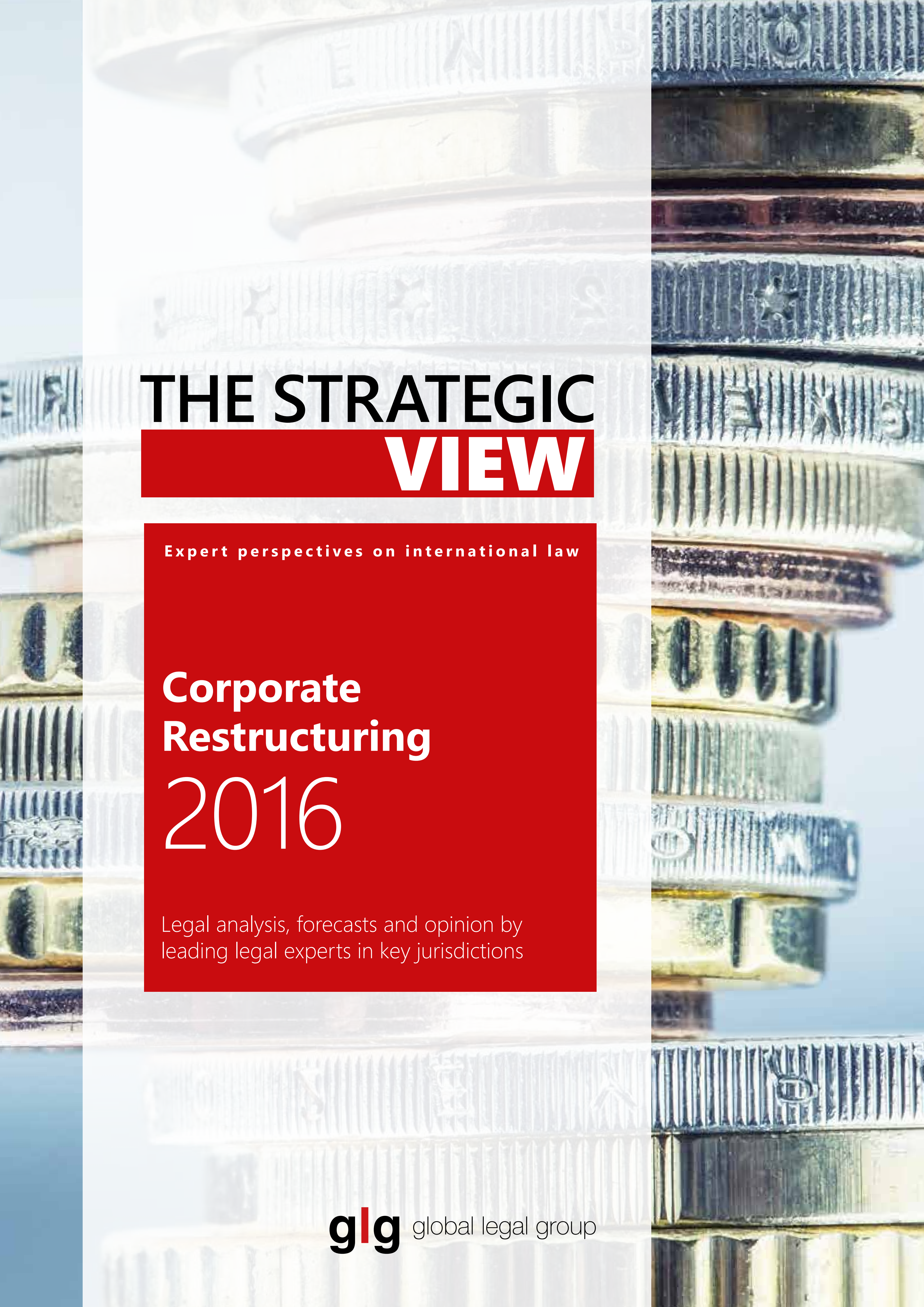

THE STRATEGIC VIEW

Expert perspectives on international law

Corporate Restructuring 2016

Legal analysis, forecasts and opinion by leading legal experts in key jurisdictions

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Corporate Restructuring 2016

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glg global legal group

Published by
Global Legal Group Ltd.
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London SE1 3PL, UK
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Fax: +44 20 7407 5255
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Cover image, chapter images
iStock.com

All other images courtesy of the authors

Printed by
Stephens & George Print Group
February 2016

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ISBN 978-1-910083-84-0
ISSN 2397-2971

Further copies of this publication and others can be ordered from the publisher - please call +44 20 7367 0720

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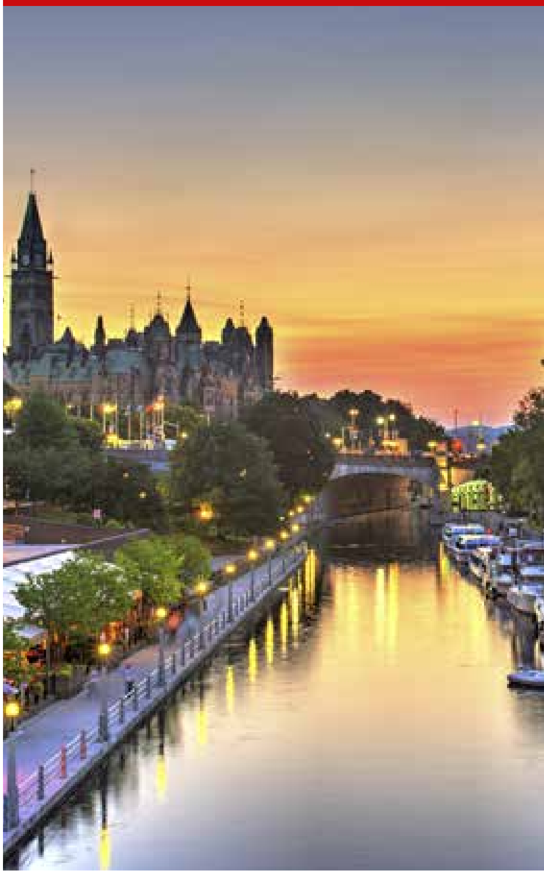

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CANADA

Robert Chadwick and Brendan O'Neill provide an insight into Canada's effective and flexible restructuring regimes, and discuss how Canada has proven to be an ideal forum for both domestic and foreign companies seeking to restructure their debt.

1. What trends, in terms of activity levels, affected industries or investor focus, have you seen in the restructuring and insolvency market in your jurisdiction over the last 12 months?

The last 12 months have seen a significant decline in the prices of oil and commodities, and the Canadian dollar relative to the U.S. dollar. The Canadian restructuring and insolvency market has experienced a corresponding and significant rise in activity within the mining, oil and gas and retail industries. During 2015, a number of high-profile mining, oil and gas, and retail companies entered into Canadian reorganisation proceedings under one of Canada's two main restructuring regimes discussed below, being the CBCA or the CCAA. Mining cases included Jaguar Mining Inc. (CBCA), Cline Mining Corporation (CCAA), Aurcana Corporation (CBCA) and North American Palladium Ltd. (CBCA); oil and gas cases included Connacher Oil and Gas Limited (CBCA), GASFRAC Energy Services Inc. (CCAA), Southern Pacific Resource Corp. (CCAA) and Laricina Energy Ltd. (CBCA); and retail cases included Target Canada Corporation (CCAA) and Comark Inc. (CCAA).

In a number of cases, Canadian companies with assets and operations in foreign countries used the CBCA to effectively, efficiently and quickly restructure their debt obligations through a solvent plan of arrangement process in respect of the Canadian parent company only, and without

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- any foreign proceedings in respect of any of their foreign assets, operations or affiliates.

2. What is the market view on prospects for the coming year?

We expect that the coming year will see the continued effect of the decline in oil prices and the Canadian dollar relative to the U.S. dollar. Most significantly, oil and gas companies are expected to continue to struggle, with a corresponding increase in asset sales both in and outside of court restructurings. Declining oil prices are also expected to impact Canadian manufacturers supplying the Canadian energy sector, although Canadian manufacturers exporting to the U.S. will benefit from higher prices for their goods. The decrease in global commodities prices is expected to cause increased stress for Canadian mining companies in 2016, and we expect that a number of Canadian mining and oil and gas companies (with domestic and foreign assets and operations) will make use of Canada's efficient and flexible restructuring regimes to address liquidity concerns and/or their capital structure. The worsening prices of commodities are also impacting Canadian consumers, businesses and investors beyond the oil, gas and resource industries. The Canadian retail market, which experienced a number of insolvency filings in 2015, including the proceedings of Target Canada Corporation, will continue to struggle in the context of the weak Canadian dollar and commodities prices.

3. What are the key tools available in your jurisdiction to achieve a corporate restructuring – are they primarily formal, court-driven processes, or are informal out-of-court restructurings possible? Do you feel that the tools you have available are effective in terms of providing speedy, fair and predictable outcomes?

The Canadian restructuring regime offers a variety of flexible restructuring tools that can be utilised to achieve the specific goals of a given restructuring. Specifically, struggling debtor corporations can consider restructuring under a number of federal statutes.

While the Canadian regime allows for quick and efficient liquidations and bankruptcies pursuant to the *Bankruptcy and Insolvency Act*, there are a number of additional options for companies seeking to restructure as an alternative to liquidation or bankruptcy. In particular, a company may wish to restructure under the *Companies' Creditors Arrangement Act* (the "CCAA"), the *Canada Business Corporations Act* (the "CBCA") or similar provincial legislation.

The CCAA is a facilitative statute that provides significant flexibility to a debtor company to reorganise its affairs while preserving its corporate existence and maintaining control of its assets and operations. The CCAA functions similarly to chapter 11 of the U.S. Bankruptcy Code as it can be used to implement restructurings in a variety of forms, whether through a plan of compromise and arrangement, the sale of the debtor's business or the liquidation of its assets.

Proceedings under the CCAA commence with an initial filing made by the debtor company with the courts. Notably, Canada has an established system of dedicated Commercial List branches in many of its provincial courts, which deal solely with corporate and restructuring matters, and several Commercial List judges were corporate, restructuring or commercial litigation practitioners prior to joining the bench. Upon the initial filing, the court grants a stay of proceedings in favour of the debtor for a period of 30 days, which can be extended upon application by the debtor to the court. The court also appoints an independent third party (a "Monitor") to monitor the company's operations and assist with the CCAA proceedings. As an officer of the court, the Monitor works to oversee and promote consensus-building among the debtor, its creditors and other stakeholders.

As an alternative to the CCAA, a corporation may restructure its debt by way of a corporate arrangement under the CBCA, the federal corporations legislation, or corresponding provincial corporations legislation, depending on the debtor's jurisdiction of incorporation. Similar to the CCAA, plans of arrangement under the CBCA provide significant flexibility to the debtor.

The CBCA plan of arrangement is unique to Canada. In order to restructure under the CBCA, the applicant company must not be insolvent within the meaning of the CBCA and, generally, courts require a vote of two-thirds of each class of affected stakeholders in support of the arrangement (there is no numerosity requirement). Unlike in the CCAA, there is no court-appointed Monitor and, instead, fairness opinions are obtained in support of the proposed reorganisation transaction. In addition, a CBCA arrangement must be reviewed by the office of the Director appointed under the CBCA. Although the Director may take a position on the transaction, ultimate approval remains with the same Commercial List branches of the courts that hear CCAA proceedings, thereby ensuring that they are adjudicated by specialised judges with substantial corporate restructuring experience.

Even when restructurings are implemented under court supervision, an increasing amount of the negotiations takes place out-of-court, prior to the CCAA filing or CBCA application, in order to reduce costs and negative press arising from court proceedings. It is common for the debtor corporation to seek to achieve stakeholder support prior

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The Canadian restructuring regime offers a variety of flexible restructuring tools that can be utilised to achieve the specific goals of a given restructuring

to the filing or application by way of a support agreement, pursuant to which creditors or other stakeholders would agree to support a transaction if subject to a formal process for approval and implementation. The debtor company would then apply to court for approval of the pre-packaged transaction, minimising time, cost and stigma surrounding the restructuring proceeding and ensuring the company's continuation in the ordinary course.

While Canadian CCAAs and CBCAs do not allow for cram-down of one class on another class, CCAAs and CBCAs do, of course, allow for cram-down on the minority within a class, once the two-thirds approval level is met within the class.

4. In terms of intercreditor dynamics, where does the balance of power lie as between shareholdes and creditors, and as between senior lenders and junior/mezzanine lenders? In particular, how do valuation disputes between different stakeholders tend to play out?

The CCAA was amended in 2009 to make very clear that equity and equity-based claims and litigation are all subordinate to debt in a Canadian restructuring, thereby confirming the "debt before equity" rule in Canada. Several recent CCAA decisions have given clear effect to that rule both in terms of shares (and shareholders) and shareholder law suits, such as class action claims based on losses on shareholdings.

With more and more capital structures being layered with first and second lien debt, more and more Canadian restructurings have encountered the presence of intercreditor agreements and had to deal with intercreditor issues and provisions that relate to a restructuring. Going forward, we expect that Canadian courts will soon be asked (as U.S. bankruptcy courts have in many cases) to determine the enforceability and scope of certain typical intercreditor provisions in Canadian CCAA cases. It will be interesting to see whether or not the Canadian courts assume jurisdiction over such issues in CCAA cases or consider it to be outside of a debtor-focused proceeding. The manner in which that jurisdictional issue is decided will likely depend on the extent to which the determination of any particular intercreditor issue is important to the debtor's overall restructuring – that is, the extent to which a Canadian CCAA court needs to determine the intercreditor issue in order to advance the debtor's restructuring, which is always the prime objective or concern of the court.

Unlike chapter 11 of the U.S. Bankruptcy Code, the CCAA does not permit cram-down of a CCAA plan by one class of accepting creditors on one or more classes of non-accepting creditors. In our experience, the absence of cram-down between classes serves to improve the efficiency of Canadian restructurings as debtors and creditors do not attempt – through what are generally protracted and expensive valuation fights – to cram a CCAA plan down on one another. Rather, the parties realise upfront that they must negotiate with one another or run a sales process or monitor-led valuation to determine value.

5. Have there been any changes in the capital structure of companies based in your jurisdiction over recent years caused by the retreat of banks from loan origination? In particular, have you found that capital structures now increasingly comprise debt governed by different laws (such as New York law governed high yield bonds)? If so, how do you expect these changes to impact restructurings in the future?

Many Canadian companies have debt documents that are governed by New York law, based on the fact that Canadian companies raising money typically want to access the significant sources of capital that reside and operate south of the border, in the U.S. As a result, many Canadian reorganisations in turn involve the reorganisation of New York law governed debt of the Canadian company under a Canadian proceeding, without the need for any proceedings under chapter 11 or chapter 15 of the U.S. Bankruptcy Code, particularly where there are no assets or operations in the U.S.

6. Is there significant activity on the part of distressed debt funds in your jurisdiction? How successful have they been in entering the market, and how much has market practice (or law) evolved in response? If funds have not successfully entered the market, can you identify reasons why?

Distressed debt funds play a major role in nearly every high-profile restructuring in Canada, as they do in the U.S. Like in the U.S., distressed debt funds often purchase the debt of Canadian companies on the secondary market, purchase and sell claims in Canadian reorganisation cases

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and originate prepetition and postpetition loans to distressed Canadian companies. As debt-for-equity plans and credit bidding are common features of the Canadian restructuring landscape, many distressed debt funds purchase the debt of distressed debt funds as part of a "loan to own" strategy to be carried out through an eventual debt-for-equity plan or credit bid in a sale scenario.

7. Are there any unusual features of your insolvency or restructuring law that an external investor should be aware of (such as equitable subordination, or substantive consolidation)?

The ability to quickly reorganise the bank and bond debt of a Canadian company as part of a solvent CBCA plan of arrangement is highly unique to Canada, and a highly effective restructuring tool. CBCA pre-pack plans of arrangement can be implemented very quickly in Canada (in 30 to 45 days typically) with no insolvency stigma, as they are solvent, corporate arrangements. Recently, several Canadian companies with assets and operations in foreign countries where insolvency proceedings are best avoided have used the CBCA to effectively restructure their balance sheet at the parent level only, without any insolvency stigma or insolvency-based defaults, and without the need to file the foreign subsidiaries in difficult jurisdictions.

Similarly, with its lack of cram-down fights, lack of official creditor committees and lower number of court attendances, coupled with oversight of the parties and the process from a court-appointed Monitor, the CCAA continues to be an efficient and highly flexible tool and forum for achieving the multi-party consensus necessary for a reorganisation of a significant, distressed company.

Finally, Canadian reorganisation proceedings have proven very adept at achieving global settlements of the myriad of class action claims and other litigation that can surround a debtor company. With the ability to deliver valuable third party releases under appropriate circumstances, global settlement CCAA cases are proving to be an ideal forum for settling mass tort or multiple securities class action claims, as was the case in the Sino-Forest, MM&A (Lac-Mégantic train disaster) and the Cash Store Canadian proceedings.

8. Are there any proposals for reform of the legal framework that governs insolvency and restructurings in your jurisdiction?

The CCAA was comprehensively amended in 2009 to, among other things, better align the CCAA process with the chapter 11 process under the U.S. Bankruptcy Code, which was important towards ensuring consistency among these two regimes that often co-exist in the simultaneous restructuring of a cross-border North American company on both sides of the border. Below are examples of these amendments:

- Canadian courts now clearly have the authority, among other things, to:
  - approve asset sales of the debtor company outside of the ordinary course of business and the filing of a plan, subject to certain requirements, including that the debtor company can and will make certain employee and pension payments;
  - order the assignment of agreements between third parties and the debtor company without the required consent of the counterparty to the agreement;
  - deem certain suppliers "critical", require such critical suppliers to continue supplying the debtor company and grant a charge in their favour over the debtor's property and assets; and
  - grant charges in favour of:
    - the monitors, trustees, receivers and other professionals (including counsel to the foregoing), in respect of fees and disbursements incurred in the proceedings (the "administrative charge");
    - the lender of a debtor-in-possession (DIP) loan, solely in respect of obligations that arise *after* the date of the initial CCAA order (the "DIP lenders charge"); and
    - the directors and officers of the debtor company, solely in respect of liabilities incurred *after* the date of the initial CCAA order and for which adequate insurance cannot be obtained at a reasonable cost (the "directors' charge").
- The debtor company may now disclaim agreements and the counterparties to disclaimed agreements now have a process to object to the disclaimer.
- The definitions, tests and remedies for preferences and transfers at undervalue have been amended, including providing the court the authority to void transfers at undervalue.
- The provision of a complete code for the recognition of foreign insolvency proceedings in Canada.

9. If it was up to you, what changes would you make?

The CCAA and CBCA provide a very effective and flexible restructuring and insolvency regime, which allow Canadian debtor companies to tailor their restructurings to their circumstances. Canada's restructuring regime is additionally growing in recognition as providing a reliable venue for foreign debtor companies to achieve global settlements of class action claims against them as part of an overall restructuring, with related third party releases. We have seen the use of the CCAA in the

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past few years in this respect for the asset-backed commercial paper crisis, Sino-Forest Corporation, Cash Store Financial Services Inc. and MM&A in the Lac-Mégantic rail disaster.

That said, professionals in charge of CBCA and CCAA restructurings will need to carefully control costs so that the restructuring benefits that can be achieved in Canada are not diluted by unreasonable or unnecessarily high professional fees and costs. In addition, while DIP financing can be a vital and important part of Canadian restructurings, Canadian courts and creditors need to be mindful not to give too much control to a DIP lender who is there to bridge the company to a restructuring for the benefit of more junior, fulcrum stakeholders.

Acknowledgment

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