What's New in the "True North" – Recent Canadian Restructurings

Robert I. Thornton[1]

The most significant restructuring events in Canada in 2004 were the successful emergence of Air Canada – Canada's largest airline - from its 18-month *Companies' Creditors Arrangement Act* ("CCAA") restructuring and the ongoing battle to restructure Canada's largest integrated steel manufacturer, Stelco.

Air Canada

The restructuring started well in April 2003. The largest debtor-in-possession type financing ever arranged in Canada, (approximately CDN$1 billion) was made available by GE Capital, which, through its aviation services subsidiary, GECAS, was also one of the largest stakeholders leasing approximately one third of the operating fleet to Air Canada. Labour concessions were soon worked out with the unions. By the fall, a critical agreement was in place with GE whereby its leases were restructured and it committed further financing totaling approximately CDN$1.8 billion to Air Canada through a combination of exit facilities, convertible notes and financing for new regional jets, the acquisition of which was key to the new fleet plan. The company obtained, after vigorous challenges, approval of an equity investment by Victor Li of Hong Kong, but early in 2004, Trinity abandoned its agreement when the unions refused a further concession regarding pension design. The Court ordered the Monitor to search for a new investor, greatly expanding upon the Monitor's traditional role. Deutsche Bank offered a standby purchase in respect of a CDN$850 million rights offering for new equity in the restructured company. The deal required further significant labour concessions (reluctantly granted) and was attractive to many of the financial creditors. It was the final piece in completing one of the largest and most complicated restructurings in Canadian history. Air Canada emerged on September 30, 2004 with support from over 99% of voting creditors.

Along the way, the case provided new law and many points of interest to practitioners in Canada, including the following:

---

[1] a senior partner of ThorntonGroutFinnigan LLP, December 2004, Toronto, Canada

(a) Limitations were imposed on the breadth of stay that a CCAA judge should grant. Specifically, regulatory regimes regarding health, safety, security and airworthiness were exempted. Language rights – always a flash point in Canada – did not achieve such special status.

(b) The law of set-off was both clarified and complicated. The Court determined that set-off applies, including pre- versus post- filing rights and obligations, but the ability to exercise set-off was made subject to a "temporal stay" early in the restructuring to enhance the stability of the debtor company.

(c) The DIP charge secured the DIP loan and also pre-filing indebtedness of the lender (in this case approximately US$724 million of pre-filing lease obligations), confirming that in Canada a DIP lender can obtain significant collateral benefit in appropriate circumstances by supplying critical financing.

Stelco Inc.

Stelco, a major Canadian steel producer, had defined benefit pension deficits similar to that which plagued Air Canada. Stelco filed for protection on January 29, 2004. Its labour unions challenged Stelco's right to have access to the CCAA on the grounds that it was not "insolvent". Although undefined under the CCAA, the Honourable Mr. Justice Farley had little difficulty finding that Stelco was insolvent under the established tests under the *Bankruptcy and Insolvency Act*. He went on to comment that, for the purposes of determining whether a debtor company was entitled to seek protection under the CCAA, it was sufficient if the company could reasonably foresee that it would run out of liquidity at some point in the future. In Farley J.'s view, a company should not have to wait until the last minute before seeking protection and could factor the time necessary to effect a restructuring into its timing.

At the time of writing, Stelco is seeking approval of a "stalking-horse" type of bid to provide exit financing and a rights offering, also backed, as in Air Canada, by Deutsche Bank. A stalking-horse bid is rare in Canada but Stelco's major customer, General Motors, as a condition of further orders, required a "base case" for exit financing. Significant resistance is being offered by a number of stakeholders to the Deutsche Bank bid. Even though these are generally buoyant times for the steel industry worldwide, the outcome of the Stelco restructuring is uncertain at present and will likely remain so well into 2005.

Capital and Financing Markets

Both Air Canada and Stelco have benefited greatly from the enormous amount of debt and equity financing which is available to insolvent companies in Canada. If the current liquidity climate prevails, major restructurings in Canada will continue to enjoy access to asset-based exit financing, equity rights offerings and convertible debt financing – all of which are attractive alternatives for financial creditors and all of which will have significant influence on the design and likelihood of success of Canadian restructuring plans.

In summary, the recent broad interpretation of when a company qualifies under CCAA and the current liquidity in the financial marketplace means that it has never been easier to get into, and out of, a Canadian restructuring proceeding.

word count: 821