Canada lags behind in fight against skyrocketing corporate winddown fees

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To date, US$915-million has been spent on professional fees and disbursements — US$268-million of that to hired guns in Canada — to clean up Nortel's corporate mess.

Chris Mikula/Postmedia News files

Amid skyrocketing professional fees, the United States and the United Kingdom have figured out that the self-regulated industry of salvaging distressed companies is in desperate need of rescue. Not so in Canada.

Consider the four-and-a-half-year winding down of Nortel Networks Corp. Small armies of insolvency practitioners – lawyers, accountants, and consultants — on at least three continents have pocketed a whopping US$915-million (US$268-million of that to hired guns in Canada) in professional fees and disbursements to sort out the wreckage after the once-mighty Canadian telecommunications equipment maker filed for bankruptcy protection from creditors in January 2009. That represents an unprecedented 9% of the estimated US$10.1-billion in Nortel's global bankruptcy estate — and the meter is still running.

Nortel is the latest in a growing list of complex corporate restructurings that have raised the ire of regulators. General Motors Corp. cost shareholders US$1-billion to put the automaker back on the road, over US$900-million to sort out the carnage 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. Professional fees in the U.S have increased 9.5% annually since 2007. In the U.K., a 2011 government study found that insolvency practitioners pocket £1-billion for every £5-billion in assets they recover for creditors.

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Concerned about the impact higher professional fees may be having on the efficiency of insolvency regimes and the overall economy, both countries are reforming their respective rules. On June 11, the U.S. Department of Justice announced new guidelines for what lawyers, accountants and their ilk will be allowed to charge in large Chapter 11 bankruptcy cases to ensure greater transparency. The

new rules, which come into effect Nov. 1, 2013, apply to cases with US$50-million or more in assets and or liabilities. In other words, the complex restructurings that cost creditors millions in fees.

"At a time when both the public and the most sophisticated participants in the bankruptcy process say bankruptcy attorneys' costs are rising too rapidly, these guidelines are designed to ensure that statutory requirements limiting bankruptcy fees to market rates – not premium rates – are followed," Acting Associate Attorney General Tony West said in a statement.

To punctuate the point, the justice department warned U.S. attorneys throughout the country it "will vigorously enforce the guidelines, defending them in bankruptcy court and through appeals as appropriate."

In the U.K., the Office of Fair Trading found that the insolvency market in that country is in need of "far-reaching reforms" to make the system more fair. Among the findings: secured creditors, the first in line to get money, and unsecured creditors are treated differently. For example, bankruptcy experts in the U.K. charge 9% more for their services when an unsecured creditor is paying them.

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Meanwhile, in Canada there's been little talk or action to curtail professional fees by either the courts or the Superintendent of Bankruptcy. In this country, the insolvency industry is less transparent because documents, including professional invoices, 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 the role of gatekeeper during the restructuring process.

However, the Court of Appeal of Ontario sought to bring the gravy train to an end. On June 20, the appellate court dismissed an attempt by the administrators of Nortel's U.K. operations to appeal a ruling by courts in Ontario and the U.S. to force a joint trial to decide how to distribute US$7.3-billion in cash held in escrow in the estate of the now-defunct company. Previously, the Ontario Court of Justice and the U.S. Bankruptcy Court for the District of Delaware both ruled that a joint trial would begin on Jan. 6, 2012. However, Nortel's U.K. administrator wanted arbitration rather than a joint trial. The court of appeal nixed the proposal, saying "granting leave to appeal would impose additional costs and threaten further delay in proceedings that have already experienced too much of both."

Even so, recent court filings suggest the fees frenzy hasn't slowed yet. Ernst & Young LLP, which has been the court-appointed monitor in Canada for Nortel, recently filed documents that forecast as much as $1.7-million a week will be paid out to lawyers, accountants, financial advisers and consultants in Canada from mid-April, 2013 to mid-October, 2013 alone. That amounts to a nifty $48-million payday for six months' work.

Furthermore, that total doesn't include an additional 10 weeks hired guns will keep the meter on before a joint trial begins in January, 2014 – and that is expected to last another eight weeks.

For Nortel's pensioners and former long-term disabled employees, who have challenged the "excessive payments," this is a bitter pill to swallow. Since the company filed for CCAA in 2009, pension income, as low as $12,811 before Nortel's collapse, has been slashed by 3% to 19%, while pensioners outside Ontario are bracing for 40% to be hacked off when the two company pension plans are wound up by early 2014. Given the magnitude of the alternate realities, surely a review of the Canadian insolvency industry is in order.