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Corporate recapitalizations as an alternative to insolvency proceedings

DECEMBER 6, 2016 6 MIN READ

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In the current economic environment, and in particular as a result of low oil and gas prices affecting the energy sector, corporations in financial difficulty are increasingly turning to the arrangement provisions of the *Canada Business Corporations Act* (CBCA) or equivalent provincial corporate statutes to restructure corporate bonds and similar debt obligations. CBCA arrangements have proven to be an effective and flexible alternative to formal insolvency proceedings to restructure or recapitalize certain debt obligations and achieve other fundamental changes to a corporation's capital structure. A successful CBCA arrangement proceeding can be completed in a much shorter timeframe than a restructuring under the *Companies' Creditors Arrangement Act* (CCAA) or the *Bankruptcy and Insolvency Act* (BIA), is potentially less costly than an insolvency filing and has fewer repercussions for a corporation's business and its reputation.

CBCA arrangements are an attractive alternative where a company does not need to restructure its contractual obligations, stay significant litigation or obtain a liquidity lift by staying payment of pre-filing obligations but is under pressure due to debt on its balance sheet that is not supported by its forecast EBITDA. The key to success is to build a consensus with major securityholders and lock up support for the arrangement long before the first court appearance.

Arrangement approval process

A CBCA arrangement is effected through a plan of arrangement that is generally approved by the holders of a super-majority (i.e., two-thirds) of the value of the affected securities and sanctioned by a court. Unlike a vote on an insolvency plan, where a plan must be approved by a double majority consisting of two-thirds in value and a majority in number of affected creditors in a given class, a CBCA arrangement vote does not also require approval by a numeric majority of the holders of the security in question.

The court proceeding formally begins with an application for an interim order that authorizes the company to call one or more meetings of affected securityholders to vote on the plan of arrangement. In addition, the interim order often imposes a stay of the rights and remedies of any securityholder that is to be affected by the proposed plan of arrangement. Courts have also granted a stay of any cross-default provisions that may be triggered by a default arising under the affected securities. The stay is normally much narrower than the stay granted in an insolvency proceeding, where a broad stay applies to the rights and remedies of creditors, contractual counterparties and other stakeholders.

Once the interim order is granted and the plan of arrangement is approved by the requisite majority of securityholders who attend the meeting(s), an application is made to the court for

a final order sanctioning the plan as fair. Following the final order, the plan can be implemented to exchange or extinguish either debt or equity securities and/or to compromise the corresponding obligations in exchange for the consideration contemplated by the plan.

Shorter timeframe

In the right circumstances, a final order approving a plan of arrangement under the CBCA can be obtained in less than 60 days from the commencement of the proceedings. A CBCA arrangement is often completed in a matter of months, whereas an insolvency restructuring generally takes longer (though either form of restructuring can be completed in a shorter timeframe in the right circumstances).

The formal commencement of CBCA arrangement proceedings is often the culmination of intense negotiations that begin long before any court materials are served. A company seeking to restructure its debt should begin negotiation of a support agreement with major securityholders well in advance of the occurrence of a looming default. A support agreement is designed to ensure that the outcome of the meeting to approve the plan of arrangement is determined before it is called.

Pre-negotiated outcome

A typical support agreement will, at a minimum, set out the principal terms of the arrangement as well as bind the supporting securityholders to vote in favour of the arrangement and to forbear from enforcing any remedies. It will also prohibit supporting securityholders from pursuing alternative arrangements with other interested parties.

Initial supporting securityholders will frequently receive an early mover premium in addition to the consideration given to all securityholders under the arrangement. The carrot represented by the premium is often coupled with a stick: the support agreement can require the company to file for insolvency protection and implement an alternative restructuring transaction on the occurrence of certain events, including failure to obtain support from shareholders or other securityholders in the capital stack. The threat of an insolvency and the corresponding potential for value erosion are often enough to bring stakeholders to the table. This is particularly effective for shareholders, who stand to lose their entire investment if the company becomes insolvent.

No need to admit insolvency

CBCA arrangements may be available to insolvent corporations so long as one of the applicant companies is solvent or the corporation will become solvent as a result of the arrangement. Unlike a company seeking insolvency protection, a corporation undergoing a CBCA arrangement proceeding does not need to admit insolvency and is not prohibited from paying its trade creditors in the ordinary course. Short-term trade credit is usually not affected. The company can continue to do business as usual, with minimal impact on employees, customers or suppliers. Some shareholder value can be preserved. Professional fees tend to be lower than in an insolvency due to the shorter length of the proceedings and the fact that fewer stakeholders are affected by or participate in the process.

An attractive alternative

In the right circumstances, a CBCA arrangement is an attractive alternative to formal insolvency proceedings. There are limits to the types of restructurings that can be accomplished using a CBCA arrangement. The CBCA arrangement provisions have not typically been used to restructure traditional bank debt (though examples do exist) and have not been used to complete operational restructurings or to address commercial contractual arrangements. In addition, a CBCA arrangement does not permit a company to seek a super-priority charge to secure any new funds that the company needs to complete the arrangement. However, where a corporation is looking to reorganize its capital and compromise securities and does not require additional liquidity, a CBCA arrangement can be a flexible and effective tool to accomplish these objectives.

Osler has been involved in some of the country's largest and most complex CBCA restructurings this year, including Tervita Corporation, Trident Exploration Corp. and Postmedia Network Canada Corporation. Osler was lead counsel for Tervita Corporation and for Trident Exploration Corp., which are two of the very few successful CBCA debt restructuring arrangements that have occurred in Alberta in the current economic environment. While a CBCA restructuring has some limitations, it is a powerful tool that can be deployed in the right circumstances.