When a (CCAA) plan comes together

In late 2020, the *Companies' Creditors Arrangement Act* (CCAA) was leveraged to effect the restructuring of an automotive parts supplier and the acquisition of its shares by a strategic partner without the court-approved sale process typically required of a sale transaction in formal restructuring and insolvency proceedings in Canada. Instead, the purchaser 'sponsored' a Part I CCAA plan of compromise, arrangement (and reorganization) that was near unanimously approved by the affected creditors, sanctioned by the court, and implemented in under 100 days from the commencement of the CCAA proceedings. It's a simple and compelling story for a few reasons:

1. the creditors actively approved the transaction;
2. the market disruption and general uncertainty of the restructuring proceedings was minimized;
3. the overall cost of the process was managed by speed of completion and coordination amongst stakeholders, and;
4. the parts supplier emerged from court proceedings as a viable supply channel for its customers.

Introduction

Despite the strong demand for automobiles in 2020, the automotive industry wasn't immune to COVID-19 disruption. When production shut down industry-wide in mid-late March 2020 for approximately nine weeks, there was tremendous uncertainty – from OEMs to retailers, not just the parts suppliers. It should come as no surprise that when production resumed in early May 2020, operations didn't immediately return to normal; the cost of the shut-down and subsequent ramp-up in a co-dependent supply chain is not straightforward at any time, and suppliers were then limited by their operating capacity (and new pandemic safety standards); demand for automobiles didn't solve the problems being faced by the manufacturing sector. In short, it was near impossible to make up for lost time, and while OEMs had been holding significant cash reserves, the same couldn't be said for their manufacturing supply base[1]. As a result, since then some of these suppliers have been forced to seek alternate solutions.

When it comes to evaluating strategic alternatives as an automotive parts supplier, there are some unique considerations: OEMs are an influential customer base; the supply chain contains important suppliers who are key to continuity – at least in the short-term; and a temporary supply interruption caused by a parts supplier could be deadly to its business relationships given the domino effect it could have down the chain. OEMs have significant influence – if not control (and IP ownership) – over the numerous parts that go into the complex production cycle of a vehicle; they also have substantial sway over the turnaround of a key member of that supply chain.

The CCAA was a restructuring 'fan favourite' in 2020, with a record 60 filings, the most under the Act since tracking began following substantive amendments in 2009. And for good reason – the CCAA's legislative flexibility allows companies to access its tools to maintain their debtor-in-possession status, and largely customize an approach to achieving their goals in an environment where the issues are diverse, circumstances and deadlines are subject to change, and unique stakeholder interests need to be addressed.

[1] "Why your grandmother was right", May 2020, KPMG in Canada

Background

The CCAA applicants ('Company A'), primarily a manufacturer of automotive component parts with operations in Canada and the U.S., had faced headwinds in their financial performance in recent years. Because of ongoing expansion, pricing pressures, and capital expenditures incurred in order to meet customers' production needs, Company A had over time depleted its cash reserves and taken on increasing secured debt to meet its capital requirements. So, when faced with the March 2020 production shutdown, which temporarily halted OEM orders and access to manufacturing inputs, Company A didn't have the balance sheet to withstand the ensuing operating losses.

Company A entered into accommodation agreements with its primary operating lender and certain key customers who provided bulge financing, and advances and other accommodations, respectively, to support working capital requirements. By July 2020, however, it became clear that a more sustainable solution and a capital injection were required. To that end, after meeting with several potential strategic partners, Company A decided to progress discussions with Company B, a Canadian-owned manufacturer with extensive global operations and partnerships in the automotive sector. Company B had the capital, relationships, and market gravitas to provide support to Company A.

The deal

Company A and B began working together on a potential restructuring in August 2020, engaging quickly with Company A's key stakeholders. Company A initiated CCAA proceedings in September 2020 on the heels of negotiated arrangements with the primary lender and the OEMs, with a clear road map for its exit. Given its significant U.S. operations, Company A also commenced reciprocal proceedings in the United States under Chapter 15 of the U.S. Bankruptcy Code[2].

Just prior to the filing, Company A entered into a plan sponsor agreement – and a related debtor-in-possession (DIP) financing agreement – with Company B, which were then approved by the court. The plan sponsor agreement stipulated that Company B, as proposed 'Plan Sponsor', would provide financial support for a plan of compromise, arrangement, and reorganization (the 'Plan') – to be put forth to Company A's creditors, and provide the DIP financing Company A required to operate in the CCAA proceedings through to the Plan implementation date. On that basis, the Plan Sponsor would acquire ownership of a restructured Company A by way of new share issuances. Importantly, the plan sponsor agreement set a tight restructuring timeline, requiring that the Plan be implemented by December 31, 2020 (i.e., within 100 days), and that certain milestones be met along the way as a condition to the Plan Sponsor's continued support prior to closing. Essentially, the terms of the agreement necessitated that, in under four months:

- key customers, suppliers, and secured lenders be on board throughout the restructuring and for the go-forward business post-closing. This included that continuing relationships with key suppliers (including tooling suppliers) and landlords be ascertained;
- a claims process be undertaken by the CCAA monitor and Company A to establish the universe of creditor claims;
- the key terms of the Plan – including the funded amount to be put forth to the affected creditors in compromise of their claims – be negotiated and finalized;
- claims be adjudicated in short order;
- proven creditors (a majority in number and two-thirds in value) vote in favour of the Plan;
- the court sanction the Plan; and
- the conditions of the Plan be met, and the Plan be implemented.

This was a major task for such a tight timeframe, and it required a cooperative and ongoing dialogue amongst the stakeholders and their advisors. The achievement of the tight restructuring timeline can be attributed to a few key deal aspects coming together that are worth discussing: the efficiency of the structure, the support and power of the OEMs, and limiting the number of key stakeholders.

[2] Chapter 15, Title 11, United States Code

Structure

First, certain efficiencies achieved by structuring the sale transaction through a plan of compromise, arrangement, and reorganization need not be overlooked. While, as noted, a sale usually needs to be the result of a robust sale process for the court to approve the transaction, the CCAA states that a plan need only be "fair and reasonable"[3] to be approved. This lesser requirement is made possible by the unique opportunity for influence that creditors have in voting for approval of a plan before it can even be sanctioned by the court. Structured as a sale transaction, Company B, as purchaser could have acted as a 'stalking horse' at the commencement of a sale process to set the purchase price 'floor' for other bidders in a competitive process.

Stalking horse purchasers do have a leg up on subsequent bidders – more opportunity for due diligence and the benefit of certain commonly-accepted terms in the purchase and sale agreement (PSA) to protect their bid (break fee, minimum bid increments for overbids, right of first refusal, etc.) – but may still be outbid. In addition to providing a relative 'certainty' to the process by instead presenting the Plan, importantly, the time saved avoiding marketing and due diligence periods in connection with a sale process assisted in compressing the timeframe, and hence allowed Company A to emerge more quickly from CCAA proceedings and resume normal operations without the oversight and stigma of court supervision (something any company having struggled with constrained liquidity for at least several months would welcome).

While there was other time spent on the Plan conducting a claims process and holding a meeting of creditors to vote on the Plan before seeking its court sanction, this was done in tandem with (and not following) the formulation of the definitive Plan – and court sanction of the Plan was achieved in only 90 days. The timeframe was certainly not longer than the time it would have taken to first negotiate a 'stalking horse' PSA and then conduct a sale process from kick-off to court approval of a transaction, particularly given that there had not been a fulsome process undertaken prior to the filing to substantiate a contracted going-concern sale process within these formal restructuring proceedings. What's more, this going-concern transaction closed less than a week following court sanction of the Plan.

Trade partners

Next, Company A and the Plan Sponsor, Company B, had the support of the OEMs. Prior to the commencement of the CCAA proceedings, the OEMs accommodated Company A with accelerated payment terms, and when approached by both Company A and B as part of a larger solution to ensure the viability of Company A as a trade partner, they agreed to continue to accommodate during the proposed proceedings and also agreed to ongoing purchase commitments following Company A's emergence post-restructuring. They were supportive of Company B as a strategic partner – a large, well-known industry player with the balance sheet to ensure Company A's access to adequate capital go-forward; all comforting characteristics, considering the importance of Company A to their supply chains.

Inherent in the supply chain were several complex arrangements – not just with the OEMs but also with toolmakers and other key suppliers. Talks and negotiations with key suppliers and secured creditors were also undertaken quickly following the filing and continued up to the Plan implementation date to secure critical go-forward arrangements. Given the influence of the OEMs and the integrated nature of the supply chains, the fact that they were supportive of Company A's plan early on particularly helped to get the key suppliers onside, including those whose pre-filing claims were being compromised.

Rationalizing the field of key stakeholders

Last, strategic moves were made to reduce the number of key stakeholders with an interest in the conduct and outcome of Company A's restructuring. The Lender had provided bulge financing to Company A in the months leading up to the filing and was not in a position to extend further credit. In the arrangement between Company B and the Lender made immediately prior to the filing, Company B acquired a portion of the Lender's debt and took assignment of its security over Company A's assets, thereby stepping into the Lender's shoes as senior secured lender. At the same time, as required in the plan sponsor agreement, Company B also took on the role of DIP lender, providing essential interim financing, thus eliminating the addition of a third party in a priority secured position, and – by holding both the senior debt and the DIP loan – innately reducing the number of parties who may oppose the priority of the DIP loan in the court-ordered charges over the assets, or impede the restructuring speed and trajectory.

[3] CCAA ss. 23 (1)(i)

Outcome

At a high level, the Plan was structured to compromise the claims of the unsecured creditors in one class, and to leave secured claims unaffected post-implementation in the restructured business. Immediately prior to the creditors' meeting on December 11, 2020 (less than 90 days after the commencement of the proceedings), the affected creditors were anticipated to yield a significant recovery on their claims.

Faced with the alternative – being a likely liquidation of Company A's assets for a significant shortfall to secured creditors – the affected creditors voted overwhelmingly in favour of the Plan. (While final claims are still being resolved, the recovery expectations remain relatively constant.)

Upon implementation, in consideration of the amounts funded into the Plan, the Plan Sponsor acquired ownership of Company A's newly-restructured business by way of the new share issuances in Company A's reorganization, and Company A exited the CCAA proceedings with a cleansed balance sheet and a recapitalization critical to its continued competitiveness.

Conclusion

While the plan of compromise and arrangement is elemental to the CCAA, it doesn't get used every day. More common in recent years has been the use of a 'liquidating' CCAA which usually results in deeper shortfalls to affected creditors. This is an example of the creative use of a CCAA plan to efficiently realize a restructuring and sale transaction, while allowing a cross-border parts supplier with complex operations to emerge from its restructuring and under new ownership in fewer than 100 days.

While certain situational factors were key to the success of this approach – a major industry player as strategic partner, the support of an influential customer base, proactive and ongoing management of key stakeholders, and the alternatives available to the affected creditors – it can serve as a value-preserving tool in other transactions as well, helping parties to execute quickly on an established turnaround plan when the obvious strategic options have already been explored. With the right fact set, this approach can be efficient and effective on a short timeline.

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