

NEWHOUSE STRATEGIC COUNSEL INC. WHITEPAPER: The CEO's Guide to Creditor Protection

October 2008

This guide is intended to give management an overview of the creditor protection process. It is also a useful reference for you when looking at what your own clients and competitors may be going through. It will help you to evaluate how the creditor protection strategy may affect your own business.

I have managed these situations for clients, as well as in my capacity as an officer of a company going through its own restructuring. When you have to examine this issue, in whatever context, or if you need an experienced professional to implement a plan, please contact me for a personal and confidential review of your company's situation.

John Mavridis, LL.B., LL.M., ICD.C.
1-877-807-3953
jmavridis@newhousecounsel.com
www.newhousecounsel.com



*"It says, 'Please disregard this reminder
if your check is in the mail.'"*

The information in this whitepaper is summary in nature and does not constitute legal advice. This whitepaper does not create a lawyer-client relationship. The transmission of this whitepaper does not suggest that we practice law in any jurisdiction other than where we are licensed. © 2008, John Mavridis, Newhouse Strategic Counsel Inc.



The CEO's Guide to Creditor Protection

John Mavridis, LL.B., LL.M., ICD.C.

October 2008

DON'T PANIC: IMAGINE THE FUTURE YOU WANT

You need to imagine what you want your company to look like when you get through this process. This is not meant to be a new-age visualization technique, but rather a tool to develop the end-goal of where you will be when the restructuring effort will be completed.

Don't focus only on the balance sheet issues, but also on what your company will be able to do when you get through this restructuring. This process will have two phases: the formal front-end and the rebuilding plan afterwards. It is important that you have a clear objective that will allow you to sell the idea of your restructured business to your creditors and all the stakeholders.

WHEN TO DO IT

The law states that any person who owes over \$1,000 and cannot pay their debts as they become due is insolvent. It is only an "insolvent" person that can seek the protection of the courts from their creditors. There are other elements to this definition in the Bankruptcy and Insolvency Act, but you will know when it is happening to you.

From a cash-flow point of view, triggering the creditor protection process should be done when you have the greatest war-chest with which to fight the battle. You will need funds to continue operating your business and to pay for the professionals involved.

The funds in your possession, be they accounts receivable you will collect, proceeds of asset sales, proceeds of any last minute financing for such an operation, all have to be planned for to provide you the widest room to manoeuver.

Timing is everything. If you wait too long you may not have the ammunition to accomplish your goal. Once you begin, time is of the essence.

DEVELOP YOUR PLAN

You have tools available to you and need to understand how to use them.

When you have exhausted your ability to continue negotiating with your creditors, the law provides for two key alternatives:

1. A proposal under the Bankruptcy and Insolvency Act.
2. A proposal under the Companies Creditors Arrangements Act.

There are technical aspects to each of these tools, but the essence remains the same:

First, the law gives you some peace and quiet: there is an immediate stay of proceedings. That means that if suppliers are suing you, or even petitioning your company into bankruptcy, everything is suspended. You can get the necessary time to organize your affairs and make an orderly proposal to creditors.

The debtor company will get an initial stay for 30 days and you will most probably be able to easily extend it for an additional 45- 60 days in all. Additional delay may be possible, but you will have to make a proposal to creditors by then.

The key is to know what you owe and to whom. Determine which debts are secured, since you would need the approval of secured creditors, and which debts could become the personal liability of the members of the Board of Directors. Review your agreements and the law on various liabilities, including:

- leases, there is a right to repudiate them under certain circumstances.
- employees, including severance obligations.
- taxes, where certain taxes are also personal liabilities of directors.
- trade creditors necessary for on-going supplies.

Most importantly, determine where the cash will be generated to finance the proposal for creditors.

Know the Players

You cannot tell the players without a program. There will be many players on the field. While some are on your side, you have to have a strategy for each one of them. They all have their classic tactics, since the law allows them to do only so much. You have to anticipate and determine a strategy to handle each of them. The players in this drama include:

- The Court which gives you protection from creditors, by applying the law.
- The Trustee in Bankruptcy who is an officer of the Court whom you will hire to assist you in managing the process with the creditors. He will send out the notices to the creditors and work with you and your lawyers in the process of obtaining their approval for the proposal.
- The Secured Creditors. These are your banks, and mortgage holders, but may also include government and taxation agencies. Each of them will have their own lawyer.
- The Trade Creditors. You owe money to each of these suppliers whose goods your company has used and for whom your company has been a very good client. Some are key to your continued operations and some are not. The larger ones will probably engage their own lawyers in order to monitor the process and attempt to maximize their position.
- The Landlord. He will also probably have his own lawyer.
- Your Lawyer will be working on your behalf in this matter. He will be making the necessary representations on behalf of your company before the Court.
- Your Restructuring Officer. This is the key management representative that is watching and managing this drama at work and ensuring that the company meets its objective.

You will be paying (at least) for your own lawyer, probably the lawyer of your banker and the Trustee for the Proposal. You will also have to cover the time and effort of your key managers involved in this process, on top of their usual responsibilities.

The Next Steps

Ensure that you can win the vote of the creditors on the proposal.

This can happen because the debtor company benefits from the impact that court-sanctioned creditor protection strategy has on most creditors. If your company fails in its restructuring, they will probably get nothing. In fact, the sad reality is that they probably have essentially written off your debt from their books. If your debt is over 90-120 days old, they most probably cannot have it financed by their banks. They know that if the restructuring fails, they will lose everything. Not only the amounts owed, but also a client (even one they service COD, or with a guarantee).

Another tool in your arsenal is that you can divide the creditors into classes. While some classes, such as secured creditors, are already defined, others can be sub-categorized. In this way, since the rules call for over half the creditors in number and two-thirds in value to approve the proposal, you can line up your ducks.

You can structure the proposal to gain the vote of the majority of the creditors in number by ensuring that the "small" creditors, owed between \$1 and \$10,000 (for example) will be paid in full, or as close to in full as necessary, to get their vote supporting the company's proposal. For the value issue, there has to be a plan on how you will work with your biggest creditors to get through the process. Always remember that they also have a problem: their alternative in a potential bankruptcy is not positive. This is their problem which will be used as a wedge to help you negotiate the acceptance of the proposal.

Your Shareholders

In the case of a public company or a Venture Capital-backed venture, your shareholders have been one of your main pre-occupations.

By the time you finish the creditor protection process, your creditors may be a big part of your shareholder base. As when you were building the company, issuing shares could be a part of the solution when you make an offer to your creditors.

This of course can be a managed process, and that is a subject of another paper. Be that as it may, this will be a process that you should address with any major shareholders. The attitude, both of the Courts and the insolvency lawyers, will be that the shareholders are of no consequence. While this may be the approach that insolvency professionals have, you have to look at the big picture - not only today, but for the future.

Ignore the Noise

Your organization is about to enter into a storm so that it can come out stronger.

During any creditor protection plan, there will be many demands and a lot of noise from inside and outside an organization. You need to be able to ignore the noise and focus on the job at hand.

Having participated inside management during a restructuring, I know how difficult this can be, but it is only by ignoring the noise, focusing on objectives and taking the next step in the process that you will be able to get through this successfully.

About Newhouse Strategic Counsel Inc.

NEWHOUSE STRATEGIC COUNSEL INC. is a legal and business advisory services firm. Its activities as a law firm, including legal representation and advice, are offered exclusively by its members who are also authorized to practice law pursuant to the rules of a law society or bar association. NEWHOUSE STRATEGIC COUNSEL INC. is registered as a multi-disciplinary firm with the Bar of Québec.

About John Mavridis

John Mavridis is the President of Newhouse Strategic Counsel Inc. He is a business lawyer and consultant solving problems for clients in Canada, the United States and Europe, specializing in the fields of corporate finance, securities law and corporate reorganization.

John serves as a director for his corporate clients and has advised on corporate governance issues and has mediated relationships between entrepreneurs and VC investors. As his commitment to improving his skills to better serve his clients and community, John has completed the Directors Education Program of the Institute of Corporate Directors and is an ICD-certified corporate director.

John holds a Masters Degree in law from the Université du Montréal and has been called upon as a speaker on various topics including securities regulation, continuous disclosure obligations and corporate governance issues.

For more information, please contact: John Mavridis, 1-877-807-3953, jmavridis@newhousecounsel.com