

CITATION: Nelson Education Limited (Re), 2015 ONSC 3580
COURT FILE NO.: CV15-10961-00CL
DATE: 20150602

**SUPERIOR COURT OF JUSTICE – ONTARIO
COMMERCIAL LIST**

**IN THE MATTER OF THE COMPANIES' LENDERS
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF NELSON EDUCATION LTD. AND
NELSON EDUCATION HOLDINGS LTD.**

Applicants

BEFORE: Newbould J.

COUNSEL: *Robert J. Chadwick, Caroline Descours and Sydney Young*, for the Applicants

D.J. Miller and Kyla E.M. Mahar, for the Royal Bank of Canada

Kevin J. Zych, for the First Lien Lenders

Jay Swartz and Robin Schwill, for Alvarez & Marsal Canada Inc.

HEARD: May 29, 2015

ENDORSEMENT

[1] On May 12, 2015, Nelson Education Ltd. (“Nelson”) and its parent company, Nelson Education Holdings Ltd. sought and obtained an initial order pursuant to the Companies’ Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the “CCAA”). Notice had been given to RBC only late the day before and RBC took the position that it had not had sufficient time to consider or prepare a response to the application. The resulting initial order was pared down from what was sought by the applicants and it provided that on the comeback date the hearing was to be a true comeback hearing and that in moving to set aside or vary any provisions

of the initial order, a moving party did not have to overcome any onus of demonstrating that the order should be set aside or varied.

[2] On the comeback date, RBC moved to have Alvarez & Marsal Canada Inc. (“A&M Canada”) replaced with FTI Consulting Canada Inc. (“FTI”) as the Monitor, and for other relief. At the conclusion of the hearing, I ordered that FTI replace A&M Canada as Monitor for reasons to be delivered. These are my reasons.

Relevant History

[3] Nelson is a Canadian education publishing company, providing learning solutions to universities, colleges, students, teachers, professors, libraries, government agencies, schools, professionals and corporations across the country.

[4] The business and assets of Nelson were acquired by an OMERS entity and certain other funds from the Thomson Corporation in 2007 together with U.S. assets of Thomson for U.S. \$7.75 billion, of which US\$550 million was attributed to the Canadian business. The purchase was financed with first lien debt of approximately US\$311.5 million and second lien debt of approximately US\$171.3 million.

[5] The first lien debt is currently approximately US\$269 million plus accrued interest. There are 22 first lien lenders. RBC is a first lien lender holding approximately 12% of the principal amount outstanding. The first lien debt matured on July 3, 2014. It has not been repaid.

[6] The second lien debt is currently approximately US\$153 million plus accrued interest. RBC is a second lien lender, holding the largest share of the principal amounts outstanding, and is the second lien agent for all second lien lenders. The maturity date is July 3, 2015 subject to acceleration.

[7] According to Mr. Greg Nordal, the CEO of Nelson, the business of Nelson has been affected by a general decline in the education markets over the past few years. In the past year,

overall revenues in the K-12 market have declined by 13% and in the higher education market by 3%.

[8] Notwithstanding the industry decline over the past few years, Nelson according to Mr. Nordal has maintained strong EBITDA, which is a credit I am sure to the efforts of Mr. Nordal and the management of Nelson. Nelson's EBITDA has remained positive over the last several years. For the fiscal year ended June 30, 2011 it was \$47.4 million, for the fiscal year ended June 30, 2012 it was approximately \$37.3 million and for the year ended June 30, 2013 it was approximately \$40.9 million.

[9] Mr. Nordal is of the view that Nelson is well positioned to take care of increasing future opportunities in the digital educational market.

[10] Nelson had a leverage ratio of debt to EBITDA of approximately 17:1 for the fiscal year 2015. Its first lien debt matured and has not repaid and it has made no interest payments on the second lien debt since March 31, 2014.

[11] Nelson's efforts to deal with this situation have led to a proposed sale transaction under which the business of Nelson would be sold to the first lien lenders by way of a credit bid and the second lien lenders would be wiped out. In their application requesting an initial order, the applicants proposed a hearing date to be held nine days after the Initial Order to approve this sale transaction. That request was not granted.

[12] In March 2013, Nelson engaged Alvarez and Marsal Canada Securities ULC ("A&M") as its financial advisor to assist the Company in reviewing and considering potential strategic alternatives, including a refinancing and/or restructuring of its credit agreements.

[13] Commencing in April 2013, Nelson, with the assistance of A&M and legal advisors, entered into discussions with a number of stakeholders, including RBC as the second lien agent, the first lien steering committee, and their advisors, in connection with potential alternatives to address Nelson's debt obligations. A number of without prejudice and confidential proposed

transaction term sheets were discussed between August 2013 and September 2014, without any agreement being reached.

[14] During this time, interest continued to be paid on the first lien debt. In March, 2014 Nelson did not paid interest on the second lien debt. In return for a short cure period to May 9, 2014, a partial payment of US\$350,000 towards interest was paid on the second lien debt. A further cure period to May 30, 2014 was given on the second lien debt but nothing was paid on it by that date. No further cure period was agreed and no further interest has been paid. Initially during the discussions that took place with the second lien lenders' agent, the professional fees of the advisors to the second lien lenders were paid by Nelson but these were stopped in August, 2014 after there was no agreement regarding further extensions of the second lien debt or agreement on any term sheet.

[15] On September 10, 2014, Nelson announced to the first lien lenders Nelson's proposed transaction framework on the terms set out in the First Lien Term Sheet dated September 10, 2014 (the "First Lien Term Sheet") for a sale or restructuring of the business and sought the support of all of its first lien lenders.

[16] In connection with the First Lien Term Sheet, Nelson entered into a support agreement (the "First Lien Support Agreement") with first lien lenders representing approximately 88% of the principal amounts outstanding under the first lien credit agreement. The consenting first lien lenders comprise 21 of the 22 first lien lenders, the only first lien lender not consenting being RBC. Consent fees of approximately US\$12 million have been paid to the consenting first lien lenders.

[17] Pursuant to the terms of the First Lien Term Sheet and the First Lien Support Agreement, Nelson, with the assistance of its financial advisor, A&M, commenced on September 22, 2014, a sale and investment solicitation process (the "SISP") to identify one or more potential purchasers of, or investors in, the Nelson business, which process was conducted over a period of several months. According to Mr. Nordal, Nelson and A&M conducted a thorough canvassing of the market and are satisfied that all alternatives and expressions of interest were properly and thoroughly pursued.

[18] The SISP did not result in an executable transaction acceptable to the first lien lenders holding at least 66 2/3% of the outstanding obligations under the first lien credit agreement. Accordingly, pursuant to the First Lien Support Agreement Nelson wishes to proceed with a transaction pursuant to which the first lien lenders will exchange and release all of the indebtedness owing under the first lien credit agreement for: (i) 100% of the common shares of a newly incorporated entity that will own 100% of the common shares of the purchaser to which substantially all of the Nelson's assets would be transferred, and (ii) the obligations under a new US\$200 million first lien term facility to be entered into by the purchaser.

[19] The proposed transaction provides for:

- (a) the transfer of substantially all of Nelson's assets to the purchaser;
- (b) the assumption by the purchaser of substantially all of Nelson's trade payables, contractual obligations (other than certain obligations in respect of former employees, obligations relating to matters in respect of the second lien credit agreement, and a Nelson promissory note) and employment obligations incurred in the ordinary course and as reflected in the Nelson's balance sheet; and
- (c) an offer of employment by the purchaser to all of Nelson's employees.

[20] Under the proposed transaction, with the exception of the obligations owing under the second lien debt and intercompany amounts, substantially all of the liabilities of Nelson are being paid in full in the ordinary course or are otherwise being assumed by the purchaser. The purchaser will not assume Nelson's obligations to the second lien lenders.

[21] On September 10, 2014, pursuant to the First Lien Support Agreement Nelson agreed not to make further payments in connection with the second lien debt, including any payment for fees, costs or expenses to any legal, financial or other advisor to RBC, the second lien agent, without the consent of the consenting first lien lenders.

Role of A&M Securities

[22] Nelson engaged A&M, an affiliate of Alvarez & Marsal Canada Inc., as its financial advisor in March, 2013. A&M has been operating as a financial advisor to Nelson for more than two years prior to the date of the Initial Order.

[23] The scope of A&M's engagement in 2013 included the following:

- (a) Analyze and evaluate Nelson's financial condition;
- (b) Assist Nelson to prepare its 5-year financial model, including balance sheet, income statement and cash flow statement and its 5-year business plan;
- (c) Assist Nelson to respond to questions from its lenders regarding Nelson's business plan and financial model;
- (d) If requested by management, attend and participate in meetings of the board of directors with respect to matters on which A&M was engaged to advise Nelson; and
- (e) Other activities as approved by management or the board of Nelson and agreed to by A&M.

[24] In September 5, 2014 A&M was further engaged to act as the exclusive lead advisor for the transaction that has led to the proposed transaction, including the SISP process undertaken by Nelson. A&M's goal was identified as completing a successful transaction in the most expedient manner. Under this second engagement, A&M's compensation was described as being based on time billed at standard hourly rates and "subject to any other arrangements agreed upon among Nelson, the lenders and A&M". The word "lenders" referred only to the first lien lenders.

[25] In undertaking its mandate under the 2013 and 2014 engagements, A&M was authorized to utilize the services of employees of its affiliates under common control with A&M and subsidiaries. The sample accounts provided by A&M indicate that a substantial number of hours

were billed to the A&M engagement for work of the personnel who are intended to act on behalf of the Monitor in this proceeding. A total of approximately \$5.5 million plus HST and disbursements have been billed by A&M for its services to Nelson.

[26] An affiliate of A&M was engaged in 2013 to advise Cengage Learnings, the name of the U.S. operations of Thomson that was changed when Thomson sold its business. The 2013 and 2014 engagements of A&M by Nelson sought Nelson's waiver of any conflict of interest in connection with an A&M affiliate's engagement with Cengage. At the time of the 2013 engagement, A&M U.S. was engaged by Cengage to provide restructuring and financial advisory services and Cengage and Nelson had common shareholders. At the time of the September 2014 engagement, an A&M affiliate was providing financial advisory and financial management services to Cengage. Nelson maintains a strong relationship with Cengage and is the exclusive distributor for Cengage educational content in Canada pursuant to an agreement that expires on January 1, 2018. Cengage also provides certain operational support to Nelson. According to Mr. Nordal, Cengage is a preferred and key business partner of Nelson.

[27] A&M was present at the meetings of Nelson's board of directors wherein the decision was made by that board to not make interest payments to the second lien lenders on March 20, 2014, March 27, 2014, April 7, 2014 and June 27, 2014. A&M was also involved in discussions with RBC and its financial advisors in connection with the extension of the cure period for payment of interest to the second lien lenders as the financial advisor to Nelson.

Analysis

[28] In its factum, RBC asserted that the application by Nelson was not an appropriate use of the CCAA as it was intended to be a nine-day proceeding to bless a quick flip credit bid by the first lien lenders to acquire the business of Nelson and extinguish the second lien lenders interest in the assets. RBC however also took the position that it would support a CCAA proceeding on the basis that there would be a neutral Monitor. I must say that in reviewing the circumstances of this application, I can see the issues raised by RBC as to whether this CCAA proceeding was an appropriate use of the CCAA. However in light of the position taken by RBC and my ruling that

A&M Canada should be replaced by FTI as Monitor, I make no further comment or finding on the issue.

[29] This is a true comeback motion with no onus on RBC to establish that A&M Canada should not be the Monitor. Rather the situation is that it is Nelson who is required to establish that A&M Canada is an appropriate monitor.

[30] The problem is that Nelson has proposed a quick court approval of a transaction in which the first lien lenders will acquire the business of Nelson and in which essentially all creditors other than the second lien lenders will be taken care of. Nelson has asserted in its material that the SISP process undertaken by Nelson prior to the CCAA proceedings has established that there is no value in the Nelson business that could give rise to any payout to the second lien lenders. The SISP process was taken on the advice of A&M and under their direction. It was put in Nelson's factum that:

The Applicants, with the assistance of their advisors, conducted a comprehensive SISP which did not result in an executable transaction that would result in proceeds sufficient to repay the obligations under the First Lien Credit Agreement in full or would otherwise be supported by the First Lien Lenders;

[31] Nelson intends to request Court approval of the proposed transaction. An issue that will be front and centre will be whether the SISP process prior to this CCAA proceeding can be relied on to establish that there is no value in the security of the second lien lenders and whether other steps could have been taken to obtain financing to assist Nelson in continuing in business other than a credit bid by the first lien lenders. A&M was centrally involved in that process. It is in no position to be providing impartial advice to the Court on the central issue before the Court.

[32] There is no suggestion that A&M are not professional or not aware of their responsibilities to act independently in the role of a monitor. A&M is frequently involved in CCAA matters and is understandably proud of its high standard of professionalism. However, that is not the issue. In my view, A&M should not be put in the position of being required to step back and give advice to the Court on the essential issue before the Court in light of its central role in the whole process that will be considered.

[33] In an article in the Commercial Insolvency Reporter, (LexisNexis, August 2010), entitled *Musings (a.k.a. Ravings) about the Present Culture of Restructurings*, former Justice James Farley, the doyen of the Commercial List for many years and no stranger to CCAA proceedings, had this to say about the role of a monitor:

I mean absolutely no disrespect or negative criticism towards any monitor when I observe that they are only human. I think it is time to consider whether a monitor can truly be objective and neutral under present circumstances- it would take a true saint to stand firm under the pressures now prevailing. It should be appreciated that monitors are in fact hired by the debtor applicant (aided by perhaps a party providing interim financing, possibly in the role of the power behind the throne) and retained to advise the debtor well before the application is made. Is it not human nature for a monitor to subconsciously wonder where the next appointment will come from if it crosses swords with its hirer?

[34] Mr. Farley went on to suggest that the role of a monitor be split in two. That may be a laudable objective, but would require legislation. In this case, I do not think it would be appropriate in light of the extremely extensive work done by A&M over the course of two years.

[35] A monitor is an officer of the Court with fiduciary duties to all stakeholders and is required to assist the Court as requested. It has often been said that a monitor is the eyes and ears of the Court. It is critical that in this role a monitor be independent of the parties and be seen to be independent. I can put it no better than Justice Topolniski in *Winalta Inc. (Re)*, 2011 ABQB 399 in which she said:

67 A monitor appointed under the *CCAA* is an officer of the court who is required to perform the obligations mandated by the court and under the common law. A monitor owes a fiduciary duty to the stakeholders; is required to account to the court; is to act independently; and must treat all parties reasonably and fairly, including creditors, the debtor and its shareholders.

68 Kevin P. McElcheran describes the monitor's role in the following terms in *Commercial Insolvency in Canada* (Markham, Ont.: LexisNexis Butterworths, 2005) at p. 236:

The monitor is an officer of the court. It is the court's eyes and ears with a mandate to assist the court in its supervisory role. The monitor is not an advocate for the debtor company or any party in the *CCAA* process. It has

a duty to evaluate the activities of the debtor company and comment independently on such actions in any report to the court and the creditors.

[36] In this case, A&M is in no position to comment independently on the activities of Nelson in regards to the very issue in this case, namely the reliability of the SISP program in determining whether the second lien lenders' security has any value.

[37] There is also a question of the appearance of a lack of impartiality. During the two years that A&M was engaged prior to this CCAA proceeding, for which it billed over \$5 million, it was involved in advising Nelson during negotiations with the interested parties, including RBC, and in participating in those negotiations with RBC on behalf of Nelson. This history can cause an appearance of impartiality, something to be avoided in order to provide public confidence that the insolvency system is impartial. See *Winalta* at para. 82. It was this concern of a perception of bias that led to the prohibition being added to section 11.7(2) of the CCAA preventing an auditor of a company acting as a monitor of the company.

[38] The issue of an appropriate monitor requires the balancing of interests. This is not like some cases in which a financial advisor has had some advisory role with the debtor and then becomes a monitor, usually with no objection being raised. Often it may be appropriate for that to occur taken the knowledge of the debtor acquired by the advisor. This case is different in that the financial advisor has been front row and centre in the very sales process that will be the subject of debate in these proceedings and has engaged in negotiations on behalf of Nelson.

[39] In all of the circumstances of this case, I concluded that it would be preferable for another monitor to be appointed and for that reason replaced A&M Canada as Monitor with FTI.

Other issues

[40] In the Initial Order, RBC was directed to continue its cash management system. There was no charge provided in favour of RBC. RBC says that it should not be required to continue the cash management system without the protection of a charge. During this hearing, Mr. Chadwick on behalf of Nelson said that it might be possible to satisfy RBC by requiring some

minimum balance in the accounts, failing which a charge would be provided in favour of RBC. I take it that this issue will be worked out.

[41] In the draft Initial Order that accompanied the CCAA application at the outset, a paragraph was included that provided that Nelson could not pay any amounts owing by Nelson to its creditors except in respect of interest, expenses and fees, including consent fees, payable to the first lien lenders and fees and expenses payable to the first lien agent under the support agreement. That provision was deleted from the Initial Order. It was replaced with a provision that Nelson could pay expenses and satisfy obligations in the ordinary course of business.

[42] RBC takes the position that there should be a level playing field for the second lien lenders consistent with the treatment of the first lien lenders in this CCAA process, and that if interest is to be paid to the first lien lenders and expenses of their financial and legal advisors paid, the same should happen to the second lien lenders.

[43] RBC points out that it was Nelson who decided in June, 2014 to stop paying interest on the second lien debt and a little later reduce paying RBC's advisors in light of Nelson's view that there was not sufficient progress in negotiations with RBC. Payment of these professional fees was stopped in August, 2014. In September 2014 Nelson agreed in the First Lien Support Agreement not to make further payments in connection with the second lien debt, including any payment for fees, costs or expenses to any legal, financial or other advisor to RBC, the second lien agent, without the consent of the consenting first lien lenders. The consenting first lien lenders are opposed to any interest or expenses being paid to the second lien lenders.

[44] The second lien credit agreement provides for interest to be paid on the debt and in section 10.03 for all costs of the second lien agent, RBC, arising out of CCAA proceedings. The intercreditor agreement between the first and second lien agents provides in section 3.1(f) that nothing in the agreement save section 4 shall prevent receipt by the second lien agent payments for interest, principal and other amounts owed on the second lien debt. Section 4 provides that any collateral or proceeds of sale of the collateral shall be paid to the first lien agent until the first lien debt has been repaid and then to the second lien agent. As there has been no sale of the collateral, there is nothing in the intercreditor agreement that prevents payment of interest and

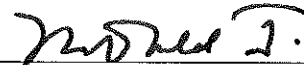
expenses of the second lien lenders. The second lien lenders are contractually entitled to receive payment of their interest, costs, expenses and professional fees.

[45] No determination has been made in these proceedings that there is no value available for the second lien lenders. RBC disputes the applicants' views on this point. RBC contends that these CCAA proceedings should not commence with the Court accepting as a *fait accompli* that the second lien lenders should not be paid in the proceeding when every other stakeholder is being paid.

[46] There is no evidence that Nelson has not been in a position to pay the interest, costs, expenses and professional fees of the second lien lenders since it made a decision in 2014 to stop paying these amounts. Since the First Lien Support Agreement with the consenting first lien lenders, the decision has been taken out of the hands of Nelson and turned over to the consenting first lien lenders.

[47] In my view, on the basis of the evidence, there is no justification to pay all of the interest, costs and expenses of the first lien lenders but not pay the same to the second lien lenders. In the circumstances, it is only fair that pending further order, Nelson be prevented from paying any interest or other expenses to the first lien lenders unless the same payments owing to the second lien lenders are made, and it is so ordered.

[48] RBC has requested costs of the comeback motion and I believe other costs. A request for costs may be made in writing by RBC within 10 days, along with a proper cost outline, and the parties against whom costs are claimed shall have 10 days to file a response to the cost request.



Newbould J.

Date: June 2, 2015