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THE ROLE OF THE MONITOR UNDER THE COMPANIES' CREDITORS ARRANGEMENT ACT

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Introduction

The Oxford Dictionary defines Monitor as follows:

- Pupil in school with disciplinary or other duties
- One who listens to and reports
- One who maintains regular surveillance.

The term Monitor was also used to describe a tropical lizard. The Monitor lizard was a large tropical lizard with a long neck, narrow head, forked tongue, strong claws, and a short body. Monitors were formerly believed to give warning of approaching crocodiles and were known as Goanna in Australia.

The writer is confident, that this latter description of a monitor is not meant to reflect on any of the members of our profession who sometimes act in this capacity. Nor do I believe the reference to approaching crocodiles refer to creditors.

The paper attempts to provide some commentary on the following:

- The role of the monitor
- Why appoint a monitor
- Independence of the monitor
- Liability and Indemnity
- Reports of the monitor
- Dealing with creditors

- Monitor vs. Interim Receiver
- Interesting cases
- Summary.

Wherever possible the writer will attempt to refer to recent case law (predominantly cases that he has been involved in, in some capacity) various papers written on the Companies Creditor's Arrangement Act (CCAA) and insolvency practice and attempt to draw from some practical experience.

It should be noted that the views expressed herein are the views of the writer and not the firm with which he is associated.

1. Role of the Monitor

Section 11.7, subsection (3) of the CCAA states that the court shall appoint a person referred to as the Monitor to monitor the business and financial affairs of the company when an Order is made by the court under CCAA and for the duration of that Order.

The functions of the Monitor are set out in subsection (3) and state that the Monitor shall:

a) File a report with the court on the state of the company's business and financial affairs, containing prescribed information:

   i) forthwith after ascertaining any material adverse change in the company's projected cash-flow or financial circumstances,

   ii) at lease seven days before any meeting of creditors under Section 4 or 5, or

   iii) at such other times as the court may order.

b) Advise the creditors of the filing of the report referred to in paragraph (a) in any notice of a meeting of creditors referred to in Section 4 or 5; and

c) Carry out such other functions in relation to the company as the court may direct.

The role of the Monitor can be described as that of a person reporting to the court on the company's ongoing financial position and on its efforts to develop and formulate a restructuring plan. This may include:

- Report to the court on any significant changes in the company's financial position;
- Report on any sales of significant assets; and

- Provide its own independent assessment of the company's efforts to reorganize and at some point, provide a commentary on the company's plan of arrangement.

Typical court orders provide a list of information the Monitor considers relevant for the purposes of monitoring the business and financial affairs of the company which may include cash-flow projections, lists of inventory, receivables, receipts and disbursements.

A typical CCAA order will include the following provisions:

a) To receive such information as the Monitor considers relevant for purposes of monitoring the Petitioner's business and financial affairs and to assist the Petitioner in the preparation of cash flow statements and other financial reports as may be required by the Petitioner or the court, including the following information from the Petitioner on an ongoing basis, satisfactory to the Monitor:

    i) summaries of the Petitioner's inventories, receivables, cash receipts, cash disbursements, expenses, short term investments and bank balances; and

    ii) projected cash flow information.

b) To have access to all books of account of the Petitioner.

c) To appoint legal counsel or other consultants, and to obtain such assistance from time to time as it may consider necessary in respect of its powers and duties hereunder.

d) To ensure that the Petitioner makes payment of all required amounts from its bank accounts in the manner directed in this order.

e) To generally oversee the operation of the Petitioner's business operations and restructuring efforts, including supervising the issuance of purchase orders and the expenditure of funds in accordance with arrangements to be settled between the Monitor and the Petitioner.

f) To conduct an ongoing review of expenses incurred by the Petitioner subsequent to the Filing Date in order to ensure that the Petitioner does not incur or pay any obligations except as authorized under this Order.

g) To immediately report to the court any material adverse change in the Petitioner's projected cash flow or financial circumstances subsequent to the Filing Date, or any failure of the Petitioner to comply with any of the terms of this Order.

h) To assist the Petitioner in the development of their Plan and in the administration of meetings of creditors to consider the Plan.

i) To report to the court from time to time concerning the affairs of the Petitioner, its financial position, and the status of the Petitioner's restructuring efforts.

j) To provide such reports to the court as may be deemed necessary by the Monitor.

k) To manage the disposition of such Assets of the Petitioner as are considered to be redundant to the business of the Petitioner, including the preparation and dissemination of sales brochures and related materials, and the solicitation of offers on behalf of the Petitioner of such Assets, with authority to apply to this court for such directions or approvals as may be considered to be necessary by the Monitor in this regard.

The last provision dealing with the power to manage the disposition of redundant assets appears to be a relatively recent addition to the form of Order.

The Monitor should be the eyes and ears of the court. He is a fiduciary not just to the debtor but also to all creditors and has an obligation to fully and fairly represent both the court and the creditors. He is to be impartial. He should be practical and helpful to the debtor, however the Monitor should not cross the line.

The line I am talking about is one where the monitor takes an active role in management. As we all know, all too often a company in financial difficulty often lacks management depth, focus, the ability to make tough decisions, and develop a strategy and game plan to execute. Absent clear language in the court order, the monitors' role in management is very limited.

2. Why Appoint a Monitor

Historically, the Monitor has been appointed to provide some comfort level to the lenders as to the ongoing financial situation and an assessment of managements' efforts to restructure the business while a plan of reorganization is being developed. All too often there appears to be a lack of trust and confidence in the management team, in the debtor and its officers. Questions are raised about (1) managements' ability to deliver (2) tell the truth or (3) act impartially.

In one situation several years ago, while acting in a CCAA restructuring in a monitoring capacity, I along with counsel, used to occasionally meet with the Judge prior to a major application to discuss the situation. From a practical point of view, I believe that particular Judge took great comfort in both counsel and my own assessment of the situation and our ongoing ability to update the court. The Judge went even further to share the fact that he was often troubled with some of the submissions and felt that the only impartial view that was being provided was that of the Monitor.

I understand that several parties frown upon the practice of meeting with the Judge outside of the formal court process. Personally I felt that it:

- Contributed to the Judge's understanding of the current situation.

- Provided a forum for the Monitor to share his views without a fear of reprimand.
- Provided an opportunity to give the court an idea of what is likely to happen down the road.

3. Independence of the Monitor

Under the current law, an auditor is not precluded from acting as Monitor under a CCAA filing. Section 11.7 (2) states that except as may be otherwise directed by the court, the auditor of the company may be appointed as the monitor. It is argued that the auditor often has extensive knowledge of the company's financial and business affairs and is more suited to giving advice on the process than an outsider.

With respect and recognizing my views are not universally shared, I do not believe an auditor can always act impartially in that capacity. I subscribe to the view that to be truly impartial and independent, you need to have no ties to the debtor. I do not have a problem with an auditor acting as the company's financial advisor and assisting in refinancing, etc. However, if the role of the Monitor is to act and report to the court and the creditors on an impartial and independent basis as to the company's efforts to restructure and so on, that party needs to be independent.

Historically the Monitor has often been appointed as a result of the debtor's counsels' recommendation. The choice of a Monitor is rarely an independent one. Frequently the choice of Monitor is predicated upon the secured creditors impact. In recent years I have seen several instances where the choice of Monitor by the debtor has been as a result of a personal relationship or acquaintance. In my opinion, this is very dangerous and does not provide the body of creditors with the comfort that their own interests are being fairly represented.

Some banks have policies where they will not retain a Consultant as their advisor if they are or have been an auditor of that company within the last two years. While as professional accountants we can all rationalize in our own minds that notwithstanding such potential conflict, we can manage the assignment. I believe a simple policy such as this makes life a lot easier.

I believe there are ample opportunities for accountants to advise audit clients who are in financial difficulty in the restructuring process. These include obtaining alternative financing, preparing and revising cash flow projections, attending meetings with management and stakeholders, etc. However, when that auditor also becomes the Monitor I believe they are wearing too many hats.

At present, the Monitor often drives several different agendas:

- He is often the bank's advisor;
- He is sometimes attempting to assist the company in formulating a restructuring plan,
- He is sometimes assisting in the sale of parts of the business on a going concern basis; and
- May be signing off on the audited financial statements.

Clearly in the post Enron era, it will be interesting to see whether the audit firms continue to be retained to act as Monitor in high profile publicly traded companies. I suspect that the profession will manage itself accordingly and determine in such instances that it may be better off to decline such appointments. However, until such time as the profession controls the process, firms will continue to believe that they can serve two masters.

4. Liability and Indemnity of the Monitor

The usual court order states that the Monitor shall incur no liability or financial obligation as a result of the making of the order, the appointment of the Monitor or the carrying out of the provisions of the order, save and except that the Monitor shall be liable for negligence or wilful misconduct on its part.

Section 11.7 (4) of the CCAA states that where the Monitor acts in good faith and takes reasonable care in preparing its reports to the court, it is not liable for loss or damage resulting from that person's reliance on the report. Section 11.8 (1) provides protection for the Monitor when the business of the debtor is continued or when the monitor continues the employment of the company's employees.

Section 11.8 (5) and (7) deal with the protection of the monitor where there are environmental conditions or damage to the property, which would require environmental remediation. The standard order also contains clauses, which protects the Monitor from becoming a successor employer, or a party who takes over possession and control of a property, which may be subject to environmental remediation.

The Monitor is generally not required to file security with the court for the due and proper performance of its powers and duties. The Monitors fees, costs and expenses are generally a first charge and security interest on the company's assets in priority to all creditors. This is often known as an administrative charge and can extend to the fees and disbursements of the Monitors legal counsel and counsel for the petitioner.

I believe that the pendulum may have swung too far in terms of the extent to which a court will grant an administrative charge ahead of secured creditors. In the case of United Auto, for example, the administrative charge that ranked ahead of three real estate mortgages ended up approaching $1 million. I think in future the courts may be more demanding of Companies to establish good reasons for a continuation of a stay of proceedings, especially where the evidence of a viable business plan, or equity available beyond the amount owed to secured creditors is questionable at best.

5. Reports of the Monitor

In my experience, the Monitor's reports sometimes are too structured and lack purpose and direction.

Too often the Monitor's reports are a recital of why the Order was granted, the role of the Monitor and a very brief picture of what is really going on. The reports tend to be short on details about the Company's operations. Lawyers sometimes edit reports on behalf of the Monitor to ensure the reports do not offend the company, management (heaven forbid), creditors or anyone else who may read the Monitor's report.

In my experience there are often management deficiencies. How many times does a Monitor's report address the management of the company? How many times does the Monitor's report actually say or state what is going on beyond a quick comparison of actual vs. budgeted cash flow. Reports need to be clear, concise and unequivocal. Monitors tend to be afraid to call it the way they see it. Sometimes a Monitor's report can get you into trouble. Sometimes not everyone agrees with your findings. Sometimes you get fired. You should be prepared to support your report. You should be prepared to discuss your report with key stakeholders.

Communication doesn't always have to be in written form, nor is the audience just the court. Often the impact of a Company restructuring has a serious and significant affect on communities.

In the early days of Skeena I, our firm was involved in a total of 18 different meetings at 3 different locations involving 6 different stakeholder groups. These meetings, were conducted early on in the CCAA proceedings, and were meant to provide those stakeholders, with an idea of where the company was, where it was going and what the implications were for the stakeholders. The stakeholder groups included trade creditors, logging contractors, union employees, management, local and municipal politicians as well as media.

Clearly Skeena was an unusual example of the extent of disclosure the Monitor felt was appropriate. On that occasion the court did not require the Monitor to conduct these meetings. We felt, however, given the numerous communities affected by the filing, opening up a forum for dialogue, and visiting the stakeholders in their communities was the correct approach.

In my opinion the Monitor's reports are often unread. All too often they are unread because they say very little. Judges do not always have a full picture. The Monitor's report is meant to be a light showing the way. The Monitor is meant to be the court's eyes and ears and should be able to assist the court in its assessment of the situation.

I subscribe to the view of more information rather than less. Reports should be informative, well laid out, and contain plenty of schedules, including a cash flow forecast, current balance sheet and operating results. A preliminary indication of asset values is helpful, though sometimes, confidentiality may restrict the amount of information that can be made public.

Attached, as appendix A, is a copy of the Monitors' first report to the court on Repap British Columbia (the old Skeena). While the report is somewhat dated, it does provide an idea of the type of information and detail that should go into a report. In my opinion, reports tend to provide the bare minimum of information, and leave several questions unanswered.

Even in this report, however, there were some deficiencies. There was no commentary on management. The lawyers effectively "gummed the report to death", and there were separate reports sent to the Banks involved, that never became public.

The table of contents and appendices of this report are shown below:

Table of contents:

- Background
- Financial position as at March 3, 1997
- Business affairs and operations since March 3, 1997
- Related party assets and liabilities
- Development of restructuring plan
- Activities of monitor
- Establishment of a creditors committee
- Action plan.

Appendices:

- List of creditors as at March 3, 1997
- Letter to suppliers dated March 3, 1997
- Projected cash flow requirements for the 8 weeks ending May 23, 1997.

6. Dealing with Creditors

The typical CCAA orders allows the company, subject to the approval of the Monitor to pay obligations including wages, goods and services supplied following the filing, capital expenditures, rent, insurance, etc from funds generated from operations. There may be a restriction that relates to the use of proceeds from the sale of assets sold otherwise than in the normal course of business.

Sometimes a fund is carved out to cover payroll and possibly even suppliers. From a practical point of view, while the payroll carve out makes sense, rarely have I seen a fund specifically for suppliers of goods and services. More often the company is placed on a COD basis, and in some instances (especially with monopoly suppliers), deposits are required.

Depending on the situation, we often send a letter out to suppliers advising them of the company's situation. We advise them that as Monitor we are not in a position to guarantee payment and that they should review the terms on which they are prepared to supply and ensure they understand the risks associated with extending credit to the company at this time.

I am always amazed at the number of creditors that continue to extend credit in such situations. In one instance various logging contractors suffered when the company filed for protection. Subsequently the same company filed yet again, and some of the very same contractors were once again burned when the company was forced to file for a second time.

One of the secured creditors attempted to ensure the contractors were paid shortly before a CCAA filing. The other secured creditor decided to freeze the bank account and send back all the cheques. Subsequently the company was forced to file and those contractors were once again left out in the cold.

7. Monitor vs. Interim Receiver

A lot has been written lately about the frequency of the appointment of an Interim Receiver and the decline of the Private Receiver appointment especially in Ontario. The National Insolvency Review, in August 2000, included a paper on this subject. It recited the experience in several cases including Royal Oak Mines, Agro Pacific and Euro United as support for the appointment of an Interim Receiver. Whenever a system favours reassessments over liquidation it should be followed. The Interim Receiver, it is argued, provides several advantages over the private receivership appointment. These include:

- Preserving tax losses;
- Managing the business; and
- The best of both worlds, speed and efficiency without liability.

My experience on a recent filing, where we were appointed Monitor under a CCAA filing, leads me to believe that the interim receivership route is preferred over a Monitor route. In that particular case our mandate effectively involved managing the company and the overseeing the disposition of redundant assets. It became very clear even before the filing that the lenders had lost confidence with management.

Our role as Monitor took on a much greater role than is normal. While at the end of the day, the results may be the same in terms of affecting a sale on a going concern basis of redundant assets and streamlining the business down to its core operations, we felt we had a fairly strong hand in overseeing and directing management. The section of the order dealing with management read as follows, "… to generally oversee… and to give directions to management, where required, in any circumstances where management would otherwise seek such directions from the Petitioner's Board of Directors." One wonders whether an Interim Receiver appointment would have been a better route to go.

To summarize the conclusion in the paper, "…the Interim Receiver offers the most opportunity and flexibility when dealing with the realization of security. The speed with which an Interim Receiver can be appointed, the range of powers available, the reduced potential for liability, and the opportunity to add value to the ultimate realization combine to form a persuasive argument for the appointment of an Interim Receiver over its privately appointed counterpart. Moreover, the extension of interim receiverships from any short-term time frame has increased the role of an Interim Receiver well beyond that of caretaker to that of receiver, manager, marketer, facilitator and vendor."

While these remarks were clearly contrasting the role of Interim Receiver and a Private Receiver, I believe they are equally relevant in comparing the role of an Interim Receiver and Monitor under CCAA.

I also believe that we will see more and more Interim Receiver appointments in conjunction with the Monitor appointment.

In the Royal Oak Mines decision, Judge Farley concluded one had to be creative and flexible to arrive at a restructuring solution, which will optimize enterprise value. Originally PricewaterhouseCoopers (PwC) had been appointed Monitor of Royal Oak Mines under a CCAA filing and subsequently recommended to the court that an Interim Receiver be appointed to market certain assets on a structured basis so as to preserve the company's tax pools.

In the course of the Royal Oak Mines' restructuring as Interim Receiver, PwC was able to take many actions that would not have been possible outside of a CCAA / Interim Receivership. This included a sale of redundant assets by the company, streamlining of operations, abandonment of various redundant properties with costly environmental problems and subsequently a structured sale through a reorganization, which converted debt to equity and allowed creditors to take advantage to significant tax losses accumulated by the company.

This process developed by the Interim Receiver was intended to cleanse Royal Oak Mines of any cumbersome or detrimental assets while leaving only those assets that would be needed on a go forward basis. Core assets were maintained while unnecessary, unwanted assets (some of which had environmental liability) were sold or abandoned.

8. Interesting Cases

United Used Auto

This case involved the operation of an auto wrecking business and extensive real estate holdings. The company's operating business had been in decline for several years, and its real business had become that of a land developer.

A foreclosure petition had been commenced and the company used the CCAA to attempt to maximize value from the sale of its real estate. The wrecking business had declined to $6 million in sales, and had not been profitable for several years. Its real estate was valued at anywhere from $32 million to $49 million.

This case involved a variety of interesting issues affecting the monitor. They included:

- Granting a charge of up to $500,000 for the monitor and counsel's professional fees and disbursements, ranking as a first charge ahead of real estate mortgages.
- Accusations that the Monitor was seen to be in the camp of the petitioner.
- Reliance by the court on the Monitors' reports to justify the continuance of an operating business (auto wrecking) while a sale of significant real estate was delayed.
- Despite the court finding that the petitioner had not acted reasonably in its attempts to sell the real estate, the company continued under CCAA protection for almost a year.

- A group of secured creditors attempts to force the company into bankruptcy were ultimately successful, but not before monitor and its counsel fees were almost $1 million.
- Leave was granted to appeal to the Supreme court of Canada, the appeal courts decision to grant a priority ahead of mortgage holders claims in favour of the monitor. Subsequently the appeal was abandoned as a result of the parties reaching a settlement on fees.

Redekop Properties Inc.

This case involved the use of a report by a third party consultant to attempt to convince the court not to grant a further stay to a company under CCAA protection. One of the secured creditors filed a report by an accounting firm showing it was unsecured for a significant amount of its debt. That consultant also swore an affidavit saying that the company's plan, which was still being formulated, was nothing more than a wing and a prayer.

The consultant was cross-examined under oath by counsel for the petitioner. The court appeared to accept the consultant's view that the company had no prospect of restructuring its affairs to be profitable in the near future. The court agreed that the proposed plan was nothing more than a "wing and a prayer".

In his reasons for judgement, Justice Sigurdson commented on the monitor's second report to the court as being a rather guarded assessment of the company's prospects. He quoted sections of the report.

"…………….It is feasible that the petitioner can present to the creditors an appropriate plan…………… However, not all of the elements which would be required to formulate the plan are known with sufficient certainty at this time to be able to assess whether that plan would be acceptable to the affected creditors."

Several things can be taken from this decision:

- The burden is on the petitioner to prove that they have acted in good faith and continued protection is appropriate.
- While the court does obviously consider the views of the monitor, it also takes account of the views of creditors' advisors which may include insolvency practitioners.
- The absence of an active business, lack of employees and trade creditors are all factors a court will consider when contemplating continued protection.
- A liquidation plan, containing risk for the secured creditors, still in its formative stage of development, and 3 to 4 months after the initial stay does not represent sound reasons for further court protection.

Skeena Cellulose Inc.

On September 5, 2001, Skeena filed for CCAA protection some three years after it emerged from previous CCAA protection. The company's operations had been marketed for sale for some three years without any real interest. One of the two lenders was seeking to recover whatever it could on its loans, since continuing attempts to find a buyer for the business was effectively being funded out of working capital. Operations had been substantially scaled down, the pulp mill had shutdown in June and two of the four sawmills had only been operating intermittently at best.

The secured creditor had taken the position that what little security it had left was being eroded at the rate of $3.5 million per month. The Monitor's report referred to a potential sale and advised the court that the purchase price was less than the projected net realizable value of Skeena's working capital. The court in its Reasons, reiterated that a further extension of the stay was subject to the Petitioner's satisfying the court that such an Order was appropriate and that the parties had acted in good faith and due diligence.

There were certain allegations that management had ignored the Monitor's recommendations.

In his Reasons for Judgment, in Skeena Cellulose Inc. dated October 5, 2002, Chief Justice Brenner made several references to the Monitor and its reports. The Chief Justice stated that the overall economic impact on the company's operations on the communities of North-western BC were of importance to the court.

It would appear that while the Monitor's report was somewhat sceptical about the ability of the company to conclude a sale and effect some form of restructuring plan (notwithstanding that future extensions continue to cause the deterioration in one of the secured creditors position and there was no real concrete offer which the court could hang its hat on) the court was prepared to grant a further extension. The overall interests of the communities of North-western BC were of more importance than the other factors.

A subsequent purchaser was found (the former owners of Repap amongst them) and a plan filed and approved by the creditors. One year after Chief Justice Brenner's decision it is interesting to note that neither the pulp mill nor three of the four sawmills have recommenced operations.

United Properties Ltd.

United Properties was a real estate developer in BC that essentially stretched its financial resources by investing in too many projects in Canada and the United States. It was forced to file for CCAA protection while at the same time attempting to complete ongoing projects.

As a third party involved in these proceedings, the one concern expressed by several parties was the perception that the Monitor was being an active advocate for the Petitioner. Attempts were made to substitute the Monitor. Attempts were made to hire a forensic accountant to conduct a more detailed analysis of the Company's assets, especially in the United States. In the end the Monitor stayed in place and the company proceeded with what appears to be a somewhat successful restructuring. A lot of the earlier problems facing the company in its restructuring could have been avoided if the Monitor had appeared to be more even handed and less of an advocate for the debtor. Allegations of a personal relationship between the principal of the company and a representative of the accounting firm did not help.

9. Summary

I believe the role of the Monitor will continue under the current CCAA regime. However, I believe we will see more appointments of an Interim Receiver in conjunction with the Monitor's role or instead of it. I hope we will see changes in who can be a Monitor and a more defined role for the Monitor. The company's accountant will play more of a role as financial adviser (which given their knowledge of the company's affairs they should be more suited to). The role of the Monitor will become more of an independent role, less the choice of the debtor and more the choice of the court based on input from the creditors.