

Declining commodity prices don't help sector Extraction companies ripe for restructuring

BY JIM MIDDLEMISS

For Law Times

You would think with slumping commodity prices and oil prices falling off the cliff that the extraction business would be awash with insolvency filings. That hasn't been the case; at least not yet.

"I think we are just at the early stage of it," says Tony DeMarinis, a corporate restructuring lawyer at Torys LLP in Toronto. "I think it's definitely coming, but it's impossible to predict how much of it there will be."

A declining commodity price cycle is no friend to the resource sector, notes Rick Orzy, co-head of restructuring and insolvency at Bennett Jones LLP in Toronto. "A lot of miners are really good operators, but it doesn't really matter how good you are if it costs you \$30 to get it out of the ground and you can only sell it for \$12," he says.

When it comes to mining, there have been some notable filings, such as Cliff's Natural Resources, the largest iron ore producer in the United States, suspending production at its Quebec Bloom Lake operations and filing for protection more than a year ago after it was unable to find a buyer.

A few months after, its nearby Wabush assets sought creditor

protection, paving the way for Cliff's to exit eastern Canada.

It also sold its Ring of Fire property in Ontario for a fraction of what it paid to acquire it.

Also last spring, Canada's Labrador Iron Mines Holdings filed for creditor protection as did North American Tungsten Corp. Walter Energy Canada Holdings was the latest coal entrant to the CCAA game, filing for protection in December, after its US parent sought Chapter 11 protection in the United States.

Coal company filings are rising throughout the U.S.

Of course, the steel companies, emblematic of a commodities slowdown, are once again going through a round of restructuring, with Essar Steel Algoma Inc. making its third trip through CCAA, while U.S. Steel Canada Inc. filed in late 2014.

On the oil and gas front, Parallel Energy Trust, which is headquartered in Calgary but has operations in Texas and Oklahoma, was the latest to file in November.

That filing highlights the impact that the precipitous drop in energy prices is having on the oil and gas business. Parallel's gross revenues before royalties in the first six months of 2015 declined 50% to \$26.9 million from \$62.2 million over the first six months

of 2014.

Nonetheless, there is a notable absence of large filings in the oil and gas sector. When commodity cycles turn, as they have for both ores and oil, lawyers say it becomes a restructuring challenge.

Volatile prices keep buyers on the sidelines, because they think the price will continue to go down, which means that there is little interest in assets.

Without buyers, lenders are reluctant to pull the trigger on their loan covenants, because no one wants to buy assets, and lenders certainly have no appetite to lend more to the sinking company. At the same time, management cuts back to the bone, which includes exploration and development, the lifeline to the future earnings companies need to pay their bills.

It's a vicious circle.

"A lender wants to call the loan because it's in default," says Jay Swartz, a restructuring lawyer at Davies Ward Phillips & Vineberg LLP.

"The question is what are you going to do with it? There are relatively few people who are willing to come in and buy distressed assets. In some cases, you have to sit on the assets," he says.

In the case of commodities, finding financiers willing to step into a distressed mine that is build-

ing out its operations when commodity prices are dropping is particularly challenging, notes Orzy.

"In terms of debt, it's harder to interest the usual type of restructuring lender or investor in something that is so binary — in the sense that either it works out well or it fails, usually with less grey area in between than in most other industries."

For juniors and exploration companies that don't have operating mines, Orzy says it's less of a problem.

"They often have more ability to last longer without incurring a great deal of ongoing cost while they wait for things to improve or find people to invest," he says.

However, he notes, "Before that can happen, the new money has got to start believing the commodity prices will recover."

That doesn't appear to have happened yet.

Swartz cites one recent instance where a client had spent more than \$130 million developing one of the few North American lithium mines when it ran into problems. Lithium is a cherished commodity used in batteries and cellphones. Debtor-in-possession financing to the tune of \$13 million was arranged to help the restructuring; however, again no buyers stepped forward and a re-

ceiver was appointed to figure out the next steps.

"What appeared to be a very valuable asset that you think was a no-brainer from a creditor standpoint wasn't as simple as that," he says.

"You are seeing quite a few instances in the extraction industries where companies are in need of doing a restructuring or a strategic process," says DeMarinis.

"There's only so many things you can do when a company is in financial distress," he adds. "You can try to work something out with existing creditors or try to amend the terms of debt."

Otherwise, you sell the business. However, he says, "In a market where there aren't many buyers, that starts drying up."

"Not a whole lot of buyers of distressed companies and properties have stepped forward. It takes a lot of courage for somebody to step forward when financial conditions and value are going down so fast," he says.

Nonetheless, he remains optimistic.

"There's always a buyer," he says. "It's really about pricing. You get a herd mentality. Right now, I think everyone is waiting to see where this bottoms out. Nobody wants to step forward and catch a falling knife." **LT**

How to get ahead in

BUSINESS?

[Get a Master of Laws]

Because business issues are legal issues. So if you want to get ahead in business, get the degree that gets you there faster.

ONE YEAR – PART-TIME – NO THESIS – FOR LAWYERS AND NON-LAWYERS



UNIVERSITY OF TORONTO
FACULTY OF LAW

GPELLM Global Professional
Master of Laws

law.utoronto.ca/ExecutiveLLM

