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Corporate salvage operations need rescuing



THERESA TEDESCO | Jan 29, 2013 7:38 AM ET
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In an effort to stop a fees frenzy, Nortel's Canadian disabled long-term pensioners filed official complaints with bankruptcy watchdogs in Canada and the United States on Jan. 25, asking regulators to investigate the payments.

Wayne Cuddington/Postmedia News files

The business of salvaging distressed companies itself is in desperate need of rescue.

Consider that insolvency practitioners — lawyers, accountants, consultants and the like — in Canada, the U.S. and the U.K. have pocketed \$837-million in professional fees and disbursements since Nortel Networks Corp. filed for court protection from creditors in January, 2009. And the tab is still running.

The restructuring of General Motors Corp. cost shareholders US\$1-billion to put the automaker back on the road; over US\$900-million to sort out the wreckage of Wall Street investment firm Lehman Bros and \$100-million to work out the tangled web of the asset-backed commercial paper (ABCP) debacle in Canada.

Clearly, corporate clean ups are big business. A self-regulated industry where few restrictions on billings mean the meter is always running. The messier the cleanup, the bigger the pay day for the hired guns.

To wit, professional fees in the United States have increased 9.5% annually since 2007. In the United Kingdom, a recent government study found that insolvency practitioners pocket £1-billion for every £5-billion in assets they recover for creditors.

While the sheer magnitude of the dollar amounts is attracting more attention, there's been very little public pushback.

It seems people are either fascinated — or repulsed — by the numbers.

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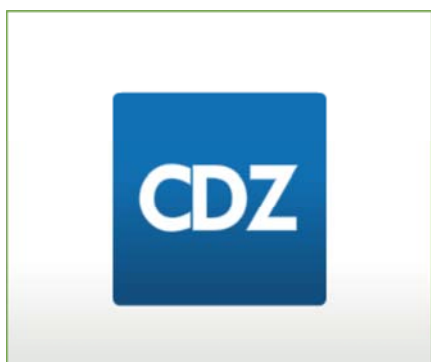
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In Canada, that hasn't materialized into much debate, let alone a Royal Commission, over the potential impacts higher professionals fees may be having on the efficiency of the country's insolvency regime and the overall economy. After all, millions in professional advisory fees could be the difference between rehabilitation and liquidation.

That may be changing. Nortel's Canadian pensioners are now challenging the "excessive payments." Currently embroiled in a protracted and expensive battle with the company's other creditors over the \$9-billion that remains of the once mighty telecommunications equipment maker, they've watched their benefits slashed. And given that two weeks of mediation failed to resolve the bitter impasse between the company and its creditors, the tab will just keep running.

In an effort to stop a fees frenzy, Nortel's Canadian disabled long-term pensioners filed official complaints with bankruptcy watchdogs in Canada and the United States on Jan. 25, asking regulators to investigate the payments. Clearly, it's a challenge for distressed companies to impose discipline on costs when the interests are so fractured along different constituency groups.



Gone are the days of simple balance sheet workouts. Today's complex corporate capital structures take more time to restructure. For example, Nortel had substantial assets in 130 different jurisdictions, each with distinct bankruptcy regimes. With so many competing interests, quickie resolutions are now the exception, not the rule, so the fee meters tend to stay on longer.

Complicating matters is the emergence of aggressive distressed investors who are radically changing the way restructurings are unfolding today.

Given this new reality, a review of the existing bankruptcy regime in Canada is in order, at the very least, if not a fundamental overhaul.

Obviously insolvency experts are entitled to be paid for their work. Still, there should be greater transparency and scrutiny of the fees billed with an eye to whether they represent value for the money. For example, charging \$100 to send an email or piling on hundreds of dollars an hour for a couple of junior lawyers to assist a senior legal gun already being paid top dollar doesn't instill much confidence in the system.

In Canada, the industry is less transparent because documents filed in court aren't required to delve into nitty gritty details. All expenses under the Companies' Creditors Arrangement Act (CCAA) are approved by a judge with the support of the court-appointed monitor, who plays role of gatekeeper during the restructuring process. In the U.S., the opposite is true. Bankruptcy trustees review files to control costs but they often tend to sweat the small stuff and pay less attention to big-ticket items.

The U.K. is leading the charge. Having examined its insolvency regime for more than a year, the government announced a review of the current regime last month. The move is the result of a 12-week study by the Office of Fair Trading in 2010, which found that the insolvency market may not work in the best interests of all creditors. Among the findings: secured creditors, the first in line to get money, have a strong incentive to control fees and are usually paid in full.

Not so for unsecured creditors, the report concluded. Bankruptcy experts in the U.K. charge 9% more for their services when an unsecured creditor is paying them. It's little wonder the U.K. government has called for "far-reaching reforms" to make the system fairer to the participants and the overall economy.

The flip side to this worrisome trend is that climbing advisory fees may make it prohibitively expensive for companies on the verge of collapse to even attempt a salvage operation. It's widely accepted that if there isn't \$1-million in cash in the coffers to pay for advisers up front, a company can't afford to file for CCAA — and usually doesn't. The fallout is devastating to employees and investors.

Still, don't look to the industry to scream for reforms because there's little incentive. Besides, most bankruptcy professionals argue there's nothing wrong with the current system and dismiss complaints about expensive advisory fees as griping and whining, or

worse, ill-informed. So for now, that leaves Nortel's long-term pensioners to carry the spear – until perhaps the next monitor's report.

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A strange choice of words to describe an industry that provides a huge benefit to the economy and market. Financial abuses and corruption are not unique to business. It also happens in government. In fact, there's more evidence to suggest business and free markets do a faster and cheaper job cleaning up corporate misdeeds.

The article conveniently overlooks the responsibility boards, managements, stockholders and employees have in creating the mess in the first place. The fees paid to IPs, lawyers and accounts is the price they pay for their mistakes. Making it less costly to fail by suggesting the IP industry "reform" through increased government regulation and oversight will only increase the very abuses and corruption such rules aim to reduce while making it more expensive through the added government bureaucracy needed to monitor it.

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