"PULP FRICTION": THE DOMAN RESTRUCTURING SAGA

Michael Fitch and Kibben Jackson*

Introduction

Herb Doman is an icon in the history of corporate enterprise in British Columbia, an immigrant who, with the purchase of a single logging truck, started a business that grew to become one of B.C.'s largest forest companies before encountering financial difficulties leading to an insolvency filing in 2002.

This paper highlights the key events and issues that arose during Doman's restructuring which ultimately resulted in the creation of new entities that continue to carry on Doman's forestry business for the ultimate benefit of all of Doman's former stakeholders, but on a basis whereby control of those entities has passed from the Doman family to Doman's former creditors.

The restructuring process, originally conceived to be a short one, ultimately lasted over two years, involved the presentation of four plan concepts, including the one finally accepted, and raised a number of challenging legal issues and practical complexities. In the end, a new, creditor-owned forestry company has been established to carry on the business founded by Herb Doman. It no longer bears the Doman name, but it continues to be a significant participant in the B.C. economy.

History

Doman was founded by Herb Doman in 1955 as a small trucking services and building supply provider, and first entered the logging and sawmilling business, which eventually came to be the core of Doman's business operations, in 1964, the same year it became a public company.

By the time of its CCAA filing on November 7, 2002 (the "Filing Date"), Doman had grown to become the second largest coastal woodland operator in the province of British Columbia, with the largest lumber production capacity and the second largest allowable annual timber harvest of all timber companies operating on the coast of British Columbia. Its manufacturing plants consisted of nine sawmills, two pulp mills, a log merchandising plant, and a value-added lumber remanufacturing plant, all but one of which survived the restructuring. Its assets were held by a large number of affiliated companies and by a limited partnership, almost all of which participated in the CCAA filing.

Doman sold its lumber and pulp products to buyers in over 30 countries throughout the world, and conducted timber harvesting operations in over 30 locations on Vancouver Island, the coastal mainland of British Columbia and the Queen Charlotte Islands. Prior to the restructuring, Doman

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* both of Fasken Martineau DuMoulin LLP, counsel to the Doman Group in their CCAA restructuring

directly employed approximately 2,500 people, many of whom were members of various unions, including IWA-Canada, the Communications, Energy and Paperworkers Union of Canada (the "CEPU") and the Pulp, Paper and Woodworkers Union of Canada.

Throughout Doman's history and rapid growth, Herb Doman retained effective control of Doman as the majority holder of the voting shares in the public company. Herb's son, Rick Doman, had been appointed as CEO of Doman in place of Herb several years prior to the Filing Date, when Herb suffered a stroke and gave up the direct management role, although he remained Chairman of Doman's Board of Directors through the completion of the restructuring.

Causes of Financial Problems

All of B.C.'s forestry companies have been negatively impacted in recent years by developments in that industry. These include the imposition of an onerous regulatory regime (the B.C. Forest Practices Code), the US softwood dispute with its resulting imposition of softwood duties, increasing provincial restrictions on harvesting timber, higher stumpage rates, more focus on environmental concerns, the advancement of First Nation land claims, and the overall decline in world-wide markets. However, and notwithstanding these events, Doman was operationally sound, having taken a number of internal steps to improve its operational performance in the years leading up to its CCAA filing and probably could have avoided a CCAA filing if not for the need to address its significant debt load. Accordingly, Doman's restructuring focus was always primarily directed towards its balance-sheet.

The expansion of Doman's business operations was initially financed through conventional bank financing, but more recently through the issuance of large bond indentures financed through the public market. Doman's historical approach to its increasing financial requirements was always to go back to the marketplace for more funding, but in recent years (and in this economic environment), Doman's balance sheet was an impediment to pursuing that remedy.

The majority of Doman's long-term debt was incurred in the 1990's and started to come due in early 2004. In particular, US $425 million in unsecured notes were to come due in March of 2004, a further US$125 million in unsecured notes were to come due in November 2007 and more significantly, US$160 million in senior secured notes were to come due in June of 2004. The secured notes were secured by a first priority lien on the vast majority of Doman's assets.

Including amounts outstanding to the holders of the unsecured notes and the holders of the secured notes, as well as amounts owing to CIT Business Credit Canada Inc. who provided a working capital facility (approximately $21 million) and general unsecured creditors (approximately $137 million), as at the Filing Date Doman had over $1.2 billion in debt. In comparison, as at the Filing Date the book value of Doman's assets was just over $900 million. The value of these assets was considerably less in a liquidation scenario.

Prior to the Filing Date, Doman had made all interest payments due to its secured and unsecured noteholders. However, it was generally accepted that such payments were being made increasingly at the expense of Doman's working capital and that Doman could not continue to do so without some radical adjustment to its financial condition. In any event, Doman was not going to be able to repay the principal amounts of the 1994 unsecured or the secured notes when they came due in March 2004, and June 2004, respectively, as no lender was prepared to finance the Company without a restructuring of its balance sheet. A default under any series of notes would trigger the cross-default provisions in the other noteholder agreements such that all notes would have come due in the event of a default. In such circumstances, Doman would have been unable to refinance its indebtedness and liquidation would inevitably have resulted.

The Restructuring Dynamic

The key to a successful restructuring of Doman was the future treatment of the unsecured notes. Although the secured notes were considered to be fully secured in any liquidation scenario, the unsecured notes significantly exceeded Doman's residual value, and swamped the unsecured debt by a significant amount. Accordingly, any change in Doman's balance sheet to effect a compromise of its unsecured indebtedness required the support of a significant majority of the unsecured noteholders.

Although Doman's bonds were widely held, Brascan Financial Corporation ("Brascan") had acquired, prior to the Filing Date, a significant percentage of the unsecured notes as well as some of the secured notes and was prepared to lead the restructuring push from the bondholder side, acting in concert with several other significant holders of unsecured bonds. Collectively, this group represented just short of 50% of the unsecured bonds outstanding.

Brascan recognized that some form of debt/equity conversion for the unsecured notes was required, but also recognized that this could only be accomplished pursuant to a formal insolvency filing which, in turn, required support from Doman. The tension between the bondholders (represented initially by Brascan) and Doman was a key aspect of the entire restructuring process, although that tension changed at various stages of the restructuring. Prior to the Filing Date, for example, Brascan appeared almost as a white knight, with its own pre-packaged restructuring concept. However, as the filing progressed and various problems arose, Brascan was seen by various other bondholders and by Doman's Board of Directors to be self-interested, leading to a very adversarial relationship at the middle stages of the restructuring. In the end, the restructuring plan ultimately approved was negotiated with Brascan's input and the full support of Doman, but the evolution from the first proposed restructuring plan to the final one was a rocky road that tested the skills and patience of all of the players, both in the boardroom and in the courtroom.

Pre-Filing Considerations

Prior to Doman's CCAA filing (and indeed, continuing throughout the restructuring process), Doman's Board grappled with its fiduciary duties and in particular the competing interests of its shareholders and creditors. The Doman Board consisted of Doman family members, former Doman employees and other long-time associates of Herb Doman, most of who had sat on the Board for many years. Notwithstanding that Doman appeared to be clearly insolvent from a balance sheet perspective, Doman continued to meet all of its obligations as they came due, including interest payments to its secured and unsecured bondholders, through early 2002 and the Board, having historically always found a way to finance Doman out of its problems, resisted the implications of its current dilemma. In doing so, they continued to be very mindful of the interests of shareholders, including, in particular, Herb Doman.

However, by late 2002, as various refinancing alternatives were explored unsuccessfully, it was becoming clear to the Board that when the first series of notes became due in early 2004, Doman would have no ability to make that payment, and therefore a very clear "hard deadline" loomed in Doman's immediate future. In the short term, funding quarterly interest payments on the notes was putting severe pressure on Doman's working capital.

Notwithstanding those facts, the Board was resistant to embarking upon a formal restructuring process until a pre-packaged plan was negotiated with their primary affected creditor group, their unsecured bondholders, on a basis that would provide *some* retained benefit to Doman's existing shareholders, notwithstanding the apparent insolvent condition of the Company. Conversely, none of the bondholders could precipitate action unilaterally so long as interest continued to be paid under the notes so that they did not go into default.

In that environment, negotiations were conducted between Doman (through a Special Committee of the Board, which, given Herb Doman's significant shareholder position, did not include Herb or Rick Doman) and Brascan that led to a pre-packaged plan concept that was settled in late 2002. The conceived plan, although not guaranteed to be acceptable to the appropriate percentage of creditors (given that Brascan could not speak for a sufficient percentage of bondholders to confirm an affirmative vote), was at least thought to have a strong likelihood of success. Accordingly, soon after that initial Plan was settled with Brascan, Doman filed for protection from its creditors.

The First Plan

Summary of Concept

The first Doman Plan was relatively straightforward. It included all of the following:

- a replacement of all debt owing to the Unsecured Noteholders with a new second position security interest behind the existing secured bonds in the sum of US$112,860,000, and a debt/equity conversion of the residual debt so as to provide 85% of the Company's equity to the unsecured noteholders;

- payment in full to all of Doman's unsecured trade creditors (subject to a claims process confirming that the total unsecured debt was less than a fixed limit of $23.5 million); and

- the retention of 15% of Doman's equity for existing shareholders, to be divided amongst common and preferred shareholders on a basis to be determined.

The unusual aspect of the Plan was the exemption from compromise of the claims of Doman's unsecured trade creditors. As a result of that exemption concept being articulated in the initial filing documents, the Initial Order (later confirmed by the Court), permitted Doman to immediately pay the pre-filing indebtedness owed to a very large number of critical suppliers. At the time, this was not thought to be prejudicial, given that unsecured trade creditors would ultimately receive full payment in any event, subject to the cap concept.

The exempted creditors included the Provincial Crown (to ensure no difficulties with negotiating the necessary consents required from the Province, as described below), and various suppliers who were considered essential to the continued operation of the Company's forestry business and who might have been negatively impacted by delayed payments. The exempted group also included Doman's Bill 13 contractors (a group of logging contractors given special rights under provincial forestry legislation), although not for significant disputed claim amounts. The exclusion of this group created problems later in the restructuring for reasons discussed below.

The Court was advised at the initial hearing that a plan of arrangement was expected to be presented to Creditors within 60 days, with emergence from CCAA protection contemplated to occur in early 2004 at the latest.

Problems with Plan Implementation

The first Plan was problematic for a number of reasons, not the least of which being the fact that Brascan could not speak for a sufficient percentage of unsecured bondholders to guarantee its acceptance. Additional problems included the following:

- the Plan involved a "loss of control" by Herb Doman and his family. Although there was no "change of control" (because no single creditor, including Brascan, would have been in a control position on emergence), the B.C. Forest Act arguably required the consent of the Minister of Forests to such a transfer. This was problematic, since the exercise of the Province's discretion in providing such consent potentially triggered consultation (and perhaps accommodation) rights for the 35 of B.C.'s First Nations that had potential land claims to forest tenure controlled by Doman. Although Doman's relations with First Nations were generally good, such a consultation process would have complicated the restructuring immensely.

As at the Filing Date, the Government of B.C. was in the process of preparing amendments to the Forest Act that were expected to change the relevant provisions and, hopefully, obviate the need for formal consent from the Province, and therefore the possible need to consult with First Nations.

In the result, a Plan was drafted that contained a condition precedent relating to government approvals, and extensive negotiations were undertaken with the Province to attempt to identify a means of completing a transaction under the existing legislation without triggering the existing consent requirements. At the same time, an alternate strategy of waiting for the amended legislation was also considered.

- The Plan contemplated that the outstanding Secured Bonds would remain in place, notwithstanding the restructuring. This required an order from the Court at the conclusion of the restructuring preventing the Secured Noteholders from enforcing the Secured Notes, notwithstanding the terms of the restructuring and any consequential breach of any covenant under the Secured Notes Indenture (see below).

- The division of the 10% equity as between preferred and common shareholders was not settled in the Plan, and therefore was a potential source of disagreement amongst the shareholders.

As it turned out, all of the foregoing problems were academic. The Petitioners' motion for an order approving the Plan for dissemination to creditors was vigorously objected to by the Secured Noteholders. In their view, the Plan was flawed because it affected the rights of the Secured Noteholders without providing them an opportunity to vote on it. In response, the Secured Noteholders filed a cross-motion seeking the approval of the Court for the dissemination of the Secured Noteholders' own plan, which included separate classification and treatment for the Secured Noteholders.

The matter was argued before Mr. Justice Tysoe on March 4, 2003. The provision of the Plan with which the Secured Noteholders took issue was the condition precedent that an Order be made in the CCAA proceedings permanently enjoining creditors and all other persons (including the Secured Noteholders) having contractual relationships with Doman from exercising any rights and remedies available to such persons as a result of breaches of the relevant contracts arising before, during or (most notably) *after* the implementation of the Plan.

Under Doman's Plan, there would be a change of control of Doman occurring on the plan implementation date. Under the terms of the Secured Trust Indenture, on a change of control, Doman was obligated, within 10 days, to mail a notice to each Secured Noteholder offering to purchase their Secured Notes at a specified price. Doman sought to permanently enjoin the Secured Noteholders from relying on this breach of the Secured Trust Indenture; the Secured Noteholders argued that the Court had no jurisdiction to make such an Order.

Tysoe J. issued oral reasons for judgment on March 7, 2003. After reviewing the facts relating to the issue, His Lordship began his decision by noting that although Doman's motion sought only authorization to hold meetings of its creditors to vote upon the Plan, the Court "should not authorize the holding of the creditor meetings if the [Plan] cannot be sanctioned by the Court following the holding of the creditor meetings or if the implementation of the [Plan] is contingent on the Court granting an order which it has no jurisdiction to make or would not otherwise make." Accordingly, Tysoe J. considered whether, if the Plan were approved by Doman's creditors, the Court could make the Order containing the permanent injunction language sought by Doman and which was a condition precedent to implementation of the Plan.

At paragraphs 15 through 16 of his decision, Tysoe J. held as follows:

> The law is clear that the court has the jurisdiction under the CCAA to impose a stay during the restructuring period to prevent a creditor from relying on an event of default to accelerate payment of indebtedness owed by the debtor company or to prevent a non-creditor relying on a breach of a contract with the debtor company to terminate the contract. It is also my view that the court has similar jurisdiction to grant a permanent stay surviving the restructuring of the debtor company in respect of events of default or breaches occurring prior to the restructuring. In this regard, I agree with the following reasoning of Spence J. at para. 32 of the supplementary reasons in [*Re Playdium Enterprises Corp.* (2001), 31 C.B.R. (4^{th}) 302, as supplemented at 31 C.B.R. (4^{th}) 309 (Ont. Sup. Ct. Jus.)]:
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>> In interpreting s.11(4), including the "such terms" clause, the remedial nature of the CCAA must be taken into account. If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the CCAA order could not be asserted by the Famous Players after the stay period. If such an order could not be made, the CCAA regime would prospectively be of little or no value because even though a compromise of creditor claims might be worked out in the stay period, Famous Players (or for that matter, any similar third party) could then assert the insolvency default and terminate, so that the stay would not provide any protection for the continuing prospects of the business. In view of the remedial nature of the CCAA, the Court should not take such a restrictive view of the s. 11(4) jurisdiction.
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> Spence J. Made the above comments in the context of a third party which had a contract with the debtor company. In my opinion, the reasoning applies equally to a creditor of the debtor company in circumstances where the debtor company has chosen not to compromise the indebtedness owed to it.

On the basis of the foregoing, Tysoe J. held that he had the jurisdiction to order a permanent stay preventing the Secured Noteholders from relying on events of default existing before or during the restructuring period to accelerate the repayment of the indebtedness due under the Secured Notes. Having so determined, His Lordship turned to the next issue, namely whether the Court could grant a stay preventing the Secured Noteholders from exercising its rights and remedies on the occurrence of the anticipated breach of the Secured Note Indenture arising post-plan implementation.

In considering this issue, Tysoe J. reviewed a number of the purposes for which stays are granted under section 11(4) of the CCAA. On of those purposes was described by Tysoe J. at paragraph 22 as being "to prevent the frustration of a reorganization or restructuring plan after its implementation on the basis of events of default or breaches which existed prior to or during the restructuring period." His Lordship continued, however, holding that in his view, "Parliament did not intend s. 11(4) to authorize courts to stay proceedings in respect of defaults or breaches which occur after the implementation of the reorganization or restructuring plan, even if they arise as a result of the implementation of the plan."

Tysoe J. reiterates the foregoing comments a number of times throughout his reasons, including at paragraph 24 where he succinctly states that the wording used in section 11(4) "is not intended, in my view, to relieve the debtor company from the performance of affirmative obligations which arise subsequent to the implementation of the plan of compromise or arrangement."

In the result, Tysoe J. held that the Court did not have the jurisdiction to make an order containing the permanent injunction sought by Doman, the effect of which would be to preclude the Secured Noteholders from accelerating payment under the Secured Notes on the occurrence of a breach of the Secured Note Indenture arising subsequent to the implementation of the plan. Having decided that he could not later make the order required as a condition precedent to the implementation of the Plan proposed by Doman, Tysoe J. decided that it would be inappropriate to authorize the calling of creditor meetings to consider and vote upon the Plan. The application of the Secured Noteholders to put forward their own plan of arrangement was likewise dismissed, albeit more perfunctorily, on the basis that it sought to amend the terms of the Secured Note Indenture without the consent of Doman, the other party to the indenture.

Tysoe J.'s decision in this regard may not yet be the final word on this issue. In the AT&T Canada restructuring, the Sanction Order granted by Farley J. contained permanent injunction provisions arguable of the same nature as those sought by Doman and denied by Tysoe J. Notably, the provisions of the Sanction Order made in AT&T Canada precluded creditors from exercising any rights or remedies available to them as a result of the ongoing possible insolvency of any of the new companies created by the restructuring transaction or as a result of any change in control of any of the Petitioners arising in connection with the restructuring transaction. Both provisions were drafted so as to be prospective in nature; that is, to cover such events of default arising after plan implementation. For a more fulsome discussion on this aspect of the AT&T Canada Sanction Order, see: Rupert H. Chartrand, Natasha J. MacParland and Edward A. Sellers, "AT&T Canada: A New Brand of Telecom Restructuring" in Janis P. Sara, ed., *Annual Review of Insolvency Law* (Toronto: Thomson Carswell, 2004) 211 at 232-234.

The Third Plan

Subsequent to the failure of the First Plan (and the Court's refusal to allow the Secured Noteholders to proceed with their Second Plan), Doman unsuccessfully attempted to negotiate an agreement with the Secured Noteholders that would have allowed Doman to obtain their support for the First Plan. It quickly became clear that this was not possible as the holders of the Secured Notes were not prepared to extend the 2004 expiry date of the Secured Notes on any basis. Accordingly, locating alternate financing to take out the Secured Notes became the only option available to Doman.

Early in 2003, Brascan presented to Doman a revised plan which contemplated that Brascan would "backstop" a refinancing of the Secured Notes. However, the extended nature of the restructuring was beginning to affect Brascan's ability to hold together its group of Unsecured Noteholders, some of whom questioned the financial terms proposed by Brascan for refinancing the Secured Notes. Ultimately, and after some delay while negotiations continued amongst the Unsecured Noteholders (without Doman's participation), Brascan was forced in the fall of 2003 to admit that it had lost the support of the other members of the Unsecured Noteholder group for its revised Plan concept, partly because of concerns about the refinancing terms, but also because the proposed post-emergence structure was perceived to carry too much secured debt, giving rise to a concern that a second insolvency would quickly follow any emergence based on the revised Plan concept.

The Restructuring Process

Once it became apparent that a deadlock existed amongst the Unsecured Noteholder group that prevented ready acceptance of the Third Plan, Doman embarked upon an independent effort to locate an alternative source of financing for a restructuring plan that would involve the complete payout of the Secured Noteholders and still ensure a significant recovery for the Unsecured Noteholders and other unsecured creditors. The Board was also hoping that some refinancing alternative could be identified which would allow Doman's shareholders to retain an ownership interest in the restructured company.

Brascan resisted this tactic on the basis that it potentially delayed the acceptance of its proposal and improperly focused on protecting the interests of the shareholders in circumstances where those interests had no economic value. The Board's unwillingness to move forward with the Brascan proposal resulted in an increasingly adversarial atmosphere in the restructuring which differed dramatically from the initial co-operative nature of the filing. However, it was undeniable that Brascan did not have sufficient support amongst the Unsecured Noteholder group to advance its plan quickly, which therefore made it possible for the Company to at least explore other options. They did so primarily with the assistance of UBS Securities, LLC, a subsidiary of UBS Bunting Warburg Inc. ("UBS"), who had been appointed as financial advisor to Doman prior to the Filing Date. Although no financial solution was identified by UBS prior to the filing, there appeared in the marketplace to be an increasing interest in the forestry industry generally and Doman in particular, which gave rise to some hope that the new financing search might be more successful then previous efforts.

The disagreement between Doman and Brascan with respect to the restructuring process crystallized late in 2003 when Doman's application for an extension of the CCAA proceeding was opposed by Brascan, who instead sought an order permitting them to proceed with their Third Plan. That dispute was ultimately resolved through the action of other significant Unsecured Noteholders (the "Committee") who, shortly prior to Doman's and Brascan's cross-applications, decided to appoint counsel other than Torys LLP, who until that time had acted both for Brascan and those other key Unsecured Noteholders. The counsel appointed by the Committee was Bennett Jones LLP (Rick Orzy) who, while supportive of the decision to explore other refinancing options, wanted to impose some structure on that process to ensure that the restructuring could be completed before the Secured Notes became due in 2004.

The matter came to a head on October 10, 2003 when, in recognition of the competing interests of Brascan and Doman, Mr. Justice Tysoe pronounced a "Restructuring Process Order". The Order, in general terms, contemplated two parallel processes, the first being descriptively referred to in the Order as the "Refinancing Solicitation Process" and the second being equally descriptively referred to as the "Plan Process".

The Refinancing Solicitation Process consisted of a list of guiding principles and timelines. In short, it obligated Doman and UBS to prepare and deliver to potential investors solicitation packages and, if requested, confidential information package by certain dates. It further contemplated dates by which non-binding expressions of interest were to be received by potential investors and provided that a meeting amongst Doman, Brascan, the Monitor, UBS and representatives of the Committee, was to be held prior to December 12, 2004 to determine whether to proceed with a restructuring based on any financing located through the solicitation process or a restructuring based on Brascan's financing proposal.

Contemporaneously, pursuant to the Plan Process, Doman was obligated to take such steps as were necessary to be in a position on December 18, 2003 to seek leave of the Court to file a plan of arrangement, whether such plan was based on Brascan's financing proposal or on alternative financing. It also provided for the contingency that two plans would be prepared if the parties could not agree on which financing option to pursue.

The Restructuring Process Order contemplated a meeting of Doman's creditors to vote on the anticipated plan by no later than January 28, 2003 and implementation of the plan by no later than February 20, 2003. As it turned out, for a variety of reasons, the Restructuring Process Order was decidedly optimistic in its time estimates.

The formal refinancing solicitation process did not, in the end, achieve the result that some noteholders and certainly Doman were hoping for. It did produce a great deal of interest in the Doman opportunity, as Doman received a number of expressions of interest. Although many of these were never made public, both Catalyst Capital Group Inc. and Cerberus Capital Management, L.P. became involved in a public way, as did International Forest Products Limited ("Interfor"), a competitor of Doman in the B.C. coastal forest industry, who proposed a form of acquisition transaction as part of a successful restructuring. However, all of these initiatives came to nothing.

In the case of the conventional financiers, the problem was an inability to provide a valuation of Doman's business upon which the investor could rely. A huge amount of effort was expended on the attempt to obtain such an evaluation, and funds were expended for that purpose and for payment of due diligence costs of prospective investors, all of which was opposed by Brascan but supported, ultimately, by the Monitor and the Court as being necessary to the restructuring process. Unfortunately for Doman, there is no clear basis upon which to value a forest company's assets, particularly in the context of forest tenure, and the valuation that was ultimately prepared for Doman was, in Doman's view, inaccurate. Although a revised version was ultimately obtained, it was not delivered to Doman, or ready for distribution to potential investors, until December 18, 2003 and ultimately was not considered sufficiently strong to support any independent refinancing proposal.

The approach from Interfor also failed, although not without a major dispute coming before the Court. Interfor, given its status as a competitor, was considered by Brascan to be hostile and any efforts by Doman to provide any support for Interfor's interest was hotly contested. The primary issue related to Interfor's request to conduct due diligence to support its offer, and the concern that providing the requested information to Interfor was competitively dangerous and damaging to Doman. In the end, Interfor received most of what they wanted and presented a proposal which Doman thought had some merit, but Interfor was unable, despite a very strong effort, to convince sufficient numbers of the Committee of the advantages of its proposal as compared with that which had been presented by Brascan.

By the New Year, it had become apparent that the hoped-for alternative financing was not forthcoming from the parties with whom Doman had to date been in negotiation. However, there was still insufficient support for Brascan's Third Plan. As a result, the Committee and Brascan entered into discussions that, prior to the January 23, 2004 deadline, resulted in an agreement in principle for an Unsecured Noteholder-sponsored refinancing of Doman's indebtedness owing to the Secured Noteholders. This agreement in principle was the framework for the fourth restructuring plan, which was the plan eventually filed and implemented by Doman.

The Final Plan

In moving toward the finalization of a restructuring plan, Doman and the plan's new sponsors were faced with a number of hurdles that either had to be addressed in the contemplated plan of arrangement or resolved outside of such plan. It is not possible here to discuss all of them, but the following were the most significant.

Environmental and structural issues

This issue arose as a result of Doman's long history as a forest company that owned, or had owned, assets that may have been environmentally contaminated. For this reason, it was determined at an early stage that rather then effecting a restructuring of Doman through a debt/equity conversion using the trading shares in the public Doman company, the restructuring would have to involve an asset transaction whereby all of the material assets of Doman would be transferred to new legal entities, with no inheritance of Doman's history and its environmental problems.

In general, this strategy was workable, though one issue remained to be addressed: Doman's pulp mill at Port Alice (the "Port Alice Mill"). The Port Alice Mill was owned by a subsidiary company of Doman. The Committee were of the view that the Port Alice Mill was inherently unprofitable due primarily to an ongoing shortage in fibre supply. This and the fact that the lands on which the mill is located are subject to an unknown degree of environmental contamination led the Committee to conclude that the Port Alice Mill should not be included as part of any restructured Doman. However, the Mill was the only significant business in the small community of Port Alice, and there were significant social consequences to that community and, of course, the 300 employees of the Mill, if a decision was made to simply abandon the Mill outside of the restructuring. It also became clear early in the process that the Province was not prepared to concede that an abandonment of the Port Alice Mill would "cleanse" the Doman entities with an ownership interest in the Mill of potential future environmental claims. This was a significant problem for the restructuring, since one of Doman's assets was a significant amount of tax losses held, to a great extent, in the companies that owned the Port Alice Mill. To preserve these tax losses, the subsidiaries needed to remain under the control of new Doman for possible future amalgamation with the new Doman entities.

The strategy adopted to address these concerns had two parts, but neither of them was sufficient to provide complete certainty to new Doman in relation to environmental risks and therefore the ability to access tax losses post-restructuring remained uncertain.

First, it was clear that the environmental risks associated with the Port Alice Mill increased substantially if the Port Alice Mill was permanently shutdown (it was temporarily not operating when this issue first came under scrutiny). For that reason, and also in recognition of the social consequences noted above, just prior to the finalization of the restructuring plan, a sale effort was implemented by Doman that ultimately produced a buyer for the Mill, although at a nominal price (see discussion below). Given the uncertainty as to whether or not a buyer would be found for the Mill before a creditor vote on the Plan, a revised, contingent claims process was instituted to deal with the potential additional claims that might have arisen on a permanent Mill shut-down.

Second, the Province was not prepared to concede that the Final Order in the CCAA proceedings could effectively eliminate environmental claims that had not crystallized at that time, but which were inherent in Doman's historical operation of the affected assets. Attempts were made to solve this problem with the Province by agreement, and failing such agreement, threats were made to place this issue before the Court for resolution at the time of the Sanction Hearing. In the end, however, the issue was "ducked" on the basis of an order preserving the rights of both parties to argue either (in the case of Doman) that the Plan had the effect of eliminating such claims or (in the case of the Province) that it did not. The parties are currently attempting to resolve this issue on the basis of settling what is known under B.C. Environmental law as "Voluntary Remediation Agreement" ("VRA"), but if that does not happen, this issue could at some future time come back before the court for adjudication as a point of principle.

Revised Process Orders

In connection with the potential shut-down of the Port Alice Mill, Doman also sought a general Order that it be entitled to commence a revised claims process and a new downsizing process. An earlier, very informal claims and downsizing process (basically simply designed to identify claims for voting purpose in a context where all claims were to be paid in full) had been put in place at the time of the Initial Order, when the First Plan concept governed. The new process was intended to pick up the claims of those people whose claims arose post-filing either in connection with the closure of the Port Alice Mill, including the employees at the mill, or in connection with the reinstituted downsizing process contemplated at the outset of the CCAA proceeding. Such an Order required an amendment to the Confirmation Order, which provided for payment in full to all employees as well as the above-mentioned exempt creditors, some of whom Doman (and the Unsecured Noteholders) now wanted to compromise.

Doman's application was opposed by a number of parties whose position would be affected by virtue of the proposed amendment to the Confirmation Order. Chief amongst the opponents were the CEPU, which represented the majority of the employees at the Port Alice Mill. The CEPU's primary argument on the application was that as Doman had, until that point in the proceeding, held out that all employee claims would be paid in full, it would be inequitable to seek now to compromise the claims of the employees that would be terminated as a result of the closure of the Port Alice Mill. A Bill 13 contractor (whose claims were previously in the exempt category, although unpaid to date because of an extended dispute process as to the claim's quantum) also objected.

In brief Reasons for Judgment issued on April 6, 2004, Tysoe J. stated "[i]t would be appropriate to amend [the Confirmation Order] in the event of a change in circumstances. The change of circumstances that has visited upon the Petitioners is the decision to close Port Alice if a purchaser cannot be located… In my view, the change of circumstances warrants a variation of the Order but not on a retroactive basis unless the change in circumstances warrants it." On that basis, His Lordship held that the claims of the employees at Port Alice Mill that would arise on their termination could be compromised, but that the claims of other employees not yet paid (these included a number involved in wrongful dismissal actions which were continuing) could not.

It was also noted by Tysoe J. in his Reasons for Judgment that there was no evidence before the Court that any of the employees had materially altered their position in reliance on the provisions of the Confirmation Order. Moreover, it was recognized that the employees had continued to work at the Port Alice Mill knowing of the risk that Doman could become bankrupt and they would lose any accrued severance rights and knowing of the risk that the Confirmation Order could be amended as a result of a change in circumstances. Leave to appeal Tysoe J.'s Order was denied.

The Port Alice Sale Process

The sale of the Port Alice Mill did not occur without a great deal of uncertainty and in fact truly did happen at the "eleventh hour". The Court's orders required that a sale be completed by May 11, 2004 in order to avoid a shutdown, and all plan and claims documentation had been prepared on the assumption that the May 11, 2004 date was irrevocable. On May 7, 2004, Doman filed a Notice of Motion seeking a hearing on May 11, 2004 for an Order approving the sale of the Port Alice Mill to La Pointe Partners, Inc. In order to ensure the continued viability of the Port Alice Mill and the retention of the persons employed at the mill, it was determined that the sale would have to close, including registration of the property transfer at the land title office in Victoria, by the end of the day on May 11, 2004.

The ensuing hearing on that date involved a lawyer with a laptop in Court typing the final version of the Order approving the sale for endorsement by Tysoe J. on the spot, followed by a relay event transporting a certified copy of the entered Order from the courthouse to a helicopter to the land title office in Victoria, which, with the assistance of the Provincial Attorney General's office, remained open late for the purpose of vesting the Port Alice Mill lands and premises in the purchaser. On that same day, notices of offers of employment by the purchaser of the Port Alice Mill were delivered to all of the employees at the mill, thereby saving those employees' jobs and eliminating a significant number of claims with a cumulative value of millions of dollars. This day and the preservation of the Port Alice Mill was a testament to the perseverance of Doman's management team and truly a highlight of the restructuring process.

Termination of Hayes Replaceable Contract

Traditionally, forestry companies in British Columbia holding timber tenures had the option of themselves carrying on logging operations within their timber license areas or instead contracting with other parties for the provision of logging and related services such as road building. However, in 1991, in order to address what was at that time considered an imbalance in relative bargaining positions between the large forestry companies holding numerous timber tenures and the logging companies vying for logging contracts, the Provincial government passed Bill 13, which amended the British Columbia *Forest Act*.

That legislation created evergreen contracts for logging contractors, or what became colloquially known as "replaceable contracts". The contractors party to such contracts became known as "Bill

13 contractors". After 1991, the *Forest Act* contained provisions which obligated forestry companies to contract out at least 50% of their annual allowable cut ("AAC") under each timber tenure. The provisions also obligated forestry companies to renew their contracts with the Bill 13 contractors every year unless the logging contractor was in default and, after notice of default, failed to remedy the default, and the holders of timber tenures could not in subsequent years reduce outside a certain range the allowable annual cut ("AAC") given to a logging contractor other than in exceptional circumstances.

The amendments to the *Forest Practices Act* seriously impacted most forest companies profit margins and in some cases threatened their continuing viability and in recognition of the problems created by the replaceable contracts, the Provincial government subsequently amended the *Forest Act* to eliminate replaceable contracts. However, existing replaceable contracts were exempted from the change in legislation, which meant that the material effects of the amendments would not be seen for some time.

In preparing a restructuring plan in cooperation with the noteholders, it was decided that certain of the replaceable contracts to which Doman was a party were undesirable. In particular, the contracts with Hayes Forest Services Limited were identified as being particularly uneconomic. Accordingly, it was determined that as part of its new downsizing process, Doman would terminate its contracts with Hayes.

The termination of an evergreen contract had previously been considered in the restructuring context in *Re Skeena Cellulose Inc*. (2002), 43 C.B.R. (4th) 178 (B.C.S.C.), affirmed (2003), 43 C.B.R. (4th) 187 (B.C.C.A.), where Chief Justice Brenner held that despite containing terms imposed by virtue of Provincial legislations, replaceable contracts were still just contracts that could, by the exercise of the Court's exercise of its jurisdiction under the CCAA, be terminated as part of a debtor's restructuring. That case, however, did not touch directly upon the economic circumstances which might support such a termination since in Skeena, termination was clearly economically necessary to the restructuring.

In Doman's situation, the economic case was not so clear. It was Doman's evidence that significant cost savings could be achieved if Hayes' contract were terminated and its allocated volume of AAC were reapportioned to remaining contractors in the relevant timber license area. In essence, it was determined that the costs associated with logging in the area in which Hayes' services were performed was higher than in other areas in the timber license area. In addition, evidence was led to show that Hayes' rates for logging services were higher than other logging contractors in the same timber license area. In all, it was estimated that the termination of Hayes' evergreen contract would result in savings to Doman of approximately $1.3 million in each of the three years commencing in 2004.

However, Doman could not say that the termination of the Hayes contract was critical to the restructuring or even that the contract itself was not economic (in the sense that it created a financial drain on Doman). It could only say that its financial situation improved without the Hayes contract.

On May 25, 2004, Tysoe J. issued oral reasons for judgment dismissing Doman's application for approval of the termination of Hayes' contract and the contract of the associated road building contractor. To the writer's knowledge, this is the first time in Canadian jurisprudence that a Court has declined to allow a debtor to terminate an executory contract as part of its restructuring and it is expected that it will be a leading case on this topic for some time.

In Justice Tysoe's reasons, he accepts the general principle stated by Farley J. in *Re T. Eaton Co.* that to restrict a debtor company from repudiating a contract "would constitute an insurmountable obstacle for most debtor companies attempting to effect compromises and reorganizations under the CCAA. Such a restriction would be contrary to the purposive approach to CCAA proceedings followed by the courts to this date." However, he also noted that the Court is obligated to consider the interests of the broad constituency served by the CCAA and, when exercising its equitable jurisdiction in regard to the termination of a contract, the Court must also consider requirements for fairness and reasonableness in weighing the interests of the affected parties.

In comparing the decisions of Lo Vecchio J. in *Blue Range* and Farley J. in *Dylex*, Tysoe J. determined that he preferred Farley J.'s statement that the approval of a termination of a contract "involves the court weighing the competing interests and prejudices in deciding what is fair and reasonable" as opposed to Lo Vecchio's description of the resistance of the aggrieved creditor as an attempt to elevate itself above other unsecured creditors. Turning to the application then before the Court, Tysoe J. held that "all the evidence establishes is that Doman will likely be able to reduce its costs to some extent at some point in the future if it can terminate the two contracts in question." He then went on to enumerate seven areas in which no evidence was led by Doman, including whether other aspects of Doman's business operated at a loss but were not rationalized, what parts of the constituency of Doman's stakeholders would benefit from the termination of the contracts and whether it was expected that the restructured company would operate at a profit.

Tysoe J. also commented on the inclusion as a condition precedent to the implementation of the Plan the Court's approval of the termination of Hayes' contract. A similar condition precedent requiring the termination of the replaceable contracts of three Bill 13 contractors was contained in the plan of arrangement in *Skeena Cellulose*. Tysoe J. noted that the condition precedent was included in the plan of arrangement in *Skeena Cellulose* as a result of a "truly adversarial negotiation". On the other hand, Tysoe J. held that he could find no evidence as to why the condition precedent was included in Doman's Plan and no evidence that it was the result of arms' length negotiations.

In the result, Tysoe J. held that the evidence was insufficient to establish that the proposed contract terminations were fair and reasonable in the circumstances, but rather suggested only that Doman would have an opportunity to be more profitable in the future if the contracts were terminated. His Lordship found that this benefit did not outweigh the prejudice that would be suffered by Hayes and the road building contractor if the contracts were terminated and, on that basis, he exercised his discretion against terminating the contracts. Leave to appeal Tysoe J.'s decision was denied.

The most significant lesson to be learned from Tysoe J.'s decision on this issue is that the ability of a debtor company to repudiate a contract in a CCAA proceeding on the basis that it constitutes part of its restructuring is not a sure thing. A debtor company and its counsel must be careful to ensure that the decision to repudiate a contract is based on evidence that (i) the performance of the contract would result in a net loss to the company or, at the very least, if replaced would result in a significant net profit gain to the company; and (ii) the repudiation of the contract will have a beneficial effect on the broad constituency of the company's stakeholders apart from the other party to the contract. Where the benefit to the company resulting from the termination of a contract is marginal in that it seeks only to increase profit rather than eliminate loss, the prejudice to the other party must be considered. As a final point, a debtor company must ensure that it is seen to have acted even-handedly amongst all of the parties with which it has contracted; Tysoe J.'s judgment suggests an element of unfairness in Doman's decision to terminate Hayes' contract as opposed to other Bill 13 contractors' contracts.

On the other hand, many of the issues that were problematic with the earlier plans disappeared. Time dealt with the most pressing problem associated with Provincial legislation; by the time this plan was ready for approval, we had new forestry legislation in place which eliminated most of the concerns that obtained under the previous version of that legislation. With respect to First Nations, in the end, no Band raised any objection to the Plan, or requested consultation rights. One of the tactics adopted to avoid these types of problems was to communicate with the Bands throughout the process, and the Order which directed dissemination of Plan materials to creditors specifically (at Doman's request) included a directive that copies of the Information Circular be sent to all potentially affected Bands with a request that they communicate any concerns to the Company. And finally, the potential issues involving shareholders and the potentially divisive issues between preferred and common shareholders essentially disappeared once in became clear that the benefit to shareholders to be fought over were nominal at best.

Content of the Plan

The final plan of arrangement between Doman and its creditors, was materially different in a number of ways from the original plan of arrangement put forward by Doman at the commencement of the CCAA proceeding. The new Plan contemplated payment in full and the discharge of the Secured Notes and a debt-for-equity swap for all of Doman's unsecured creditors with no other issuance of new security. Financing for the Plan was to be provided in part (or in full if needed by way of a backstop) by a group of bondholders (the "Restricted Group") that included Brascan, but the bulk of the financing was available for participation by all of Doman's creditors.

As discussed above, the concerns about protecting new Doman from historical claims necessitated a mass asset transfer as part of the Plan. This meant that every one of Doman's assets, apart from the Port Alice Mill, was to be transferred into one of two new companies. The transaction required the creation of two new companies, Western Forest Products Inc. ("Lumberco") and Western Pulp Limited ("Pulpco"). The former company has assumed all of Doman's logging, sawmilling and related operations and the latter has assumed Doman's remaining pulp-production and related operations.

In addition to the sale or abandonment of the Port Alice Mill, the Restricted Group also maintained that under the Plan, Doman's current equity-holders were to retain effectively no ownership interest in restructured entity. Needless to say, this was a much contested issue and one that, to some extent, delayed the preparation and presentation of the Plan. In the end, some concession was made to the existing equity-holders, as will be seen below.

The recovery to Doman's unsecured creditors was primarily a debt-for-equity swap. Unsecured creditors would receive their pro-rata allotment of Lumberco warrants and their pro-rata allotment of common shares in Lumberco. The shares issued in connection with this distribution were to comprise 75% of the issued and outstanding shares of Lumberco at the conclusion of the restructuring. The Lumberco warrants could be exercised at the price of US$950 in exchange for which the creditor would receive one "Unit", which consisted of one secured bond issued by Lumberco with a face value of US$1,000 and a further pro-rata allotment of common shares in Lumberco. The Lumberco secured bonds bear interest at a rate of 15% per annum and are due in 2009. There was also a cash election option whereby unsecured creditors with claims of $50,000 or less, or who agreed to reduce their claims to $50,000, could elect to receive the lesser of 20% of their claim or $10,000.

Under the Plan, persons holding shares in Doman received, depending on the class of their shares, a pro-rata allotment of "Class C" warrants. These warrants entitled the holders to purchase shares in Lumberco at specific prices.

The Refinancing Issues

In order to pay out the Secured Notes, make payment to those creditors that elected to receive cash and cover the costs of the restructuring transaction, it was determined that Doman required US$210 million. This financing was to be raised from two sources: the Restricted Group and Doman's creditors.

Notionally, the financing occurred in three separate stages. Firstly, the Restricted Group participated in a private placement, paying collectively US$105 million in exchange for 12.5% of the shares to be issued in Lumberco and secured bonds issued by Lumberco with a face value of US$110.5 million.

The remainder of the US$210 million was to be raised through the exercise of warrants by Doman's unsecured creditors and by way of additional financing (the "Standby Commitment") to be provided by the Restricted Group. That is, any Units not taken up by unsecured creditors on the exercise of the Lumberco warrants would be purchased by the Restricted Group. Those purchasing Units by warrant exercise or as part of the Standby Commitment would receive their pro-rata allotment of the remaining 12.5% of the common shares to be issued in Lumberco. An additional US$110.5 million in Lumberco secured bonds would likewise be issued pursuant to the warrant exercise and Standby Commitment.

It was initially expected that the warrant exercise would provide somewhere in the neighbourhood of US$20 million in financing. In fact, beating all expectations, unsecured creditors exercising warrants contributed approximately US$95 million to the refinancing. This was the first indication as to the level of confidence that Doman's creditors and the public generally had in the restructuring plan and the emergent entity. Pursuant to the Standby Commitment, the Restricted Group subsequently financed the remaining US$10 million.

Sanction Order Issues

What began as a standard from of sanction order comprising five pages became, after input from counsel for a number of parties, including Doman, the Monitor, the Restricted Group, Brascan, the Secured Notes trustee and the Provincial government, a 41 paragraph, 14 page opus – exclusive of schedules! This was not atypical for this proceeding, which often involved drafting by committee, a process to be avoided at all costs.

The application for the Sanction Order was heard by Tysoe J. on June 11, 2004. After reviewing the draft order with counsel for Doman, His Lordship advised that although he had some reservations regarding a number of aspects of the draft order, as not one creditor present in Court objected to the form or content of the draft order, he was prepared to grant the Sanction Order without any changes to the draft presented to the Court. In doing so, Tysoe J. cautioned that the Sanction Order was not to be relied upon as a precedent on any future applications.

The Sanction Order contained much of the standard language, including approval of the Plan and releases by creditors whose claims were compromised. However, it did contain a number of other provisions worthy of comment:

- "U.S. Securities Act Exemptions – Findings of Fairness". Under U.S. securities law, the issuance of shares and/or warrants to creditors in compromise of their claims must be registered under the U.S. Securities Act, a costly and time-consuming process. However, where a court, which includes a Canadian court in CCAA proceedings, deems the proposed debt-for-equity swap to be "fair" to the affected creditors, the issuance is exempt from registration. As Doman had a number of creditors domiciled in the U.S. that would received shares and warrants under the Plan, Doman needed to seek the available exemption. Accordingly, the Sanction Order contained language to the effect that the terms and conditions of the debt-for-equity swap were substantively and procedurally fair to the affected creditors and that the hearing (i.e. the application for the Sanction Order) was open to the affected creditors. On that basis, the exemption was obtained.

- "Vesting of Assets". The transaction contemplated under the Plan involved the transfer of all of Doman's assets, which included over 400 fee simple properties and approximately 20 other interests in land such as mortgages and undersurface rights. It was recognized that the preparation of the necessary documents to effect the transfer of these interest in real property to Lumberco or Pulpco would be incredibly laborious. Accordingly, language borrowed from foreclosure precedents was included in the Sanction Order which in effect directed the Registrar, upon filing of a Court certified copy of the Sanction Order with the Land Title Office, to transfer all of the real property to either Lumberco or Pulpco, as specified, subject to those charges registered against those properties as at the date of the Sanction Order. Similar language was included for the transfer of the other interests in land held by Doman. This language reduced the filing requirements to only a few document.

- "Permanent Injunction". In recent years, plans of arrangement have typically contained language enjoining third parties from enforcing contractual remedies where defaults occasioned by virtue of the CCAA proceeding or transactions effected in relation to the restructuring continue after implementation of the plan and emergence from creditor protection. This is necessary particularly in cases where the restructuring includes the assignment of a contract to which the debtor is a party to another party despite non-assignment clauses in the contract. This issue was squarely decided in *Re Playdium Entertainment Corp.* (2001), 31 C.B.R. (4th) 309 (Ont. Sup. Ct. Jus.), wherein Spence J. held that the Court had the jurisdiction under the CCAA to grant permanent injunctions where the benefit to the debtor's stakeholders in doing so outweighed the prejudice to the other contracting party.

  In Doman, the permanent injunction language was particularly important as the restructuring involved the transfer of all of Doman's assets to new entities, including the assignment of innumerable contracts to those entities. In addition, language was added to enjoin parties from terminating agreements on the basis of any change in control of Doman or new Doman resulting from the restructuring. The Province, of course, had concerns with respect to the breadth of these provisions, particularly as they impacted on its ability to control the assignment of forest tenures and like assets. Those concerns were met by exempting the Province from certain of the permanent injunction provisions.

- Finally, as noted earlier, the Order contained very complicated language intended to address the Province's concerns that nothing in this order should stand as a precedent in future reorganizations in relation to the environmental issues which were never settled amongst the parties.

General Comments and Lessons Learned

This restructuring was very lengthy by any standards, and raised a number of interesting issues, not all of which were resolved conclusively. For example, it will have to remain to another CCAA filing to conclusively determine how far a CCAA court can go to eliminate prospective environmental claims associated with assets held historically by an insolvent debtor.

From a case law perspective, only two reported judgments resulted from this filing, but both were significant. The decision rejecting the First Plan on the basis of the court's lack of jurisdiction to impose a plan on a secured creditor which breaches non-financial covenants is controversial, and perhaps in conflict with Ontario authority. The decision rejecting the Company's ability to terminate an executory contract is perhaps less controversial, but certainly a landmark decision on what criteria should apply in this context, where heretofore, a debtor has had the ability to act pretty much unilaterally.

From a strategy perspective, there are many things to be learned. First, it is not always clear where a Board's fiduciary duty lies, and the simple statement that a Board must look to the interests of creditors when a company is insolvent is much more easily stated then it is put into practice. Second, it is very difficult to negotiate with a bondholder group, particularly one that is amorphous and always changing (the bonds traded throughout the process, and it was almost impossible at any point in time to determine exactly who the key constituency was with any certainty). That being said, there is no way that any restructuring can be accomplished without attempting to work with noteholders where their interests are as prevailing as they were for Doman.

Finally, it is always sad to see something come to an end as it did for the Doman family in this case. However, Herb Doman and his family can continue to be proud about what was accomplished by one man with a vision; the fruits of his labour are still evident and will no doubt remain an integral part of life in B.C. forever.