



# Restructuring Your Business

## It Is Not As Bad As You Think!

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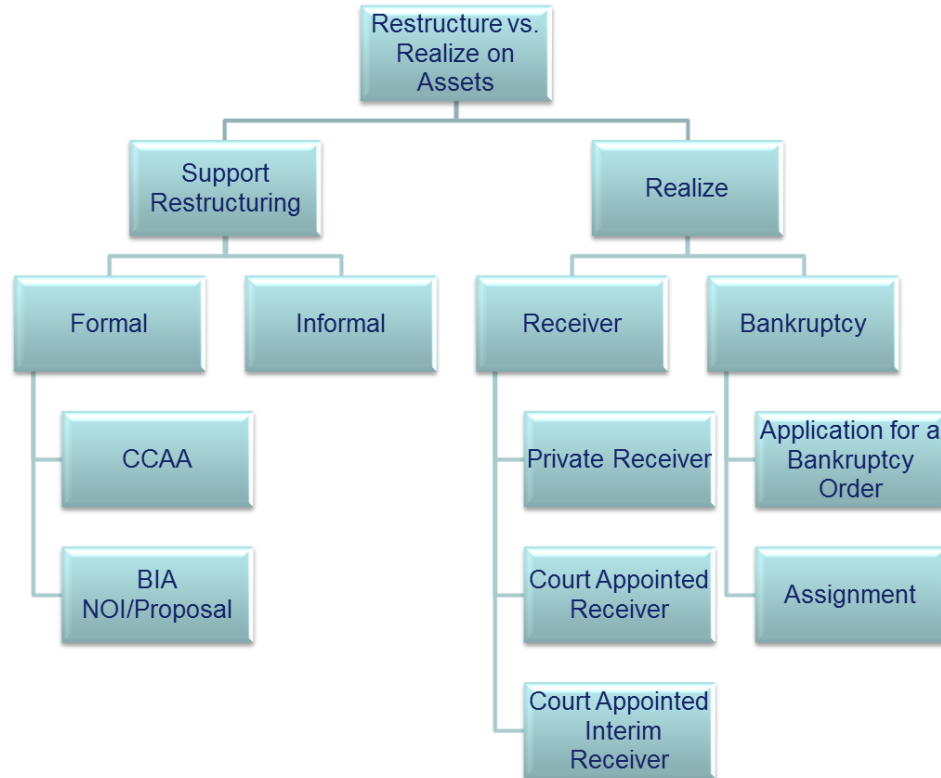
# Overview

This primer will provide:

1. an introduction to the various restructuring and liquidation tools available to both creditors and debtors;
2. an overview of the types of debts and obligations that may be owing by a debtor company;
3. the role of the court appointed officer (i.e. a Trustee, Receiver or Monitor) in a formal restructuring/insolvency proceeding; and
4. practical tips for assessing and managing any troubled waters that lay ahead.

# Overview – Insolvent Companies

## Restructuring vs. Realization on Assets





# Overview – Solvent Companies

- The previous slide provided the options available to companies that are insolvent, BUT, companies do not need to be insolvent to restructure their affairs.
- Our business law statutes (OBCA, CBCA) provide ways for solvent companies to restructure or wind up their business in an orderly (and sometimes court supervised) process.
- The restructuring / winding up of a solvent company is very similar to that of an insolvent company, however, there are additional considerations such as:
  - additional tax implications;
  - shareholder rights; and
  - dividend distributions.

# Creditors – Types of Claims

- There are many types of debts and obligations that a company may have, some of the most typical are:
  - Loans
  - Tax obligations
  - Trade debt
  - Employee obligations
  - Pension deficiencies
  - Unsatisfied judgments
  - Rent payments
  - Lease payments
  - Etc.





# Creditors – Priority of Claims

## Who gets paid first?

- All of these creditors want their money, but what if there isn't enough money for everyone? That's why our laws have created a priority system.
- The priority system is very complicated and there are exceptions to the rules, but generally the priority is:
  1. Trust claims
  2. Secured creditors
  3. Preferred creditors (at least in a bankruptcy)
  4. Unsecured creditors
  5. Shareholders

# Creditors – Types of Claims

- Trust Claims
  - Several different types of trusts.
  - Two main types seen in insolvency proceedings are statutory trusts (trust relationships created by law, most often related to a company's obligation to collect taxes and remit back to the government) or express trusts (trust relationships created by agreement and maintained in accordance with trust law).
  - Are usually the first to be paid because trust property is not considered to be property of the debtor company...it is merely property held by the debtor on behalf of a third party (the government, a beneficiary etc.).
  - Only are entitled to the “trust property” in priority to everyone else BUT, statutory trusts often state that all of the debtor's assets are impressed with a trust.
  - Will be important when we discuss tax arrears and employee obligations.

# Creditors – Types of Claims (cont...)

- Secured Creditors
  - Are generally anybody who has loaned money to a debtor and as security for the loan has been granted a lien over some or all of the assets of the debtor (i.e. a mortgage, security over equipment, over receivables etc.).
  - The security can be over specific property (like a mortgage over real property, or a lien against a financed vehicle) or can be over all of the debtor's assets.
  - There is a ranking (or priority) as between secured creditors. As a general rule, if more than one party has security over an asset, absent a priorities agreement between secured creditors, the first to perfect will get paid first, then the second...and so on.
  - BIG exception to the priorities scheme for secured creditors are Purchase Money Security Interests (aka PMSIs).
  - Secured creditors will be discussed in greater detail later.



# Creditors – Types of Claims (cont...)

- Preferred Creditors
  - Are unsecured claims that the government has decided should have priority over the other unsecured claims.
  - The list of preferred claims can be found in the *Bankruptcy and Insolvency Act* and include such things as unpaid employee wages, rent arrears and expenses relating to administering a bankrupt's estate.
  - Like secured creditors, there is a ranking (or priority) system for preferred claims. Section 136(1) of the *Bankruptcy and Insolvency Act*, provides the order of priority.
  - Many preferred claims limit the amount that a preferred creditor can receive on account of their preferred claim. The balance of their claim is an unsecured claim.

# Creditors – Types of Claims (cont...)

- Unsecured Creditors
  - Unsecured creditors are everyone else that is owed money from the debtor company but do not fall into the other categories above.
  - These creditors do not get anything until all of the other claims have been paid in full.
  - If there is money available for unsecured creditors, they all share on a *pro-rata* (or in proportion to the amount of their debt) basis.
  - There are limited circumstances where unsecured creditors can see their claims rise in priority. These will be discussed later in the presentation.

# Roles of the Court Officer

## Who Does What?

- Bankruptcy – Trustee
- Receivership – Receiver or Receiver and Manager
- Proposal (Restructuring ) – Trustee
- CCAA (Restructuring) – Monitor/Plan Administrator

Role	Duties	Powers
Trustee (Bankruptcy/Proposal)	An individual or corporation licensed by the federal government pursuant to <i>The Bankruptcy and Insolvency Act</i> to administer insolvent debtors' estates for the benefit of the debtors' creditors.	Based on <i>The Bankruptcy and Insolvency Act</i>

# Roles of the Court Officer (cont...)

## Who Does What?

Role	Duties	Powers
Receiver or Receiver-Manager	An individual or corporation appointed by the Court or a creditor under a security instrument to receive and/or manage and sell the assets of the debtor. A receiver may also be appointed by the Court for other reasons. For example, a receiver may be appointed in a shareholders' dispute or to safeguard assets pending litigation.	Based on Court Order or powers granted under the security instrument

# Roles of the Court Officer (cont...)

## Who Does What?

Role	Duties	Powers
Monitor/Plan Administrator under CCAA	An individual or corporation appointed by the Court to monitor the business and financial affairs of the company while the debtor formulates a plan of compromise or arrangement, and to report to the court. Once a plan of compromise or arrangement is accepted/approved, the role shifts to administering such plan	Based on Court Order and plan of compromise or arrangement

# Tax Claims in an Insolvency

## What is your Exposure?

Type of Tax	Priority of Tax Claim	Directors' Liability
Source deductions	Section 227 of <i>the Income Tax Act</i> (ITA) and related legislation gives Canada Revenue Agency ("CRA") claims an absolute priority against the property of the debtor for any amount that has been deducted or is deemed to have been deducted from employees' wages for statutory remittances to CRA but which were not remitted.	The ITA and related legislation provides that where a debtor corporation has failed to remit tax withheld (source deductions) the directors of the corporation are jointly and severally liable for the amount withheld, plus penalties and interest.

# Tax Claims in an Insolvency (cont...)

## What is your Exposure?

Type of Tax	Priority of Tax Claim	Directors' Liability
GST/HST	Section 222 of the <i>Excise Tax Act</i> (ETA), gives CRA an absolute priority against the property of debtor for any GST/HST amounts that have been collected but were not remitted.	The ETA provides that the directors of a corporation that was required to remit GST/HST collected, are jointly and severally liable with the corporation for the payment of that tax.

# Tax Claims in an Insolvency (cont...)

## What is your Exposure?

Type of Tax	Priority of Tax Claim	Directors' Liability
Income Tax (Corporate)	No Priority (however, could be claimed as an off-set against SR&ED claim refunds)	None
Employer Health Tax (Ontario)	No Priority (however, could be claimed as an off-set against OITC claim refunds)	None



# Secured Creditors and the Insolvency Process

## Generally

- Most secured claims (with the notable exception of certain statutory secured claims) are creations of contract. That means the relationship between creditor and debtor is governed by that contract.
- Most security agreements outline the secured creditors rights in the event that a debtor defaults. These rights usually relate to rights to enforce on the collateral and the way in which enforcement may take place.
- While the security agreement may define the terms of the debt and the remedies available on default, there is legislation governing how enforcement can occur. For example:
  - notice requirements under the *Bankruptcy and Insolvency Act*, *Personal Property Security Act*, *Farm Debt Mediation Act* etc.
  - stay of enforcement proceedings if debtor embarks on court supervised restructuring

# Secured Creditors and the Insolvency Process (cont...)

## Typical Enforcement Options

- Once a secured creditor has provided adequate notice and if the debtor has not obtained a stay of proceedings, the secured creditor may enforce. Two typical enforcement options are:
  1. Receivership
    - Licensed trustee in bankruptcy is appointed and takes possession of the assets subject to the secured creditor's security.
    - Receiver's mandate is to liquidate the assets and maximize recovery.
    - Receiver can be privately appointed (i.e. security agreement provides for appointment of receiver on default) or by court appointment (i.e. court appoints licensed trustee to act as its officer in managing the liquidation of assets).
    - Most common secured creditor enforcement method where there are substantial assets and secured creditor has priority over most, if not all, of those assets.
  2. Sale of Assets/Foreclosure
    - If a secured creditor only has security over a specific asset, or a small number of assets, it may decide to sell or foreclose on the asset without the need for a receiver.
    - Sale must still be commercially reasonable.

# Secured Creditors and the Insolvency Process (cont...)

## Private Receiver vs. Court Appointed Receiver

- When the security permits the appointment of a receiver, the secured creditor can elect to proceed with a private appointment or a court appointment. Some key differences between the two are:

	Private Appointment	Court Appointment
<b>Cost</b>	usually cheaper	usually more expensive
<b>Stay of Proceedings?</b>	no	yes
<b>Role of Receiver</b>	agent of secured creditor	officer of the court
<b>Protections for Receiver</b>	very limited	court ordered release of liability except for gross negligence or willful misconduct
<b>Funding of Receivership</b>	at the discretion of the secured creditor	at the discretion of the receiver and the court



# Unsecured Creditors and the Insolvency Process

## Debtor Restructuring

- Unsecured creditors often have little leverage in a liquidation, but can hold much of the power when a debtor company wishes to restructure its affairs.
- Restructuring under either the CCAA or the BIA requires creditors to vote in favour of any plan of arrangement by a majority of creditors in number in a class representing at least two thirds of debt value in that class.
- The result is that large creditors (or a block of like minded creditors) can exert influence on the nature of the plan of arrangement proposed to creditors.
- Furthermore, many creditors are likely suppliers or partners of the debtor. If the debtor wants to continue doing business with those suppliers it will likely need to treat them fairly.



# Unsecured Creditors and the Insolvency Process

## Liquidation of Assets

- In Canada, when a company is wound up due to insolvency, the liquidation is most often instigated by the secured creditors.
- In most instances this means little or no money for unsecured creditors, however, there are instances where unsecured creditors may be able to recover some or all of their debt by other means. For example:
  1. Do you owe the debtor money? You may be able to set off those payments against the debtor's obligations to you.
  2. Did you deliver goods within 30 days of the receivership or bankruptcy? You may have the right to repossess those goods.
  3. Is your claim something that allows you to claim lien rights (construction liens or storage liens for example)? Your lien (or lien rights) may give you leverage in negotiations with the secured creditors.



# Employees and the Insolvency Process

## Employee Rights/Entitlement

- Employees are often a significant stakeholder in an insolvency and restructuring situation. Understanding employee rights and claims is important in the context of assessing the position of a company, its directors and its creditor in the event of an insolvency. In addition, it is key to assessing the alternatives available.
- In the situation of a bankruptcy or receivership, employees are able to be compensated up to \$3,738 (2014) for unpaid wages, vacation, severance and termination pay earned during the 6 month period preceding the insolvency under the Wage Earner Protection Program/Service Canada.
- The insolvency and restructuring professional is charged with administering certain aspects of the laws designed to protect the rights of employees.

# Employees and the Insolvency Process (cont...)

## Employee Rights/Entitlement

- Employee rights and employer obligations and liabilities are governed for the most part by provincial legislation (The Employment Standards Act) and/or collective bargaining agreements, as well as certain federal legislation (BIA and WEPPA) in the situation of an insolvency.

Type of Tax	Company's Liability	Directors' Liability
Ontario Employment Standards Act (OESA)	<p>Wages and vacation pay are a provincial (Ontario) statutory trust claim, in the case of a receivership, but not in a bankruptcy (reversal of priorities)</p> <p>No priority for termination or severance pay</p>	<p>The directors are jointly and severally liable to the employees for amounts not exceeding 6 months' wages that become payable while they are directors and for the vacation pay accrued while they are directors for not more than 12 months</p>

# Employees and the Insolvency Process (cont...)

## Employee Rights/Entitlement

Type of Tax	Company's Liability	Directors' Liability
BIA/WEPPA	Protected by a statutory security over current assets in the event of bankruptcy or receivership. The claims that are protected are wages, salaries and other like remuneration, including vacation pay, for work performed in the 6 months before the bankruptcy or receivership, up to \$2,000/employee.	The directors are liable to Service Canada for such balance not recovered from the receiver or trustee out of the realizations in the estate, up to the \$2,000/employee paid under the WEPPA.



# Employees and the Insolvency Process (cont...)

## Employee Rights/Entitlement

Type of Tax	Company's Liability	Directors' Liability
OBCA and CBCA (as applicable)	No statutory priority	<p>OBCA - The directors are jointly and severally liable to the employees for amounts not exceeding 6 months' wages that become payable while they are directors and for the vacation pay accrued while they are directors for not more than 12 months.</p> <p>CBCA – The directors are jointly and severally liable with the corporation for amounts due, up to an amount of 6 months' wages.</p>



# Employees and the Insolvency Process (cont...)

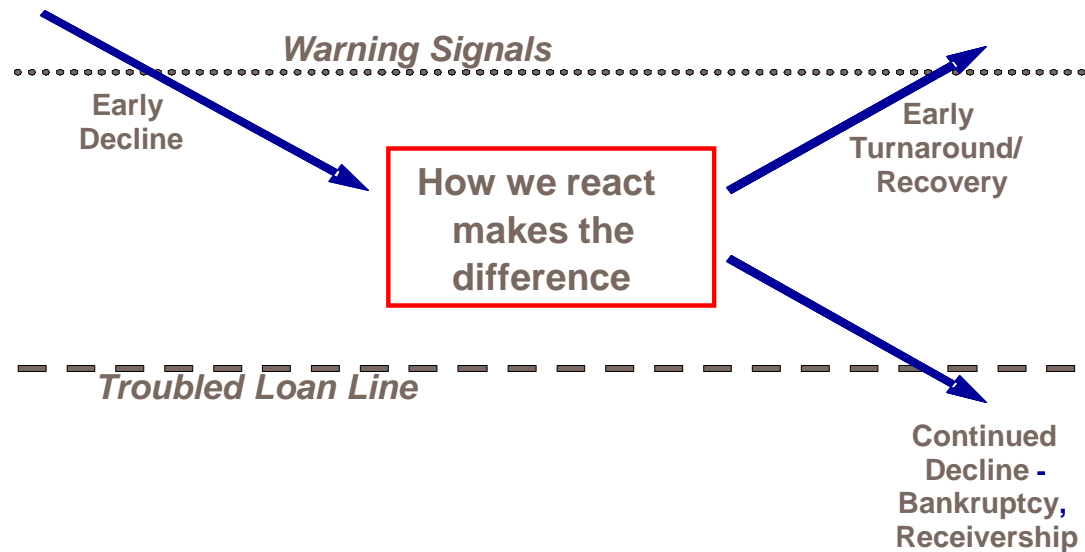
## Employee Rights/Entitlement

- Employees' benefits arising from pension plans are also protected by a statutory security in the event that the employer becomes bankrupt or goes into receivership. The claims that are protected are amounts withheld from the employees' salaries, contributions due by the employer to a defined contribution plan, and normal cost payments due by the employer in connection with a defined benefit plan.

# Are Financial Storm Clouds on the Horizon? Can You Restructure?

All companies experience difficulties or setbacks at one point or another - **What's important?**

- Recognizing the Warning Signals.
- Having the ability to respond on a timely basis.
- Being proactive to address the problem or issue.



Source: Turnaround Management Association – Troubled Loan Workout Program (November 6, 2002)



# Are Financial Storm Clouds on the Horizon?

## Required Elements for Restructuring

- Viability of the Business
  - Is there a profitable core business
  - Grow revenue to key customer (strategic, significant, profitable)
  - Tactical cost reductions
  - Management changes
- A Balance Sheet that can be Repaired
  - Working capital improvements
  - Redundant assets, underperforming divisions
- Refinancing or Cash Injection
  - Replacement of senior debt
  - Sub-debt or equity
  - Strategic investor or partner



# Are Financial Storm Clouds on the Horizon?

## Required Elements for Restructuring

- Commitment of Management
  - Up to the challenge
- Turnaround Action Plan
  - Achievable
  - Reflects well define Actions to be taken, no simply Strategies
  - Accountable and measurable (financial projections/budget)
- Support of Key Stakeholders
  - Major lender(s)/investor(s)
  - Employees/union
  - Major suppliers/customers

Key - Understand your options and the outcome you desire to be achieved

# Your Financial Difficulties

## What to Do - Tips and Tricks

- If your company is in financial difficulty, here are three key things to remember:
  1. In most instances, your creditors just want to get paid...BUT, the long term relationship is often just as important to them. If you can show them a credible long view, many will take short term pain to keep a long term customer, supplier, business partner etc.
  2. Banks are not in the business of shutting down companies, they are in the business of making money off the money you borrow from them. Shutting down a business is often a very costly proposition that rarely gets the bank paid in full. In contrast a credible plan from a debtor company, executed by people the bank trusts and provides an appropriate exit plan for the bank will often gain traction.

And, most importantly:

3. When you first see financial problems on the horizon, engage respected insolvency professionals. Not just to line our piggy banks, but because there are many restructuring options available when you are the only one who knows of the problems on the horizon. Once your suppliers, customers and banks figure it out, there are fewer options and less we can do.

# Your Customers with Financial Difficulties

## What to Do - Tips and Tricks

- If you do business with a company that is in financial difficulty, here are three ideas for protecting your payment:
  1. Shorten or eliminate the payment terms provided to that company. Cash in advance or cash on demand would be ideal, but may be untenable.
  2. Consider whether there are ways to secure payment for your product. If you are providing equipment or inventory to your customer, maybe the purchase can be financed and secured by way of PMSI). Maybe your customer will grant you security in assets for continued payment terms.
  3. Depending on the relationship with your customer, think about whether this is a time to acquire some or all of your customer's business. If the synergies are there and the timing is right, distressed companies are often a good value. In addition, if you can make the acquisition without your customer becoming bankrupt or subject to a receivership, you may be able to set off the debts as part of the purchase price.



## Case Study

# What Happens When you Don't Engage Insolvency Professionals Soon Enough...

- Facts

- Canadian nutritional supplement company is a subsidiary of an American corporation that is experiencing financial difficulties.
- US corporation transfers shares of Canadian subsidiary (we will call them “SubCo”) to secured creditor (we will call them “Private Bank”) in partial satisfaction of its debt.
- SubCo has expanded too quickly and shortly thereafter lost one of its largest customers.
- SubCo has significant tax arrears, payables are not being paid in a timely fashion and Private Bank is extending additional money to keep the Canadian business operational.
- Ultimately, Private Bank decides that it will no longer fund losses. SubCo will either live or die on its own cash flows



## Case Study (cont...)

# What Happens When you Don't Engage Insolvency Professionals Soon Enough...

- Management Decisions

- SubCo made its first call to an insolvency professional in early 2012 regarding restructuring options. At this time, only security in place was that of Private Bank and as they were (through a related entity) the sole shareholder, Private Bank was cooperative. Key issues were \$1M in trade/supplier debt and significant tax/employee remittance liabilities. Cash flows could sustain business IF SubCo did not have to make payments on account of arrears (just pay accounts payable on a go forward basis).
- Numerous restructuring options were available, however, SubCo decides against a formal restructuring and instead opts to factor receivables. Result is that Private Bank's security in the receivables is subordinated and while there was a large influx of cash on closing the factoring arrangement, within months there is a cash flow problem as the company is now having to operate on reduced cash flows due to the factor's fees and charges reducing the value of the receivables.



## Case Study (cont...)

# What Happens When you Don't Engage Insolvency Professionals Soon Enough...

- Management Decisions (cont'd)
  - SubCo makes its second call to an insolvency professional in the summer of 2012 and wishes to revisit its restructuring options. With its receivables encumbered by a factoring company, there are fewer restructuring options available, but the receivables (albeit reduced now) together with existing inventory and customers could provide some opportunities providing that there is a stay of proceedings in place and fruitful negotiations with the landlord regarding a reduction in both rent and space required.
  - Rather than restructure, SubCo chooses to finance the purchase of its raw material. To put this in perspective, now each dollar of A/R that comes in is automatically reduced by an amount sufficient to pay the factor and an amount to service the raw material loan, not to mention that Private Bank has subordinated its security to yet another lender. Furthermore, without an insolvency proceeding, there was limited leverage in negotiations with the landlord.
  - However, the raw material financing certainly created short term relief on the cash flows as the lender was now paying the suppliers directly.



## Case Study (cont...)

# What Happens When you Don't Engage Insolvency Professionals Soon Enough...

- The End of the Road
  - Around Christmas 2012 SubCo makes its third call to an insolvency professional. At this point everyone at SubCo acknowledges there is nothing more they can do and ask the insolvency professionals to present a plan to restructure the business.
  - Unfortunately, with both A/R and raw materials fully encumbered and Private Bank insisting it will not inject further funds into SubCo, the only option available was an orderly wind down and liquidation of assets.
  - Recoveries from the liquidation left very little for Private Bank, no jobs for SubCo's employees and many customers scrambling.



## Case Study (cont...)

# What Happens When you Don't Engage Insolvency Professionals Soon Enough...

- Takeaways

- While certainly a distressed company, SubCo's cash flows in early 2012 were sufficient to fund a restructuring. With appropriate concessions from suppliers, the government and the landlord, a downsized version of SubCo could have been returned to profitability.
- However, the hardest thing for all of us to do is admit we need help. SubCo was no different. It thought it could "right the ship" on its own without help from the insolvency professionals or court protection.
- While cash is always important to a company, when a company is in financial difficulty it is most important.