

Distressed M&A Opportunities are Emerging

M&A Top Trends 2016

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Canadian distressed M&A activity seems poised to rise, as low commodity prices and tight capital markets spur a re-examination of business models and balance sheets built for better times. Investment capital is readying itself for upcoming distressed opportunities, and restructuring laws are conducive to facilitating these deals.

Some investors and strategic buyers have shied away from distressed opportunities in the past because they see them as being especially risky, complicated and contentious. While there is some truth to this, savvy investors know that this field also comes with unique benefits and potentially outsized returns.

What is Distressed M&A?

Distressed M&A typically refers to deals completed when the target company is facing insolvency or is already insolvent. The *Companies' Creditors Arrangement Act* (CCAA) is a popular proceeding for larger insolvent companies, while receiverships are more common for smaller companies. Solvent companies have increasingly used the plan of arrangement provisions under the *Canada Business Corporations Act* or its provincial counterparts to de-lever balance sheets by way of securities exchanges. Most restructuring proceedings now involve a competitive sales process, equity subscription, debt-to-equity conversion, or other M&A component.

Benefits and Considerations

Court oversight and the involvement of a CCAA monitor or a receiver can significantly reduce acquisition risks. These independent eyes add rigour to the disclosure process and a dealmaking orientation. A court's powers can also simplify the process. For example, a court can stay the exercise of contractual remedies by counterparties and override restrictions against assignment or other actions. For asset purchases, a court can vest title free and clear of liens and other interests to achieve a level of title certainty rarely equalled by even the most comprehensive (and costly) legal due diligence exercises. Meanwhile, judicial oversight and approvals reduce liability exposure for boards of directors.

There can also be extraordinary opportunities to re-model the target business. In addition to debt reduction, uneconomic contracts can be terminated or left behind. A purchaser can also "cherry pick" attractive parts of a business with more ease than in the ordinary course.

There are, however, unique considerations. Even in "debtor-in-possession" CCAA proceedings, it is not always clear that a company's management and board are firmly in control. Lenders, bondholders, employee groups and other key stakeholders are often heavily involved and can strongly influence outcomes. Confidentiality can also be challenging. Generally, the transparency and multi-party nature of most insolvency proceedings promotes leaks and disclosure. And asset sales may deliver "cleansed" assets, but they can also leave behind valuable tax attributes (although share transaction alternatives exist). Restructuring processes can also be notoriously fluid and unpredictable.

Some distressed M&A opportunities allow buyers to "cherry pick" parts of a business with more ease than in the ordinary course.

Sector Opportunities

Perhaps topping the sights of distressed investors presently is the oil and gas sector. A steep drop in oil prices, tightening of the capital markets, and other factors are taking their toll. The sector has already seen insolvency filings for companies like Laricina Energy and Southern Pacific, and it is still uncertain where we sit in the cycle.

Elsewhere, players in the mining and retail sectors are also looking to generate distressed M&A opportunities. With investment options across a number of sectors, those prepared to enter distressed M&A waters may find attractive opportunities in the coming year.

To discuss these issues, please contact the author(s).

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