

Corporate governance challenges facing the chief restructuring officer

By Mary Plahouras, Canada¹

Abstract

A chief restructuring officer encounters numerous challenges in its attempt to successfully restructure a corporation in financial distress. The author explores the doctrine of corporate governance challenges facing the chief restructuring officer. The author also touches more generally on Canadian restructuring statutes and reviews emerging issues in corporate governance and restructuring. The author concludes that although the appointment of a chief restructuring officer is not necessary in all corporate restructurings, in the right circumstances the impact of a chief restructuring officer's expertise in strategic decision making may ultimately mean the survival of the corporation.

1. Introduction

The chief restructuring officer (CRO) plays a dynamic and critical role in corporate restructuring in Canada. The CRO's role can differ widely from corporation to corporation but their main duty is to oversee the restructuring of the financially distressed corporation through a senior executive leadership role which may include restructuring both the corporation's balance sheet and the corporation's operations. Notwithstanding that it may be difficult to determine if a corporation is solvent or insolvent strictly on a balance sheet basis, if the operational problems are not corrected, fixing the balance sheet will only result in a temporary solution to the corporation's financial distress.

There are two principal restructuring statutes available to insolvent corporations under Canadian law: (i) the Bankruptcy and Insolvency Act (BIA); and (ii) the Companies' Creditors Arrangement Act (CCAA). The BIA is available to insolvent corporations that owe at least CAD 1,000 in unsecured debt and are unable to meet their obligations as they generally become due. The CCAA is restricted to more complex restructuring of larger corporations or affiliated corporations that are insolvent or bankrupt and have claims against them exceeding CAD 5,000,000. To be eligible to take proceedings under the CCAA, the company must be incorporated in Canada or have assets in or do business in, Canada.²

Although the CRO is in charge during the restructuring, the corporation's management is often free to operate the business. Some discussions that may take place between the

¹ I am grateful to Dr Jennifer L L Gant of University College Cork, Cork, Ireland for her support of the INSOL ERA Publication Project and for the invaluable mentorship which she provided to me in finalising this paper. I am also grateful to Professor Stephanie Ben-Ishai of Osgoode Hall Law School, York University, Ontario, Canada, for the exceptional learning experience which she provided to me in Bankruptcy and Insolvency Law and to Edward A Sellers for his teaching excellence on Governance Responsibilities in Insolvency at Osgoode Hall Law School, York University.

² Excluded are banks, railway, insurance, trust and loan companies.

corporation's chief financial officer and the CRO with respect to debtor-in-possession (DIP) financing during the CCAA proceedings may include how DIP will be prioritised in the initial order; the interest rate to be charged on the DIP loan; the terms, length and amount of the loan; reporting requirements (including to whom and when); notice to existing lenders of a DIP lender; court approval for DIP financing, and remedies available to the DIP lender in the event of a breach of covenant.

The Canada Business Corporations Act (CBCA)³ contains four principals with respect to the duties of a corporate director. They include: (i) the fiduciary duty to the corporation; (ii) duty of care to the corporation; (iii) duty not to oppress; and (iv) duty to manage or supervise the affairs of the corporation.

It was held in *BCE Inc.*,⁴ and in *Peoples Department Stores Inc.*,⁵ that the directors of a corporation have a fiduciary duty to act in the best interest of the corporation by giving a broad range of consideration to a broad range of people. As a result of *BCE Inc* and *Peoples Department Stores Inc*, current and future directors would be well advised to exercise due diligence and fulfil their duty of care and their fiduciary duty to the corporation pursuant to the CBCA and related Provincial Corporations Act by relying upon the advice of the CRO.

This paper will survey corporate governance challenges facing the CRO from a theoretical and practical perspective drawing on Canadian case law. This paper will examine, among other things, how the CRO manages the restructuring of a distressed corporation; why there is a need for a CRO; the terms governing the appointment of the CRO; the scope of the CRO's duties; and the qualities of a successful CRO.

2. Why the need for a chief restructuring officer?

When a corporation is experiencing financial losses on its operations and threats from other various sources, or when it is lacking talented senior management and reliable data and is running out of time to retain control of its restructuring, the CRO is often viewed by the secured lender as an independent skilled professional that can help the corporation regain some level of confidence in restructuring its operations.

The CRO is typically a chartered public accountant, a chartered insolvency and restructuring professional, a certified turnaround professional, or a lawyer with expertise in corporate restructuring,. The CRO is often hired by the directors at the request of the corporation's secured lender to address the corporation's crisis and attempt to return it to a viable and profitable business.

³ CBCA, (R.S.C., 1985, c. C-44) ss 102(1), 122(1) and 241.

⁴ *BCE Inc* [2008] 3 SCR 560, 2008.

⁵ *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461, 2004.

Despite the fact that the directors and management may be comprised of individuals with appropriate education, financial knowledge and experience, the initial appointment of a CRO may be due to a corporate governance response to lender concerns that the directors and / or management may not have the skillset or expertise to deal with a restructuring;⁶ or it may be due to lack of trust between the directors, management and the corporation's secured lender. A CRO may be needed to implement actions against opposing forces such as the corporation's own board of directors, management, employees, unions, creditors and other stakeholders.

In certain corporate restructurings there may be a special need for a skilled CRO to implement internal governance changes by reconfiguring the corporation's existing governance processes. This can be accomplished by placing the audit committee on alert to the warning signs of financial distress;⁷ establishing a special committee free of conflicts whose members would have the expertise to examine the principal issues causing the corporation's financial distress; and retaining an independent advisor such as a financial advisory firm to oversee the corporation's existing accounting, auditing, and financial reporting systems.⁸ In the case of *Consumers Packaging Inc*, the board established an independent restructuring committee to assess the corporation's financial distress. The committee hired a CRO who assumed operational control of the corporation under the supervision of the court during the CCAA proceedings.⁹

The CRO can assist the directors in re-establishing a level of trust with the corporation's stakeholders by facilitating direct meetings with stakeholders to confirm their intentions.¹⁰ Retention of a CRO is a recommended course of action where the lender is concerned about management's capabilities. In these circumstances, in addition to the CRO's role of managing the restructuring, the CRO may be requested to supervise the corporation and offer advice or direct its operations¹¹ where directors are unwilling or unable to restructure; there has been a communication breakdown between the directors, management, employees, and stakeholders; there has been employee exodus; or the corporation has had prolonged periods of severe cash flow difficulties.

In *Atlas Cold Storage* the resignation of the chief executive officer and the chief financial officer as officers and directors as a result of a restructuring caused by "financial statement misstatement", the hiring of a CRO and appointment of interim directors had a beneficial effect on the ability of the company to address governance issues.¹² In *Aveos Fleet*

⁶ JP Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in JP Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 350.

⁷ *Idem*, 393 to 395.

⁸ As explained by E A Sellers, Osgoode Hall Law School, 6 February 2015. Hollinger international Inc established a special committee to investigate the company's affairs.

⁹ JP Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in JP Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 351.

¹⁰ WE Aziz, EM Grudzinski and EA Sellers, "Practical Aspects of Governing Distressed Enterprises in Canada" in JP Sarra, *Annual Review of Insolvency Law: 2006* (Thomson Carswell, Toronto, 2007) at 399.

¹¹ *Idem* at 346.

¹² *Idem* at 401.

Performance Inc.,¹³ the court appointed a CRO when all the directors save one resigned a few hours after the company filed for protection from its creditors under the CCAA.¹⁴

3. Who appoints the chief restructuring officer?

Prior to accepting an appointment as a CRO, it is imperative that the CRO be free from actual or perceived conflict of interest. The appointment of the CRO is typically influenced by the corporation's secured lender whose covenant has gone into default and as a result will not advance further funds to the corporation unless the corporation retains a CRO to act as the corporation's advisor and solve the problems at hand. In *iMarketing Solutions Group Inc.*,¹⁵ the DIP lender required the appointment of a CRO to manage the day-to-day operations of the company, including formulating and implementing a restructuring plan for the company.

The CRO's appointment may also be at the request of the directors, or it may be by order of the court under the CCAA pursuant to the court's inherent jurisdiction and its general statutory power to make any order that it considers appropriate. If the CRO is appointed by the court, or the terms of the CRO's appointment have been approved by the court (notwithstanding that the CRO may formally report to the directors), the CRO has a reporting obligation to the court and must act neutrally with a responsibility to all stakeholders.¹⁶

A CRO can be appointed before or after a corporation takes proceedings under the CCAA to institute pre-event preparations such as establishing adequate diagnostic and reporting systems; determining sources of liquidity; preparing communication plans; identifying the stakeholders whose combination of claims can carry or veto a potential restructuring plan; and engaging with the stakeholders in building consensus to a proposed plan of action to resolve the corporation's financial distress and lead it to a successful restructuring.¹⁷

Unlike a monitor appointed by the court under the CCAA, whose mandate is to be the "eyes and ears" of the court, the CRO is an advocate for the corporation with a role in formulating and carrying out a restructuring plan for the benefit of the corporation. Early intervention and allowing a corporation to restructure, rather than go into receivership or bankruptcy, may result in the retention of jobs for employees, continuation of contracts for suppliers, and collection of crown debts by municipal, provincial and federal government agencies.

¹³ J P Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in J P Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 352.

¹⁴ CCAA, RSC 1985, c C-36.

¹⁵ *iMarketing Solutions Group Inc et al.* Initial order of Justice Newbold, 12 April 2013.

¹⁶ J P Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in J P Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 353.

¹⁷ W E Aziz, E M Grudzinski and E A Sellers, "Practical Aspects of Governing Distressed Enterprises in Canada" in J P Sarra, *Annual Review of Insolvency Law: 2006* (Thomson Carswell, Toronto, 2007) at 411.

4. Terms of the chief restructuring officer's appointment

The terms of the CRO's appointment may be found in the engagement letter, or in the court order if the corporation is undergoing proceedings pursuant to the CCAA, and will typically include the terms of the CRO's financial compensation, indemnification from liability, the scope of the CRO's role and their powers.

The engagement letter should make it clear that the CRO has the authority to carry out their responsibilities. In *Aveos Fleet Performance Inc.*,¹⁸ the court appointed a CRO with authority to carry on, manage, operate and supervise the management of the business and affairs of the corporation subject to the execution of an engagement letter with the CRO on terms satisfactory to the monitor and to the third-party secure lender.

The financial terms of a CRO's engagement can be very expensive. This may be due in part to the fact that the CRO's job is a temporary position. The CCAA¹⁹ authorises the court to make any order it considers appropriate declaring that all or part of the property of the corporation is subject to a security charge to cover any financial, legal or other experts engaged by the corporation for the purpose of the CCAA proceedings. Hence, the CRO can be assured of receiving compensation.²⁰ If the CRO is ultimately successful in restructuring the corporation and returning it to profitability, the benefits of engaging a CRO should result in tremendous value to the corporation. In *Consumers Packaging Inc.*, the restructuring generated a value of more than CAD 61,000,000 greater than the corporation's estimated liquidation value.²¹

5. The successful chief restructuring officer

CROs may share similar personal traits, yet have significantly different skill sets that are imperative to addressing the needs of a financially distressed corporation. An effective and successful CRO needs to be a highly skilled financial advisor and negotiator familiar with all of the techniques required to save a corporation and reduce the risk of financial distress re-occurrence. A CRO's successful restructuring of a financially distressed corporation centers on an assessment and analysis of the corporation's affairs, resulting in the formation and execution of a speedy restructuring plan. The CRO will need to have the practical experience and knowledge required to stabilise a financially distressed corporation and possibly lead it to increased value.

A CRO may recommend whether a corporation should be saved or whether there should be a receivership sale or liquidation of the corporate assets; identify early in the process the financial and operational problems of the distressed corporation; communicate to the directors and to the stakeholders a restructuring plan that will address the existing

¹⁸ *Aveos Fleet Performance Inc.*, 2012 CarswellQue 1449 (Que SC).

¹⁹ CCAA, RSC 1985, c C-36, s 11.52(1).

²⁰ J P Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in J P Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 352.

²¹ *Ibid.*

underlying problems with the operations of the business; advise the directors as to whether the corporation has the resources to execute a restructuring plan; and maintain appropriate communications with the stakeholders throughout the process and ensure that the stakeholders have confidence in the integrity and capabilities of the directors and of management.

6. The governance role of the chief restructuring officer

When a corporation retains a CRO there is an expectation that the CRO is in full control of the corporation, has a high level of independence and displays a duty of care to the corporation. Although a CRO can take formal appointments on the board of directors, the CRO is independent of the board and of the corporation's management team. Granting the CRO the executive powers that they need (such as joining the board) is good governance practice as it may provide for a more meaningful discussion of the pertinent issues that will need to be addressed as part of the restructuring process.

The increasingly common role of the CRO is prevalent in Canada in the context of both informal restructurings and court-supervised insolvency restructurings. In proceedings under the CCAA, the CRO can be appointed by either the court or by the corporation for the period of those proceedings. During the CRO's appointment, the CRO may be faced with complex governance issues in deciding how to best provide their specialised restructuring skills to effectively deal with the corporation's financial distress.²² It is imperative that the CRO establishes and maintains, for the duration of their term, a renewed rapport and good relations with the corporation's directors, management, employees and its other stakeholders if the restructuring is to succeed.

In determining whether the corporation is viable, the CRO will need to determine the degree of reliability of the financial statements and whether the corporation has sufficient liquidity and necessary financing in place to successfully restructure its business. The ultimate goal of the CRO's role, in parallel with the directors, is to save the corporation by re-engineering its operations while avoiding a short-term quick fix. The CRO may be responsible for the entire operation of the corporation, or the CRO may have a role that is restricted to specific aspects of the restructuring plan.

7. The scope of the chief restructuring officer's duties

When a CRO takes on the role of the corporation's restructuring professional, the CRO becomes part of the governance structure of the corporation. Typically, in a private appointment by the secured lender or by the corporation's directors, the CRO will formally report to the secured lender and / or to the directors. In *US Steel Canada Inc.*,²³ the court approved the appointment of a CRO with responsibility for directing the restructuring

²² W E Aziz, E M Grudzinski and E A Sellers, "Practical Aspects of Governing Distressed Enterprises in Canada" in J P Sarra, *Annual Review of Insolvency Law: 2006* (Thomson Carswell, Toronto, 2007) at 367.

²³ *Idem*, at 397.

process in conjunction with the corporation's senior management and reporting directly to the board. The court further ordered that the appointed CRO shall not be deemed to be a director or employee of the corporation. However, in proceedings under the CCAA the CRO can replace the chief executive officer. In circumstances where an immediate change in management is needed, the retention of a CRO may be the better approach either because of time constraints in searching for new management personnel, or because qualified permanent candidates will not accept the position until the restructuring has been completed.²⁴

An experienced and objective CRO will bring renewed credibility to the corporation in its dealings with its stakeholders. Ideally, the CRO will have the skills and knowledge to address large restructuring issues and help stabilise the corporation. Appointing an experienced CRO to conduct a "look-see" or viability analysis of the corporation may bring a fresh perspective to the corporation, from the balance sheet to financing and operations, while allowing management to focus on the day-to-day operations of the business.

It has been reported that effective CROs share certain characteristics such as people skills, management skills, strategic skills, and job knowledge.²⁵ The job of a CRO is not for the faint-hearted, nor for the individual who is not skilled in the area of corporate restructuring. The job is for the individual who is committed to fulfilling duties to the corporation with due regard for the interest of the affected stakeholders, while seeking to achieve a successful outcome in resolving the corporation's financial distress and minimising personal exposure for the directors and the stakeholders.

The CRO's mandate can be found in the CRO appointment letter or court order and is subject to the degree of empowerment given by the corporation's directors and / or the stakeholders. Typically, a CRO's mandate is to execute operational improvements and usually entails identifying the causes of the corporation's financial distress and the possible solutions in meeting the objectives of stabilising the corporation and ensuring that there is sufficient cash flow or outside sources of capital to steer the corporation through the crisis. The mandate typically further includes preparing cash flow projections and outlining financing or restructuring alternatives to the directors and to the stakeholders; overseeing management and the corporation's operations including maintaining supplier and customer relations; participating in the sale of assets; approving and negotiating credit terms with lenders and trade creditors to ensure continuing supply; managing legal actions including initiating or continuing legal proceedings by or against the corporation, terminating leases, contracts and employees; formulating a "roadmap" for restructuring; executing the restructuring plan; preserving market share; and identifying and establishing new business opportunities.

Where the corporation is undergoing CCAA proceedings, the CRO will work closely with the court-appointment monitor. In a restructuring under the CCAA the court, under its

²⁴ *Ibid.*

²⁵ *Ibid.*

inherent jurisdiction, may grant specific powers to the CRO. These powers may include taking all necessary steps to carry out a restructuring of the distressed corporation; having full access to the property of the distressed corporation to the extent that it is necessary to adequately assess the corporation and its financial affairs; and evaluating the restructuring, sale, or recapitalisation alternatives.

In *Aveos Fleet Performance Inc.*,²⁶ the court granted the CRO broad powers, including the power of a “CRO signing officer” in respect of all of the corporation’s bank accounts and the power to control the corporation’s receipts and disbursements; retain employees or terminate employment contracts; and represent the corporation in negotiations with any party. In *Ivaco Inc.*,²⁷ the court permitted the participation of a CRO in the sales process to assess the various bids and make recommendations.²⁸

In *Northstar Aerospace Canada Inc.*,²⁹ the order appointing the CRO under the CCAA included provisions limiting liability and providing the requisite powers and authority to allow the CRO to carry out their mandate. These provisions provided that neither the CRO nor any officer, director, employee or agent of the CRO are deemed to be a director or officer of the corporation; incur any liability or obligation as a result of their appointment or carrying out their mandate; and the debtor company was required to indemnify and hold harmless the CRO and any officer, director, employee or agent of the CRO who may have assisted the CRO with the exercise of their powers and obligations. It was provided that this indemnity should be secured by a charge on the debtor company’s assets, usually as part of the directors and officer charge. Any actions or other proceedings against the CRO should be stayed except with leave of the court and the CRO should be permitted to resign or the debtor company should be permitted to seek an order terminating the appointment of the CRO at any time.³⁰

7.1. Obtaining the facts

The nature, quantity and quality of internal and external information available to the CRO upon their appointment will affect the quality of the decisions made and the process that the CRO will follow to implement a restructuring plan.

A primary focus of the CRO is to ensure that accurate, complete, and reliable information necessary for informed decision-making is available on a timely basis. Acting on an informed basis will limit omissions and errors and allow the CRO to exercise sound business judgment in carrying out their mandate. The CRO will keep a formal record of all material matters pertaining to the corporation’s restructuring, including the accuracy and completeness of the information; documentation considered; and the risks associated

²⁶ *Aveos Fleet Performance Inc.*, 2012 (Que SC).

²⁷ *Ivaco Inc.*, 2004 3 CBR (5th) 33 (Ont SCJ [Commercial List]).

²⁸ J P Sarra, “Governance of the Insolvency Corporation During the CCAA Proceedings” in J P Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 351.

²⁹ *Northstar Aerospace Canada Inc et al.* Initial order of Justice Morawetz, 14 June 2012.

³⁰ *Ibid.*

with decisions taken, hence, bringing clarity and efficiency to decisions that are implemented.

7.2. Management, stakeholders and external resources considerations

The CRO may be an instrumental force in establishing and / or enhancing the corporation's diagnostic and reporting systems³¹ so that reports and other reliable information necessary for informed decision making are available to the directors and stakeholders. The CRO may also be instrumental in ensuring that the corporation is capable of attracting and retaining talented and committed management, stakeholder co-operation and adequate external financial resources.

7.3. Assessing the corporation's debt restructuring alternatives

For a successful restructuring, the CRO will need to assess the corporation's debt-servicing capabilities. It is imperative that the CRO builds a rapport and good relations with the corporation's secured lender and communicates with the stakeholders the amount of debt-servicing capabilities that the corporation will have when it has been stabilised and returned to profit.

7.4. The chief restructuring officer can help the corporation's directors exercise their due diligence defense

Where a corporation is in financial distress or is approaching insolvency and undertakes to restructure its business, a CRO understands the nature and extent of the statutory liabilities facing the directors for source deductions, unpaid wages, unpaid vacation pay, unfunded pension contribution, and environmental liabilities. The CRO can assist and advise the directors by conducting an internal assessment of the risk factors associated with the statutory liabilities, so that the directors can understand the extent of their potential liabilities as part of their informed decision-making process and as to whether or not they should continue to serve as directors or resign during the restructuring. For instance, in *Afton Food Group Ltd*,³² the initial court order under the CCAA indemnified the directors to keep them in office and secured that indemnity by a third ranking charge on assets.

The CRO may also assist the directors in establishing controls such as establishing a segregated account to pay directors' liabilities from the available cash flow and implementing operational processes requiring an officer of the corporation to certify that the required statutory payments have been made. In *Peoples Department Stores Ltd*,³³ the Supreme Court of Canada held that where a CRO takes over the management of the affairs

³¹ WE Aziz, EM Grudzinski and EA Sellers, "Practical Aspects of Governing Distressed Enterprises in Canada" in JP Sarra, *Annual Review of Insolvency Law: 2006* (Thomson Carswell, Toronto, 2007) at 374.

³² *Idem*, at 390.

³³ JP Sarra, "Governance of the Insolvency Corporation During the CCAA Proceedings" in JP Sarra, *Rescue! The Companies Creditors Arrangement Act* (2nd ed, Thomson Reuters, Toronto, 2013) at 353.

of the corporation, the CRO will acquire a statutory duty of care and should consider the interest of the stakeholders who have an interest in the restructuring.

8. Conclusion

In conclusion, while the appointment of a CRO is not necessary in all corporate restructurings, in the right circumstances the impact of a CRO's expertise and his power to veto strategic decisions on behalf of a distressed corporation may mean the survival and profitability of the company; the retention of jobs for employees; continuation of contracts for suppliers; the collection of crown debts by municipal, provincial and federal government agencies; and the removal of the corporation from the immediate dangers of a receivership or bankruptcy.