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CCAA: BET ON THE RIGHT HORSE - THE "STALKING HORSE" IN QUEBEC

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THE CASE OF THE ARRANGEMENT RESPECTING WHITE BIRCH PAPER (THE "WHITE BIRCH GROUP") WAS ONE OF THE MOST SIGNIFICANT MATTERS BROUGHT BEFORE THE COMMERCIAL DIVISION OF THE SUPERIOR COURT OF QUEBEC IN 2010. NOT ONLY DID THIS MATTER RECEIVE A LOT OF ATTENTION ON ACCOUNT OF ITS CROSSBORDER ASPECT AND THE NUMBER OF PARTIES INVOLVED, IT ALSO CONSTITUTED A PRECEDENT FOR SALES OF ASSETS UNDER THE NEW PROVISIONS OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT* (THE "CCAA"). IN PARTICULAR, MR. JUSTICE ROBERT MONGEON APPROVED A RELATIVELY COMPLEX PROCESS FOR THE SOLICITATION OF OFFERS AND THE SALE OF ASSETS BASED ON THE AMERICAN "STALKING HORSE" METHOD AND ALLOWED A SECURED CREDITOR TO USE THE SECURED PORTION OF HIS DEBT TO BID ON THE ASSETS OFFERED FOR SALE ("CREDIT BIDDING"). WHILE CREDIT BIDDING IS THE SUBJECT OF ANOTHER IN FACT AND IN LAW BULLETIN, THIS ARTICLE IS INTENDED TO FOCUS ON THE USE OF THE STALKING HORSE METHOD.

CONTEXT

The White Birch Group carries on business in the pulp and paper industry. It employs approximately 1,200 people and operates plants that are mainly located in Quebec (Stadacona, Papiers Masson, F.F. Soucy, Scierie Leduc), but also in Virginia (Bear Island). The White Birch Group obtained the protection of the Court under the terms of an initial order issued under the CCAA on February 24, 2010. Since it held assets in the United States, the White Birch Group also obtained the protection of the U.S. Court under the provisions of Chapter 15 of the *U.S. Bankruptcy Code*. While under the protection of the CCAA, the White Birch Group was of the view that it was preferable that its reorganization be effected by means of a bulk sale of all of its assets as a going concern. It also decided that the scale and value of the assets to be offered for sale justified the use of the stalking horse method, which, although fairly widespread in the United States, is not very common in Canada and even less so in Quebec.

STALKING HORSE

A particular feature of the stalking horse method is the establishment of a floor price, which is disclosed to all potential purchasers (the stalking horse). This floor price is established by a potential purchaser who negotiates a complete agreement with the debtor. The agreement, which constitutes the initial bid, is then filed and disclosed to all potential purchasers. Interested third parties may thereafter submit qualifying offers that are higher than the initial bid. An auction then follows, in which the stalking horse and those who submitted qualifying offers participate. The auction opens with the highest qualifying offer and the participants may bid each in turn by submitting higher offers.

The winning bidder is required to complete the proposed transaction according to the terms of the initial bid, as improved during the auction. If no qualifying offer is received, there is no auction and the stalking horse is required to complete the transaction according to the initial bid.

The apparent benefits of this method are that it makes the bidding process more transparent and, especially, it provokes higher bids, thus generating a higher sale price than that obtained through the more traditional sealed bids process. By establishing a floor price and then participating in an open auction, the purchasers have the opportunity to improve their offers until the highest bidder wins. The drawback of the method is that it takes more time and is costlier. It is especially useful in major matters.

Normally, the process provides for certain protections ("bid protections") in favour of the stalking horse. Among other things, it may be provided that in the event that the stalking horse does not win the auction, the amount of the expenses he incurred will be reimbursed and that he may receive a break fee, which is essentially a risk premium to compensate him for the commercial risk he incurs by agreeing to put his cards on the table for all to see. The amount of the expenses to be reimbursed and the break fee may be expressed either as a dollar amount or as a percentage of the sale price. For instance, the courts have accepted combined percentages varying between 1% and 5% of the sale price, according to the circumstances, as everything is a question of negotiation between the parties and the discretion of the court. The U.S. average is approximately 3% of the sale price for the combined expenses and break fee. The court may also create a preferential charge on the assets to secure these protections. Thus, any offer subsequent to the initial bid must be higher by an amount that is at least equal to the stalking horse's expenses and the break fee. For example, in the White Birch Group matter, the initial bid submitted to the court for approval provided that, to be deemed higher than the initial bid, any subsequent offer was required to provide for the reimbursement of the expenses (fixed at \$3 million) and the payment of the break fee (fixed at \$2 million), in addition to being higher than the higher

bid by a minimum amount of \$500,000. In summary, for his bid to be deemed to be higher than the initial bid, a bidder was required to offer at least \$5.5 million more than the amount of the initial bid.

PROCESS

Here is how the process was carried out in the White Birch Group matter:

FIRST STEP: FINDING THE STALKING HORSE

As a first step, the White Birch Group developed and proposed a *Sale and Investor Solicitation Process ("SISP")*, which was approved by the Superior Court on April 29, 2010. The SISP provided for the rules that governed the search for potential purchasers, the qualification of offers, the identification of the stalking horse, the implementation of an initial offer and the holding of an auction. Once the SISP was approved by the Court, the White Birch Group commenced the search for potential buyers who might be interested in acting as the stalking horse and submitting an initial bid. Upon finding the stalking horse, the parties undertook an intensive negotiation process to reach an agreement for the sale of the assets that, once completed, was submitted to the Court for approval, along with rules of procedure for holding the auction. Only those who submitted, by a given date, a qualifying offer meeting the criteria set out in the SISP were to be invited to the auction.

SECOND STEP: APPROVAL OF THE STALKING HORSE AND THE AUCTION

On September 7, 2010, the White Birch Group filed a motion seeking approval of the initial bid and the choice of the stalking horse, as well as the auction procedure. Mr. Justice Mongeon approved the stalking horse, the \$175 million initial bid and the auction procedure. He approved the amount of \$3 million provided for as reimbursement of the expenses incurred by the stalking horse in the event that a third-party bidder won the auction and he agreed to secure this protection by means of a preferential charge on the White Birch Group's assets. However, Mr. Justice Mongeon refused to approve the proposed \$2 million break fee, although none of the interested parties present at the hearing contested this aspect. Unfortunately, in view of the very short deadlines imposed by the transaction, Mr. Justice Mongeon did not have the opportunity to state the reasons for his decision not to approve the protection that would have been afforded by a break fee for the stalking horse. This aspect thus remains somewhat of an unknown.

Only one potential purchaser, in addition to the stalking horse, presented a qualifying offer with the result that the auction was held on September 21, 2010, with only those two parties participating. The auction was conducted by the White Birch Group, assisted by the Monitor. At the auction, the parties bid in turn and, in the end, the last offer of the stalking horse, which was \$236 million, was declared the best and highest offer, in accordance with the rules of the auction approved by the Court.

THIRD STEP: THE FINAL APPROVAL

Lastly, the White Birch Group submitted the result of the auction to the Court by means of a motion for the approval of the sale of the assets. On September 24, 2010, relying in particular on the criteria of section 36 of the CCAA, Mr. Justice Mongeon granted the motion and approved the sale of the assets to the purchaser who had been chosen as the stalking horse and won the auction. Since the stalking horse won the auction, the issue of the break fee was not discussed. As previously mentioned, it seems that this issue will remain somewhat of an unknown for the time being.

CONCLUSION

The use of the stalking horse method is not appropriate for all matters. In Canada, it has been mostly used in major crossborder files, for example, in the *Stelco*, *Nortel* and *Eddie Bauer Canada* cases. In Quebec, the use of the stalking horse method was discussed in the *Boutique Euphoria* case but was not approved by the Court due to the specific circumstances of that case.

As to the result, it would seem that the objectives of the process implemented in the White Birch Group file were met. Indeed, the process was very transparent and was conducted under the supervision of the Monitor and the Court. Lastly, the final sale price of \$236 million for the assets constituted a substantial improvement over the initial bid of approximately \$175 million.

The White Birch Group matter will no doubt serve as a precedent for the use of the stalking horse method in Quebec, subject to the issue surrounding the possibility of granting a break fee and the amount thereof, which remains to be clarified. All in all, the stalking horse method is a horse on which one may bet in the context of major asset sales. You only have to bet on the right one!

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