CORONAVIRUS: HARBINGER OF A NEW (OLD) APPROACH TO RESTRUCTURING IN CANADA?

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The global COVID-19 pandemic, coupled with an ill-timed crude oil price war between Saudi Arabia and Russia, has in a matter of mere weeks materially disrupted the global marketplace. While we are months or years away from understanding the full impact of the coronavirus pandemic on the economy at large, it is increasingly likely that we may be sliding into a recessionary period. We anticipate that businesses will need to restructure in one way or another to deal with immediate liquidity needs, or long-term financial health. Given the risk of tightening capital markets and the impact of government efforts to curb the coronavirus, businesses may not have the time or certainty necessary to pursue an immediate restructuring. We expect that some businesses may even elect to file immediately under the *Companies' Creditors Arrangement Act* ("**CCAA**"), without a definitive plan or prompt sales process, in order to harbour under an extended stay period until the situation stabilizes.

Near-term challenges

It appears likely that many Canadian companies (with domestic and/or international operations) will need some type of formal or informal restructuring. The airline and travel industry, followed closely by the hospitality and entertainment industries, are likely to feel the most immediate impact of domestic and foreign government efforts to contain the spread of the coronavirus. The closing of the border between the United States and Canada, in particular, is already having a material impact on Canadian carriers, with Porter announcing that it is suspending flights and Air Canada and WestJet, the country's two largest carriers, significantly reducing service.

Travel restrictions have also resulted in the cancellation of cruises, conferences and social events, and "social-distancing" protocols have postponed film and television productions in Toronto and Vancouver, suspended virtually all major professional sports and closed theaters and cinemas across the country. While some of these businesses may be able to manage through the kind of short-term liquidity challenges they are currently facing, it is far from certain how long the current crisis will last and if consumer spending will return quickly to pre-crisis levels. Ultimately, a number of these business may seek protection under the restructuring provisions of Canada's *Bankruptcy and Insolvency Act* or protection under Canada's large-company restructuring statute, the CCAA.

Canada's oil and gas industry, already under extreme financial pressure, has been hit with the one-two punch of a coronavirus-related decrease in demand and an international price war between Saudi Arabia and Russia. Add to that the as yet unclear impact of the unwinding of fuel forward contracts with various airlines, and it appears likely that we will see an uptick in energy company bankruptcies in Canada.

In addition to the most obvious candidates, the coronavirus pandemic is also likely to have a negative impact on a variety of manufacturing businesses that face supply chain interruptions, workforce challenges, decreased consumer spending and volatile capital markets. The recent shut-down of all North American production by the big four automakers, in particular, may have immediate and lasting consequences for Tier 1, 2 and 3 suppliers.

A return to the status quo?

In the wake of the 2008 global financial crisis, restructurings in Canada shifted to more organized and deliberate affairs. Armed with new tools set out in the 2009 amendments to the CCAA – 363-style sales, codified DIP financing rules, critical supplier relief, etc. – businesses now largely arrive before a CCAA judge with a "pre-packaged" restructuring plan (pre-approved by certain creditors) or a stalking-horse backed sales process in hand, with most of the planning, thinking, stakeholder negotiation and vote-securing having been completed well in advance of the filing date. This approach, while typically less costly and faster, requires time and an adequate source of funding to stabilize a debtor company's operations in the lead up to a restructuring case.

We do not think that time is on the side of businesses facing the fallout of the COVID-19 pandemic. Volatility in the market and uncertainty as to the length and nature of the current crisis could result in a tightening of the credit markets, making it more difficult for businesses to secure the kind of bridge-financing necessary to negotiate a restructuring plan ahead of a filing. Although both the Bank of Canada and the Federal Reserve have dropped interest rates and begun to dip into their 2008 toolkit to support liquidity, it is not yet clear whether the current interventions will be sufficient in the short-term. In addition, the speed of government interventions (restrictions on crowd size, forced closures) may result in businesses simply not having the time to plan and execute an orderly CCAA filing.

Even if businesses can obtain some form of pre-filing or DIP financing, the targeted impact of COVID-19 on specific industries means that companies may be filing into very much a buyer's market. Faced with depressed valuations and uncertainty, businesses may deliberately elect to file under the CCAA without a restructuring plan or proposed sale process and, for an extended period, simply shelter under the stay of proceedings until financial gravity reengages and the full impact of the pandemic is clearer. In other words, we may be returning to the very roots of CCAA practice, where maintaining the status quo in order to give a company breathing room to solve its financial challenges is the sole purpose of the stay proceedings.

New players, new perspectives

Not everyone will be supportive of a “shelter-in-place” CCAA proceeding. Suppliers, customers, landlords and other stakeholders may argue that a prolonged stay without a plan unfairly prejudices their ability to find new customers or re-source supply. Those stakeholders will have to overcome the debtor company’s arguments about the social costs, valuation challenges and inefficient capital deployment that may flow from the premature implementation of a plan or sale. From a pure recovery perspective, traditional stakeholders like lenders may actually prefer the company to wait out the crisis in the hope that valuations improve and capital returns.

Many businesses will also face new pressures in the restructuring space. Over the last 10 years, private equity (**PE**) firms have increased their presence as owners of, and lenders to, Canadian businesses. For example, Pitchbook reported that PE investments in Canada totalled C$22.3 billion in 2018, which represented a jump of 62% in deal value as compared to 2016. The presence of PE players in a restructuring presents new challenges for companies and their boards. Opportunistic PE owners may seek to push the debtor company into a quick transaction, taking advantage of low valuations to buy-back their investment. It will be particularly challenging to resist this pressure as those same PE funds may well be providing the liquidity to keep the company operating. Courts will be tasked with holding businesses to high-standards of transparency, so as to avoid allegations of insider misconduct. PE funds may also consider helping themselves by injecting a degree of independence to the process through independent board members/committees.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.