FINANCIAL SERVICES

SEMINAR MATERIALS

October 27, 2005
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Borden Ladner Gervais LLP offers clients the services of a fully integrated national network of seasoned legal talent. The firm’s track record is based on the expertise and commitment of more than 670 lawyers, intellectual property agents, and other professionals.

Working as a team, we represent a variety of regional, national, and multi-national corporations in a number of business sectors. We also represent public institutions such as colleges, universities, educational authorities, governments, governmental agencies, hospitals, and other health care facilities. In addition, business, trade, and charitable groups are among our clients.

At Borden Ladner Gervais, our clients have choice. They can engage a particular lawyer offering particular expertise or, for more complex transactions requiring a number of individuals or crossing several practice areas, they can engage a team of lawyers. While it may sound costly, this approach actually is sensitive to time and cost because it quickly and readily matches specific skills and experience with specific client needs.

To meet these needs, our team pushes boundaries and seeks innovative approaches. With leading work in emerging fields and a keen focus on evolving business priorities, we help clients master a rapidly changing world.

Accordingly, Borden Ladner Gervais is committed to the use of advanced technology. All members of the firm are linked by a network, which supports an array of information and project management software. The firm encourages and maintains direct electronic connections with its clients, ensuring our interactions are efficient and cost-effective.

We are in the business of finding the right answers. Daily, our Canadian and international clients make decisions based upon what we deliver: superior advice, strategic perspectives, and innovative business approaches - in the right place and at the right time. They value our dynamic, responsive partnerships based on personal relationships.

Clients also value our firm’s national and international scope. More than 20 languages are spoken at our firm, and our experience is global in nature. We have acted in the resolution of international litigation and trade disputes; in international banking transactions (including sovereign risk lending); international insolvencies, liquidations and restructurings; international joint ventures, reorganizations and acquisitions; and international communications networks and contracts of many kinds.

At Borden Ladner Gervais, we are committed to teamwork, innovation, proactive strategies, and personal client service - all supported by advanced technology and delivered within a global context.
Borden Ladner Gervais LLP Firm Profile

Areas of Practice

Borden Ladner Gervais LLP serves its clients in all areas of a modern law practice. In addition, we offer the following specialized services:

- Aboriginal Law
- Administrative, Regulatory and Public Law
- Advertising and Sponsorship
- Appeal and Review
- Asia Pacific Group
- Aviation
- Banking Litigation
- Biotech and Pharmaceutical
- Broker Liability and Compliance
- Business Immigration
- Class Actions
- Commercial Arbitration and Alternative Dispute Resolution
- Commercial Lending
- Commercial Litigation
- Commercial Real Estate
- Commodity Tax
- Communications Law
- Competition and Marketing Law
- Constitutional Law
- Construction and Engineering
- Construction, Engineering, Surety and Fidelity
- Corporate Commercial Group
- Corporate Finance
- Corporate Governance
- Corporate Tax
- Directors’ and Officers’ Liability
- Education Law
- Electricity Markets
- Entertainment Law
- Environmental Law
- Estate and Family Law Litigation
- Expropriation Law
- Federal Court
- Financial Services
- Financial Services Regulatory Group
- Forestry Law
- Franchise and Distribution Law
- Fraud Law
- General Property and Casualty Claims
- Government Relations
- Health Care Institutions and Services (non-litigious)
- Health Law
- Hotel and Hospitality
- Information Technology
- Infrastructure/Public-Private Partnership Projects
- Insolvency and Restructuring
- Insurance and Tort Liability
- Intellectual Property Agency
- Intellectual Property and Technology
- Intellectual Property Litigation
- International Group
- International Tax Law
- International Trade Law
- Investment Management
- Japan Group
- Labour and Employment
- Life and Disability Insurance
- Marine
- Media Law and Defamation
Areas of Practice (cont’d)

- Mergers and Acquisitions
- Municipal, Government and Police Liability
- Municipal Law
- Not-for-Profit
- Oil and Gas
- Pensions
- Personal Injury and Accident
- Personal Tax and Estate Planning
- Privacy and Access to Information
- Private Company
- Product Liability
- Professional (non-medical) Liability
- Regulatory Law
- Securities and Capital Markets
- Securities and Shareholders Litigation
- Structured Finance and Leasing
- Tax
- Tax Litigation
- Venture Capital
- Wealth Management

Firm History

Five firms, recognized in their communities for outstanding success and service, founded Borden Ladner Gervais. They were Howard, Mackie (Calgary), McMaster Gervais (Montréal), Scott & Aylen (Ottawa), Borden & Elliot (Toronto), and Ladner Downs (Vancouver).

Today, we are Borden Ladner Gervais LLP, one of Canada’s largest and most respected national law firms. We are committed to the same tradition of excellence established by our founders.

- Borden Ladner Gervais LLP – Calgary

The Calgary office began as Howard, Mackie, founded in 1888. As one of the largest legal firms in Western Canada, it has been closely associated with the growth of Calgary as an international business centre. Today, the firm plays a role in transactions generated by the city’s dynamic business community on the local, national, continental, and global levels.

- Borden Ladner Gervais LLP – Montréal

Our Montréal office incorporates the oldest continuous legal practice in Canada, founded in 1823. Today’s fully bilingual office resulted from the 1998 merger of McMaster Meighen and Mackenzie Gervais. Together, their history is interwoven with the maritime, industrial, financial, and economic development of Montréal, Québec and Canada. In the 19th century, the firm’s lawyers helped bring about the formation of Canada’s railways.
Borden Ladner Gervais LLP Firm Profile

Firm History (cont’d)

- **Borden Ladner Gervais LLP - Ottawa**

  The Ottawa firm of Scott & Aylen was founded in 1952, and merged with Borden & Elliot in 1999 to form Borden Ladner Gervais - Ottawa. Our Ottawa office is fully bilingual and one of the largest in the nation's capital. Borden Ladner Gervais - Ottawa pioneered a multi-disciplinary approach that puts lawyers together with patent and trade-mark agents under one roof. Borden Ladner Gervais - Ottawa ensures a full suite of legal and intellectual property services to clients in Canada and beyond.

- **Borden Ladner Gervais LLP - Toronto**

  The Toronto firm was founded as Borden & Elliot in 1936. It is one of Canada's most prominent full-service law offices, with one of the largest litigation practices in the country.

- **Borden Ladner Gervais LLP - Vancouver**

  The Vancouver firm of Ladner Downs was founded in 1911. Today, as Borden Ladner Gervais - Vancouver, we are present in significant transactions in every area of British Columbia and in every major sector of its economy. Borden Ladner Gervais - Vancouver is one of the pre-eminent law offices of Western Canada.

Our offices have a collective depth of experience that cannot be bought or assembled from scratch. This depth of wisdom is what clients look to when evaluating their potential for success. Ours is a track record that extends right across Canada, into the United States, and overseas.

For further information on our firm and our services, please visit our website at [www.bigcanada.com](http://www.bigcanada.com).
Financial Services Group

Our Financial Services Group, in conjunction with our other Practice Groups, provides comprehensive and specialized advice and legal services in all aspects of financial services law.

Our Group is a large multidisciplinary team with expertise in all areas of financial services law, including banking, lending, leasing, structured finance, project finance, securitizations, regulatory matters, bankruptcy, insolvency, restructuring, and related disciplines. Our multidisciplinary approach reflects the reality of financial services both domestically and internationally where traditional financial sectors have become integrated and traditional activities require special expertise.

Our Financial Services Group provides a wide range of services to major Canadian and foreign banks, financial institutions, trust companies, credit unions, insurance companies and investment dealers. The Group also represents numerous corporate borrowers and lessees in diverse sectors of the economy. We make it our business to know and understand the financial services marketplace and to respond practically and efficiently to our clients’ needs.

Our Services

Members of the Financial Services Group provide advice on all aspects of financial services law, including:

- Governmental, corporate and commercial financing
- Syndicated loans and participations
- Structured finance and leasing
- Securitizations
- Project financing
- Real estate financing
- Natural resource and energy financing
- Acquisition financing
- Venture capital financing
- Formation and operation of credit unions, co-operative associations and other financial institutions
- Admiralty financing
- Aircraft financing
- Receivership, bankruptcy and insolvency
- Enforcement and realization of security
Financial Services Group

Our Services (cont’d)

- Corporate Restructuring
- Fraud and forensic/investigations
- Work-outs and arrangements
- Financial instruments and derivative products
- Trade finance
- Electronic banking
- Clearing system issues
- Regulatory issues, including "branching"
- Consumer credit
- Credit and debit cards
- Joint ventures, partnering, alliance building between and with financial institutions
- Establishment and acquisition of banks, trust companies, insurance companies and mortgage companies
- Mergers and acquisitions of financial institutions
- Preparation of standard security and loan documents
- Corporate trust services
- New products and expanded services of financial institutions
- General corporate and commercial concerns of financial institutions

Our Experience

Our Financial Services Group has played a key role in some of the highest profile and most complex financings, workouts, restructurings and liquidations in recent Canadian and international business history.

We have a diversified practice which ranges from advising small business and entrepreneurs to advising banks and financial institutions in connection with a large volume of corporate and commercial lending of all types, equipment leasing and vendor finance programs, as well as advising financial institutions on regulatory matters. The common thread is the Group’s focus on achieving client objectives in innovative ways.
Financial Services Group

Our Experience (cont’d)

Borden Ladner Gervais LLP’s lawyers serve on the boards of directors of various financial institutions and industry associations, and many of them are active in speaking and teaching on lending and financial service issues. A number of lawyers in our Group have been described in international publications as amongst the leading lawyers in Canada in their specialty. The educational qualifications, backgrounds and interests of the Group’s lawyers create a resource that is highly responsive to the needs and concerns of our clients and the financial service sector in which they do business.

Members of the Financial Services Group draw on expertise from our other Practice Groups in all areas, including capital markets, energy, real estate, tax, litigation and other relevant specialties such as international business, communications and environmental law.

We pride ourselves in addressing client needs in an effective and cost efficient manner through the utilization of partners, associates and paralegals individually and in working groups appropriate to particular projects. Combined with our leading-edge expertise, as one of the largest firms in Canada, we have the depth of resources within each regional office and throughout the firm, nationally, to handle a high volume of transactions and projects.
Financial Services Group

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Opportunities for Financing P3 Projects in BC

Financial Services Seminar
Ron L. Bozzer
October 27, 2005
1. Imperative for Public Private partnerships – Commonly known as P3

- Governments at all levels have budget constraints
- McGill study shows a large infrastructure gap and crisis in Canada
  - Municipal deficit - $44 billion
  - Combined federal, provincial and municipal deficit - $100 billion
- Failed government infrastructure projects with enormous construction overruns.
2. What is a Public Private Partnership?

- It is a long term contractual arrangement between the public sector and the private sector for the provision of services which provide public infrastructure.

- The structure involves a sharing of risks and rewards and responsibility for success or failure.
3. The Structure of P3s
The “Traditional” Construction Contract Scenario

- Owner
- Designer
- Lender
- General Contractor
- Bonding Co.
- Trade

Trade
Trade
Trade
Trade
The Typical Public Private Partnership Structure

Public Entity

Concession Agreement

Project Co.

Operation & Maintenance (“O&M”)

Lender

Equity

Bonding Co.

Designer

Trade

Engineering Procurement & Construction (“EPC”)

Bonding Co.
4. Legislative Mandate in B.C

**Transportation Investment Act (2002) (“TIA”)**

- TIA became law on October 31, 2002
- TIA empowers BC Minister of Transportation, with Cabinet approval to enter concession agreements with approved concessionaires.
- TIA specifies mandatory provisions that must be in the concession agreement
4. Legislative Mandate in B.C. (cont’d)

**Health Sector Partnerships Agreement Act (2003) (‘HSP”)**

- HSP became law on December 2, 2003
- HSP more a labour law statute which cleared the way for private sector participation in the health sector

**Significant Projects Streamlining Act (“SPSA”)**

- SPSA became law on December 2, 2003
- Project declared in public interest get constraints removed
5. British Columbia Projects Currently Underway or Financing Completed

5.1 Hospitals

- Academic Ambulatory Care Centre (VGH site)
  365,000 sq. foot
  - integrated health care facility, out patient care service, specialty clinics, research and related commercial/retail space
  - ABN AMRO sponsor, arranger and underwriter with senior annuity bonds and equity
  - $120 mm project

- Abbotsford Regional Hospital and Cancer Centre Project
  (55,000 square metres)
  - ABN AMRO sponsor, arranger & underwriter
  - $450 million project value
5. British Columbia Projects Currently Underway or Financing Completed (cont’d)

5.2 Waste Water Treatment Plants

- Britannia Mine Water Treatment (under construction) – Epcor
- Whistler Wastewater Treatment Plant (Deadline for RFP submissions was Oct 26, 2005)
5. British Columbia Projects Currently Underway or Financing Completed (cont’d)

5.3 Highways

- Sierra Yoyo Desan Road – 188 Km road near Fort Nelson, B.C. (under construction)
- Sea to Sky Highway
  - Concession let to Macquarie led group (June 2005)
  - Financing completed and syndicated offshore
  - one Canadian Bank syndicate member
  - $600 million project
  - 25-year concession
5. British Columbia Projects Currently Underway or Financing Completed (cont’d)

5.3 Highways (cont’d)

- Kicking Horse Canyon Project – 26 Km Trans-Canada Highway from Golden to Yoho National Park
  - 3 phase project
  - Phase 2 - underway
5. British Columbia Projects Currently Underway or Financing Completed (cont’d)

5.4 Bridges

- William R Bennett Bridge (Okanagan Lake Bridge)
  - SNC-Lavalin chosen
  - June 29, 2005
  - $145 million
  - 30-year concession

- Golden Ears Bridge consortia selected and Proposals currently being submitted
5. British Columbia Projects Currently Underway or Financing Completed (cont’d)

5.5 Other Projects

- RAV
  - SNC-Lavalin led consortium selected over Bombardier rival
- Northern Sports Centre
  - City of Prince George and University of Northern B.C. as “public entity”
  - indoor sports centre, multi-court gymnasium
  - indoor track and field and training centre
6. Other Provinces

6.1 Alberta Project

- Anthony Henday Drive Ring Road around Edmonton
  - ABN AMRO as project sponsor and sole underwriter
  - 32 year senior annuity bonds

6.2 Quebec & Ontario on the way
7. How have P3 Projects been financed

- Sponsors bring together consortia, attract equity and debt
- Some deals have bank debt as construction short term financing with long term debt provided by life insurance company
- Equity comes from in-house infrastructure funds
- Bank debt done in world-wide infrastructure syndication market
8. What Sectors will be hot in BC for P3 Projects

8.1 Health Care
- Long term care field
- St. Paul’s Hospital RFQ ready soon
- Children’s and Women’s Hospital Extension
- Dogwood Pearson Lodge
- Kelowna General Hospital

8.2 Transportation
- Pacific Gateway, including a New Pitt River Bridge and Ring Road for port service connection to US
8. What Sectors will be hot in BC for P3 Projects (cont’d)

8.3 Education
- Royal Roads On Vancouver Island- Living Centre
- University College of the Fraser Valley
- Seismic upgrading of schools

8.4 Municipal Services
- Waste water treatment
- Recreation facilities
9. P3 Selection Process

■ Request for Qualification stage ("RFQ")
  ■ Credit worthy contractor
  ■ Skilled contractor and designer
  ■ Public Authority select usually 3 consortia

■ Request for Proposal stage ("RFP")
  ■ Approved proponent submits bid based on a pre-determined concession agreement which has been negotiated by the three consortia to one common document
9. P3 Selection Process (cont’d)

- Request for Proposal stage (“RFP”) (cont’d)
  - Bidder must have an unconditionally financed bid
  - Lenders + Equity must be committed before project proponent is selected
  - After selection concession signed and held in escrow until financing closed
9. P3 Selection Process (cont’d)

- Request for Proposal stage ("RFP") (cont’d)
  - Consortia often have a range of financing options
    - bank debt construction financing with takeout or go public debit
    - private long term funding (life cos)
    - infrastructure funds
10. What is Special about P3 Projects

- Lender’s primary objective is to have principal repaid with interest
- Minimize risk borne by project company
- Mitigate risk by transfer to third parties (subcontractors; insurers; bonding companies; other lenders)
- Higher than usual gearing, i.e. 90% debt – 10% equity
10. What is Special about P3 Projects (cont’d)

- To be successful a P3 should be structured so that each party is assigned the risks that:
  - economically impacts that party more
  - it can efficiently mitigate
  - it can transfer to a third party (i.e. an insurer)
  - is within its control
11. Transfer of Risk/Obligation

- Change in Law
- Cost overruns
- Warranty/defects
- Dispute risks
- Environmental
- Contractor default
- Force majeure

- Supplier default
- Input demand
- Offtaker default
- Operational
- Permits
- Project Co. default
11. Transfer of Risk/Obligation (cont’d)

- Project revenue (“fare box risk”)
- Public entity default
- Schedule
- Set-off
- Site access
- Site - geotechnical

- Site – environmental
- Site – fossils
- Step-in rights
- Third party default
- Variations
12. Players in the Industry

12.1 Infrastructure Groups

- ABN AMRO Bank
- Macquarie North America Infrastructure
- Plenary Group (Deutsche Bank connection)
12. Players in the Industry (cont’d)

12.2 Major Financiers
- CIT Capital Finance
- Bank Project Finance Groups
- Life Insurance Companies

12.3 Major Construction Groups
- Bilfinger Berger
- Aecon
- Amec
- SNC-Lavalin
12. Players in the Industry (cont’d)

12.4 Major Accounting Firms

- PWC
- E & Y
- Deloittes
- KPMG
13. Can Canadian Banks and Financial Institutions Compete?

- Review of the Australian Experience suggests Banks and other Financial Institutions can play
- Need Expertise and Understanding Structure – Form specialty infrastructure finance groups
- Need good technical and legal support for concession agreement analysis of risk sharing (law firm) model analyses (usually by CA firm) technical support and insurance advice
- Look for construction financings and municipal deals
14. Opportunities for Collateral Banking Services

- Treasury operations
- Account and cash management
- Blocked accounts agreement
- Hedging Arrangements
- Letters of Credit to support obligations
15. BLG Infrastructure Group

- Multi-disciplinary teams of over 30 lawyers
- Commercial/contract, project finance, construction and procurement lawyers plus numerous specialties:
  - Tax
  - Aboriginal Law (BC)
  - Environmental and Permitting
  - Labour Law (esp. health section)
  - Dispute Resolution
15. BLG Infrastructure Group (cont’d)

- Recent deals where BLG involved
  - Sea to Sky
  - Anthony Henday – Edmonton Ring Road
  - RAV
  - Kicking Horse Pass
  - Yukon River Bridge
  - Britannia Water Treatment
  - Ottawa Light Rapid Transit
16. Useful websites include:

- Canadian Council For Public-Private Partnerships
  www.pppcouncil.ca
- Partnerships BC
  www.partnershipsbc.ca
- Partnerships UK
  www.partnerships.org.uk
- National Council for P3s (US)
  www.ncppp.org
17. BC Chapter of CCPPP – You can get involved.

- Review Partnerships BC Best Practices Papers and Recommendations - Currently Working on these areas
- Review of Conflict of Interest Guidelines which is stifling the small market
- Developing standardized approach to certain key legal concepts such as:
  - Supervening events
  - Change of law
  - Compensation on termination
  - Change events
17. BC Chapter of CCPPP – You can get involved. (cont’d)

- Considering Insurance Requirements
- Considering Financial Issues
  - Bid requirements for RFP
  - Long Stop Dates
Opportunities for Financing P3 Projects in B.C.

Thank-you!
BANKRUPTCY REFORM:
THE IMPACT OF BILL C-55 ON
LENDERS AND OTHER CREDITORS

Clive S. Bird
Borden Ladner Gervais, LLP
October 27, 2005
Topics

- Statutory Priority Charge for Unpaid Wages
- *Wage Earner Protection Program Act* ("WEPP")
- Super-Priority for Unremitted Pension Contributions
- Collective Agreements
- Rejection of Existing Contracts
Topics (cont’d)

- Assignment of Contracts
- Dip Financing
- Corporate Governance
- Insolvency of Income Trusts
- Conclusions
Statutory Priority Charge for Unpaid Wages
Wage Earner Protection Program Act ("WEPP")
Super-Priority for Unremitted Pension Contributions
Collective Agreements
Rejection of Existing Contracts
Assignment of Contracts
Dip Financing
Corporate Governance
Insolvency of Income Trusts
Conclusions
Thank You!
Bankruptcy Reform: The Impact of Bill C-55 on Lenders and Other Creditors

By Clive S. Bird
October, 2005

Bill C-55 was tabled in Ottawa on June 3, 2005. It proposes changes to both the Bankruptcy and Insolvency Act (the “BIA”) and the Companies’ Creditors Arrangement Act (the “CCAA”)

The most significant proposed changes are:

- Super-priority for pre-filing wage claims and unremitted pension contributions; and
- The prohibition against the repudiation of collective agreements as part of a restructuring.

This protection of union collective agreements and pension arrangements will make the restructuring of these “legacy” obligations much more difficult, and in some cases impossible.

STATUTORY PRIORITY CHARGE FOR UNPAID WAGES

Claims for unpaid wages (including vacation pay) to a maximum of $2,000 per employee will be secured against the debtor’s “current assets” (accounts receivable, inventory, cash). These charges arise on receivership or bankruptcy and have priority over all other claims except deemed trusts.

WAGE EARNER PROTECTION PROGRAM ACT (“WEPP”)

WEPP will require that the Federal Government pay former employees of an insolvent debtor up to a maximum of $3,000 per employee for wages owing during the six months before bankruptcy or receivership. The Federal Government will then be subrogated to the rights of the former employee to the extent of the payment, and will be entitled to the benefit of the charge for wages described in the previous heading.
SUPER-PRIORITY FOR UNREMITTED PENSION CONTRIBUTIONS

Regular pension plan contributions by employees and their employers that were not remitted at the time of the bankruptcy or receivership will be secured against all of the assets of the debtor. This creates a statutory charge that ranks ahead of all claims except for the wage charge described above and except for unremitted withholdings covered by a deemed trust.

Perhaps the most alarming provision of this section is that no plan of reorganization, in a restructuring under the BIA or the CCAA, can be approved unless it provides that the unremitted pension amounts are to be paid immediately following Court approval of the Plan, unless the pension regulators agree to payment over time. Either way, they have to be paid.

This is a very troubling provision since it will effectively mean, in my view, that in situations where there is a large pension deficit, a restructuring will be rendered impossible.

This provision is surprising to me, since it runs contrary to the trend in the United States where Courts have the ability to limit or extinguish pension deficits in circumstances where a restructuring could not otherwise be accomplished.

COLLECTIVE AGREEMENTS

The question in Canada of whether in a restructuring a collective agreement can be repudiated by the debtor company, thereby forcing the negotiation of a new collective agreement, has not been resolved. Perhaps the Air Canada restructuring was as close as the Courts came to ordering the termination of a collective agreement, in the interests of achieving a successful restructuring.

Extinguishment of collective agreements is possible, if certain conditions are present, under the US Bankruptcy Code.

Bill C-55 says that collective agreements may not be repudiated.

Under Bill C-55, there is a mechanism to encourage renegotiation of a collective agreement with the union, but an existing collective agreement will remain in force unless it is changed by agreement between the parties. As well, where a collective agreement is revised, the
negotiating agent may make a claim, as an unsecured creditor, for an amount equal to the value of the concessions granted in the renegotiated collective agreement.

Therefore, the best that the debtor company can do is to seek a Court Order requiring negotiation. At the end of the day, there is no ability to restructure labour arrangements without the agreement of the union.

REJECTION OF EXISTING CONTRACTS

Bill C-55 clarifies the ability under the CCAA or the BIA to repudiate contracts, thereby allowing debtor companies to avoid unwanted contract obligations. The other party is left only with the ability to prove a claim in the restructuring.

Two exceptions to this ability to reject contracts are:

- Collective agreements (see above); and
- Eligible financial contracts ("EFCs").

ASSIGNMENT OF CONTRACTS

Under existing law in Canada, a Trustee in Bankruptcy (in most provinces) has the right to assign real property leases without requiring the consent of the landlord.

This ability to assign does not apply, at present, in the case of the CCAA.

Bill C-55 will give the Court in a CCAA case the power to approve the assignment of any kind of contract in an appropriate case (excluding, of course, collective agreements and EFCs).

DIP FINANCING

As a result of recent case law in restructurings, it is now common for the Court to permit post-filing borrowing by a debtor company, such loans being secured by Court Ordered first-ranking security known as debtor-in-possession ("DIP") loans or DIP Charges.

Bill C-55 provides that DIP loans will be available under both the BIA and the CCAA.
CORPORATE GOVERNANCE

In the *Stelco* CCAA case, the Ontario Court of Appeal recently held that the CCAA Judge did not have the power to remove Directors.

Bill C-55 will make it clear that where “real” governance issues arise, the Court will have the power to deal with them, including the power to remove and replace Directors.

INSOLVENCY OF INCOME TRUSTS

There has, for some time, been concern in Canada that since a trust is not a person, the trust would not be eligible to file for protection or to seek to restructure through the BIA or the CCAA.

In fact, in the only income trust insolvency filing in Canada so far (*Heating Oil Partners*), the trust is not part of the protective filing.

Bill C-55 will make it clear that income trusts will be entitled to take advantage of the CCAA and the BIA.

CONCLUSIONS

While some of the changes outlined above clarify and strengthen the restructuring provisions in Canada, the overall effect of Bill C-55 is very disappointing.

This disappointment arises from my perception that the new provisions will make it impossible to sweep aside unworkable collective agreements, or to limit or extinguish burdensome pension deficits.

The law in Canada appeared to be evolving in a manner consistent with the law in the United States. Such an evolution seemed logical, since for decades it has been “open season” in restructurings on the rights of creditors, both secured and unsecured, and therefore there seems no reason why the rights of other parties, such as pension claimants and union members, should be exempt from the changes to existing contractual arrangements that are necessary if a restructuring is to be achieved.
It appears that Ottawa was unwilling to make changes to empower debtor companies to successfully restructure in circumstances where a collective agreement or pension deficit stands in the way. These components of Bill C-55 are, in my view, a step in the wrong direction.
Dealing with Distressed Income Trusts

Insolvency and Restructuring Group
Borden Ladner Gervais LLP
Presented by Financial Services Group
Thursday, October 27, 2005
Michael McNaughton
INTRODUCTION

1. Business Trust Structures and Their Purposes
2. Typical Income Trust Structures
3. Gaps in Legislation
4. Insolvency and Restructuring Issues
5. A Recent Income Trust Filing
6. Proposed Legislative Amendments
Business Trust Structures and Their Purposes

- Corporation, Shareholders, Dividends and “double taxation”
- Income Trusts as “flow-through entities”
- Advantages for sellers, businesses and unitholders
Typical Income Trust Structure

- Leverage model
- Flow-through model
- IDS/IPS Structure – an alternative to income Trusts
Leverage Model

Unitholders

Cash Distributions (income and return of capital)

Trust

Trust Units

Operating Company

Senior Bank Debt

(equity)

(debt)
Flow-Through Model

Unitholders

Trust

Units

Operating Entity

Shares

Notes

General Partner

Limited Partnership

Canada

United States

Limited Partnership Units

Shares
IDS/IPS Structure

IDS/IPS Holders

clipped shares/notes

Operating Corporation
Legislative Gaps

- A trust is a relationship among persons

- A trust is not a “person” under the Bankruptcy and Insolvency Act – it cannot be put in bankruptcy or reorganized under that Act

- A trust is not a debtor corporation and so cannot be an applicant in a CCAA case
Insolvency and Restructuring Issues

a) Significant leverage

b) Focus on cash generation

c) Suitable for all business types?

d) Effect of structure on senior debt?

e) Is restructuring possible in light of the Legislative Gaps?
Heating Oil Partners

Heating Oil
Partners Income
Fund
(Ontario)

All HOP Holdings Notes and all HOP Holdings Common shares

11.9% limited partnership interest
5,000 limited partnership units

Delaware Limited Partnership

HOP business

500 limited partnership units

Heating Oil Partners, G.P. Inc.
(Delaware)

Heating Oil
Partners, G.P.
Inc.

11.9% common stock
88.1% common stock

Existing Investors

11.9% common stock
88.1% common stock

HOP Holdings, Inc.
(Ontario)

100% common stock

Head Office Partners, Inc.
(Ontario)
Filling the Gap

- **CCAA**
  
  (a) “income trust” added to the definition of the term “company”

  (b) term “director” defined to include the trustee of an income trust

- **BIA** – terms “person” and “director” similarly defined
Dealing with Distressed Income Trusts
(Speaking Notes)

By Michael J. MacNaughton

October, 2005

1. BUSINESS TRUST STRUCTURES AND THEIR PURPOSES

- Dividend paying corporations are taxed on their income at the corporate level. Dividends are usually taxed in the hands of the shareholder in receipt. Some say that this results in the "Double Taxation". This "Double Taxation" effect is reduced by the dividend gross-up and dividend tax credit provisions of the Income Tax Act. However, the "Double Taxation" effect remains significant.

- This "Double Taxation" can be eliminated and certain other tax efficiencies obtained through the use of income trust and other kinds of "flow-through entities". One of the factors contributing to the phenomenal growth in the use of income trusts (and other "flow-through entities") is the ability of those vehicles to "flow through" income to investors so that income tax is not paid at the entity level. Also, "flow-through entities" can distribute amounts (i.e., the return of capital) that is generally taxable upon the disposition of the units rather than upon the receipt of distributions. Dividends paid are usually taxable on receipt.

- In the simplest income trust structure (for example see the leverage model on page 5) unit holders hold units in a fund. The fund is an income trust. The unit holders are beneficiaries of the trust. The trustees of the trust make loans at interest to an operating company and hold the shares (often all of them) in the operating company.

- Interest payable by the operating company on the debt obligations owing by the operating company to the income trust should be deductible against the income of the operating company. Hence, the interest payments will reduce the tax payable at the operating company level.
If the income trust qualifies as a mutual fund trust under the *Income Tax Act* then tax will not be payable at the level of the trust but taxed in the hands of the beneficiaries/unit holders. (Note that qualification as a "mutual fund trust" under the *Income Tax Act* does not constitute the fund a "mutual fund" for the purposes of provincial securities laws.)

There have been many income trust IPOs in the last few years. Income trust IPOs have provided an enhanced means of taking a business public. In simplistic terms, purchasers of income trust units in income trust IPOs may be prepared to pay more in an income trust IPO for units because the units are expected to generate a higher return in part because of the tax efficiencies generated by the use of the income trusts structure. Rates of return to unit holders have been upwards of 8% and in one case as high as 14%. In the current interest rate environment, that is a significant return.

This is an advantage for the existing owner of a business because the leverage may provide larger payments to them through the IPO.

There is an advantage to the unit holder who will obtain a greater rate of return than he or she would have as a shareholder in a traditional structure.

### 2. TYPICAL INCOME TRUST STRUCTURES

There are two typical trust structures: (1) The leverage model and (2) The flow-through model; though there are many variations on each theme. In addition, the development and use of flow-through structures has not stopped with income trusts. Most recently a new structure sometimes referred to as "income deposit securities" or "income participating securities" has emerged. It effects the same result as a flow-through entity but without the need for the flow-through entity,

(a) **The Leverage Model** - (see chart on page 5)

This is the simplest of the trust structures (go to the slide):

- Unit holders pay for units in the Income Trust.
- The payment is made to the Trustees of the Income Trust. (Often the Trustees and the Income Trust are referred to together as the "Fund".)

- The Trustee will use the money received to acquire the shares of the Operating Company.

- However, the largest portion of the money received will be loaned by the Trustees to the Operating Company. (Note the subordination point below.)

- The Operating Company will make interest and principal payments to the Trustees on the loans. (The interest component should be deductible by the Operating Company against its income.)

- The Trustees will make regular (usually quarterly but sometimes monthly) payments to the unitholders. The income received will be taxed in the hands of the unitholder. To the extent that payments constitute a return of capital that gain, if there is one, will not be taxable until the unitholder disposes of his or her unit in the Income Trust.

- Bank debt will be advanced at the operating company level and will be secured.

- The "Trust Debt" (the debt owing by the Operating Company to the Trustees of the Income Trust for the benefit of the Unitholders) will be subordinated to the Bank debt. It likely will not be subordinated to the Operating Company's obligations to its other creditors (structural equality, one might say).

- The ability to make payments on the Trust Debt will depend on satisfaction of financial and other covenants stipulated by the senior lenders/the Bank.

- Sometimes the senior lenders at the operating company level will take a guarantee from the trust and a pledge of the debt owing by the operating company to the trust as security. In those cases, a so-called "trust on trust" structure is often employed. In that case a non mutual fund trust is interposed between the mutual fund trust (at the top of the structure) and the operating
company (at the bottom of the structure). The tax effect is the same but the pledge of the debt owing by the operating company is made simpler.

(b) Flow-through Model

- The flow-through model (see chart on page 6) is often used in cross-border income trusts.
- The operating business will be owned by a limited partnership. Limited partnership units will be owned by a Canadian based corporation which will also own all of the shares of the general partner.
- Because partnerships are also "flow-through entities", income will be effectively earned at the level of the Canadian based corporation but, because of the typical trust structure above, the Canadian based corporations distributions from the partnership can "flow-through" the Canadian based corporation and the trust on an efficient basis.

(c) Income deposit securities and income participating securities (see page 7)

- Instead of the interposition of a trust in an IDS/IPS structure, shares are physically clipped together and issued to holders.
- This should effect the same efficiencies as an income trust structure but without the interposition of a trust.
- The IDS/IPS structure is a relatively recent development.
- The first IDS/IPS IPOs took place in late 2004.

3. LEGISLATIVE GAPS

- Concern has been expressed about possible difficulties in the reorganizing or restructuring of business using the income trust structure.
The concern arises because a trust is not an entity or a person. It is a relationship among persons.

Both the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act stipulate what kinds of entities may take advantage of those statutes.

Under the Bankruptcy and Insolvency Act only an insolvent person may make a proposal, file a notice of intention, have a receiving order in bankruptcy made against it or make an assignment in bankruptcy. The term "person" in the Bankruptcy and Insolvency Act does not include a trust or an income trust. Therefore, it is impossible to reorganize an income trust under the proposal provisions of the Bankruptcy and Insolvency Act. It is impossible to put an income trust into bankruptcy for liquidation purposes. It is impossible for a creditor to put an income trust into involuntary bankruptcy proceedings. It is impossible for an income trust to file a notice of intention to make a proposal and obtain a stay against "its" creditors.

The Companies’ Creditors Arrangement Act applies only to a "debtor company". A company for the purposes of the CCAA does not include an income trust. Accordingly, subject to the inventiveness of lawyers and courts, an income trust cannot be reorganized under the CCAA.

4. INSOLVENCY AND RESTRUCTURING ISSUES

(a) Significant Leverage

- Businesses in an income trust structure are almost necessarily significantly leveraged. From a lender's or creditor's perspective (though not the unit holder's perspective) increased leverage may equate to increased risk.

(b) Focus on Cash Generation

- The income trust structure is premised on timely and regular payments by the business to unitholders, One of management's focuses therefore likely will be
ensuring that sufficient cash is available or made available to fund distributions to unitholders. Typically income trusts are said to be best suited to mature businesses with steady income streams and limited capital expenditure requirements. Nonetheless, the need to make payments to unit holders can reduce or eliminate any cushion that might otherwise be available to deal with unforeseen events, reduce the ability to make necessary capital expenditures, and the like.

(c) Suitable for all business types?

- As mentioned, income trusts are said to be best suited to stable, non-cyclical businesses which do not and are not anticipated to require significant capital expenditures.

(d) Effect of Structure on Senior Debt

- From the perspective of the senior lender an income trust structure, if properly structured, should not have a significant effect on security or risk. The senior lender will take first security on the assets of the business. The obligations owing indirectly to unit holders will be subordinated to the lender and the lender's security (subject to permitted payments in accordance with the terms of the credit agreement and financial covenants to permit payments to unit holders).

(e) Is restructuring possible in light of the legislative gaps?

- From the perspective of a senior lender and from the perspective of other ordinary creditors, the fact that, at present, it is not possible to reorganize an income trust through the CCAA or the BIA should not be of significant consequence. Since the operating business will be conducted through a partnership or a corporation and since those entities can be liquidated or reorganized under either the BIA or the CCAA (but note that partnerships are not covered by the CCAA) no significant concerns should arise. Having said that, since no business that utilizes the income trust structure has been the subject of
insolvency proceedings in Canada (with one exception) there must still be some uncertainty simply because of lack of experience. Nonetheless, the concern, again from a the perspective of a creditor of the operating business, that income trusts are not subject to the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act seems to be overstated.

• However, the perspective of the trustees of the trust, unit holders and the trust generally may be different. There are obvious advantages in being able to seek protection under insolvency statutes for corporations, their management, stakeholders and directors. At present, that is not available at the income trust level.

5. THE ONLY INSOLVENCY PROCEEDING SO FAR

• Heating Oil Partners is one of the largest suppliers of heating oil in the North Eastern United States.

• We act for the independent directors of the Canadian holding company and the trustees of the income trust and so our comments about Heating Oil Partners are necessarily constrained. Nonetheless, its present circumstances are instructive and publicly known.

• Heating Oil Partners did an income trust IPO in 2002.

• The structure is set out on page 10 of the handout. As you will see it follows the second or "flow-through" cross border model.

• While the diagram does not show it, Heating Oil Partners senior lenders made secured loans at the partnership level secured upon all the property of the business. The obligations of the partnership to the lenders were guaranteed by the general partner of the partnership and the Canadian holding company. According to the materials filed on the application, the obligations of the Canadian holding company to the trust are subordinated to the obligations of the Canadian holding company to the operating business' bankers. ●●
Dealing with Distressed Income Trusts
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- The business encountered difficulty.

- The partnership, the general partner and the Canadian holding company made Chapter 11 filings in Connecticut. They also made a protective application under section 18.6 of the CCAA in Toronto. A DIP facility was put in place in the Chapter 11 case and recognized in Canada.

- The restructuring process continues.

- What is most interesting is that no attempt was made to file the fund. It was left outside the Chapter 11 and CCAA processes.

- If anything this suggests that the ability to file the trust was not critical to the possibility of restructuring the business or to the "ordinary" creditors of the operating business.

- Nonetheless, one can imagine a case where it would be beneficial, to some extent, to include the trust and the trustees in a reorganization case.

- Bill C-55 proposes to address this gap in a very simple way.

- The definition of person will be amended to include an "income trust" and the definition of the term "director" will be expanded to include the trustees of an income trust.

- Likewise, the term "company" in the CCAA will be expanded to and include an income trust and the term "director" will likewise be expanded to include the trustees of an income trust.

6. CONCLUSION

- From a creditors perspective, the inability to reorganize or liquidate an income trust under the BIA or the CCAA does not seem to be of material significance.

- As a matter of coherence and logic, the proposed legislative changes make sense.
LESSONS FROM RECENT RESTRUCTURINGS

Magnus C. Verbrugge
Borden Ladner Gervais, LLP
October 27, 2005
Topics

- New Insolvency Test In Restructurings
- The Unions Will Be At The Table
- Corporate Governance And The Board Of Directors
- Dip Loans: Harder To Get?
- Receivers And Trustees As Successor Employees
- Emergence Of Private Equity Funds
NEW INSOLVENCY TEST IN RESTRUCTURINGS
THE UNIONS WILL BE AT THE TABLE
CORPORATE GOVERNANCE AND THE BOARD OF DIRECTORS
DIP LOANS: HARDER TO GET?
RECEIVERS AND TRUSTEES AS SUCCESSOR EMPLOYEES
EMERGENCE OF PRIVATE EQUITY FUNDS
Thank You!
Lessons from Recent Restructurings

By Magnus C. Verbrugge

October, 2005

NEW INSOLVENCY TEST IN RESTRUCTURINGS

Lenders, creditors, and other stakeholders are likely to encounter a new insolvency test in the case of companies which are seeking to restructure.

Since it is necessary to be insolvent in order to take advantage of Canada’s two restructuring statutes, the Companies’ Creditors Arrangement Act (the “CCAA”) and the Bankruptcy and Insolvency Act (the “BIA”), the test applied in recent years was the simple insolvency test which is typically applied in receiverships or bankruptcies. The most usual test is that the debtor company is unable to meet its obligations as they come due.

In early 2004, however, in the Stelco case, Mr. Justice Farley, of the Ontario Superior Court of Justice, permitted Stelco to make a CCAA filing on the basis that, while it was not actually insolvent at the time of the application to Court for the CCAA Order, it was a reasonable expectation that, within the time that it would take to restructure the company, it would run out of cash as a result of a large pension deficit and therefore become insolvent.

The unions in the Stelco case challenged the restructuring on the basis that Stelco was not, in fact, insolvent. The unions lost.

The simple lesson here is that many insolvency practitioners believe that in the future, it may not be necessary to prove actual insolvency, but only that an insolvency is likely or possible. This would bring us closer to the practice in the United States, where it is not
actually necessary to be insolvent to seek protection under Chapter 11 of the U.S. Bankruptcy Code.

THE UNIONS WILL BE AT THE TABLE

In the last 15 or 20 years, most restructurings took place in an arena where the unions were not participants. While the unions were not entirely ignored, they were marginal players and typically stood on the sidelines while the major constituents, the large creditors and the company, sorted out the issues in the restructuring.

Recent large restructurings in Toronto, notably Air Canada and Stelco, have seen the unions become major players in the restructuring proceedings, appearing not only at the boardroom table, but also in Court, in the newspapers, on T.V., and often in the worst nightmares of the company and its major creditors.

The presence of the unions in restructurings introduces a new level of uncertainty in a process which is already uncertain.

Furthermore, the provisions of Bill C-55, if passed, will further strengthen the union’s position by making it clear that collective agreements are “special” contracts which cannot be cancelled, unlike other contracts in a restructuring, which may be terminated by the debtor.

CORPORATE GOVERNANCE AND THE BOARD OF DIRECTORS

In an unprecedented decision earlier this year, Justice Farley in the Stelco case made an Order which dismissed two directors from Stelco’s Board of Directors.

This firing of the two directors was met with outrage by the unions, who took the matter to the Ontario Court of Appeal and won. The Court of Appeal reversed Justice Farley’s decision, saying basically that he did not have sufficient power to remove directors.
Bill C-55 provides that where “real” governance issues arise, the Court will have the power to deal with such issues, including the power to remove and replace directors. This provision in Bill C-55 should be regarded as a positive move which will likely enhance the possibility of restructuring in certain circumstances where the Board of Directors is not functioning effectively.

**DIP LOANS: HARDER TO GET?**

In British Columbia, at least, there is speculation among insolvency practitioners that debtor-in-possession financing (“DIP Loans”) maybe more difficult to obtain in the future.

This sense of potentially greater resistance to the granting of a DIP Loan arises from two recent cases in British Columbia, *Western Express Airlines Inc.* and *Interact Lumber*, both failed CCAA restructurings, in which DIP Loans were granted in circumstances where the existing secured creditors were not supporting the application for DIP funding.

It is possible that the usual tests for the obtaining of DIP financing will be more rigorously applied, requiring a higher standard of proof indicating that the restructuring is likely to be successful, and that the DIP Loan is (more or less) certain to be repaid.

**RECEIVERS AND TRUSTEES AS SUCCESSOR EMPLOYERS**

All insolvency-watchers should be waiting for the Supreme Court of Canada decision in *TCT Logistics*. The hearing will be held later this fall, with a decision likely to appear in early 2006.

The Supreme Court of Canada will need to deal with the issue of whether the accounting firms, in performing their tasks as Receivers or Trustees in Bankruptcy, can be considered to be successor employers, and therefore liable for significant employee obligations, if the Receiver or Trustee take such steps as would characterize them as successor employers under provincial labour legislation.
If the Supreme Court hands down a decision which leaves the door open for Receivers and Trustees to face liability as successor employers, Receivers will either look to the secured lenders for an iron-clad indemnity agreement, or will flatly refuse to operate a business or maintain employee relationships, thereby making it much more difficult, or, in fact, impossible, to sell businesses as going concerns.

A decision adverse to the position of Receivers and Trustees would appear to make it likely that pure asset liquidations will become far more likely than going concern sales.

EMERGENCE OF PRIVATE EQUITY FUNDS

Recent restructurings have seen a growing interest by private equity funds in the goings-on of various large restructurings.

Private equity funds, typically astute and frequently aggressive investors, have an appetite for buying up secured debt from more conventional lenders like large banks, thereby changing the landscape of a restructuring.

Private equity funds tend to be more creative and more likely to seek solutions which are unconventional.

This trend also provides a convenient exit strategy for large banks who may not wish to engage in the rough and tumble of a restructuring, but would rather sell out their position at a (deep) discount and move on to something else.

All of the above is part of the constantly shifting landscape of corporate restructurings.
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