

Recovering Value: *The Case of Hamilton Specialty Bar*

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In today's highly liquid marketplace, deal flow can be hard to find. U.S.-based hedge fund Delaware Street Capital (DSC or Delaware) has found an unusual way to craft a transaction that brings a Canadian steel company in liquidation back to life. Using techniques unprecedented in Canada, Delaware has achieved a result many players had given up on after two years of attempts at restructuring. It is a story of extraordinary investor persistence, operating leadership skilled at managing crisis, and unusual legal creativity and skills.

In this article, the team of investment, operating, and legal professionals who made it happen discuss the challenges each faced in pulling off an intricate transaction, rescuing the operation from liquidation while dealing with an uncooperative seller, the complexity of working with organized labor, lender group opposition, and few legal precedents.

THE INVESTMENT OPPORTUNITY

Slater Steel, operating in CCAA (Companies' Creditors Arrangement Act) is a multiple division specialty steel manufacturer. One of its operating divisions, Hamilton Specialty Bar, a niche supplier for the automotive sector, was destined for liquidation. A potential new management team, believing there was value hidden in the liquidation process, approached DSC with what was an allegedly turnkey opportunity, simply needing a funding source

to support a structure already agreed to by labor, Slater's lender group, and the relevant regulatory authorities. Speed was of the essence as the closure and subsequent liquidation of the operation had already been publicly announced.

Due diligence indicated that the situation, while it held promise, was not the turnkey operation originally represented. While labor was potentially willing to come to terms, necessary concessions had not been agreed upon, the seller was preoccupied with the overall CCAA process, and the banks had already approved a liquidation plan for the asset with no perceived closing risk, and thus were not motivated to pursue a sale transaction. Within the operation deferred maintenance problems, caused by the liquidity issues and the intention to liquidate, required immediate attention if the operation was to continue. Slater management was focused on the overall company, not the needs of one division and as a result leadership able to focus directly on Hamilton Specialty Bar was lacking. Additionally, far from being a small transaction under the radar screen of other potential investors, DSC discovered that this situation had been reviewed and passed on by a significant number of other potential equity investors.

THE OPERATIONAL CHALLENGE

Undaunted, DSC pressed on, working with the union to find a possible solution while struggling to assess the situation and its real

prospects. Having parted ways with the putative management team that had originally sought to use DSC as a funding source, DSC needed expertise in the operating realities of the world of specialty steel. DSC tapped Glass and Associates, international turnaround managers, to help them assess the possibilities. Povl Jorgensen of Glass, a veteran steel man accustomed to managing chaos, flew to Hamilton on less than three hours notice to help Andy Bluhm, Gary Katz, and the DSC investment team assess the plant's operating prospects, deal with the union, and determine if the operation could be brought back from the brink, and, if so, at what cost and in what time frame.

In the midst of confusion, with not much financial information, a neglected plant, and customers and vendors disappearing, the DSC/Glass team pushed forward on due diligence and spent time with customers—and began to believe that Hamilton filled an important niche in the auto supply world, and customer demand was there. There seemed to be a reason to press on provided that order could be quickly imposed on the current chaos and an operating plan could be developed that involved the support of labor, key customers, and vendors. All of this work needed to be completed in a highly compressed time frame given the previously announced liquidation and the lenders' refusal to allow Slater to accept any new orders for the plant, thus forcing the plant's customers to source product from its competitors.

Due diligence had to be completed, the initial operating plan developed and implemented, a union contract needed to be negotiated and ratified, and a method of negotiating with the unwilling seller and its banks needed to be devised. Most importantly, though, Povl and Delaware needed immediately to reverse the decline in the division's operations and send strong signals to the marketplace and employees that the operations were fundamentally viable, even before the deal was final.

For its part, DSC had to find a way to effectively stabilize the situation while they worked on union solutions, and sought a legal and financial framework through which to make an investment in what was a soon to be liquidated division of a company that itself was in CCAA proceedings. Though employees of the Hamilton plant could by necessity continue to work for Slater, the owner of the division, until a definitive transaction could be consummated, it was imperative to the success of the investment for DSC to immediately gain operating control if they were to have any chance of restoring the confidence of labor, suppliers, and most importantly customers.

Inside the operation, not yet a company, Povl found

the typical attributes of organizational disarray of deep distress: uncertainty, information voids, and job concerns, compounded by the announcement of impending liquidation. Key personnel, in the dark as to what was going on, were actively seeking alternatives. Slater management, having determined that liquidation would inevitably occur, was unwilling to provide needed reassurance or direction at this critical stage.

It was this void into which Povl stepped, essentially taking charge of the operation, even before the transaction was finalized, and running both the business affairs of the division and moving forward with the novel legal and financing structures being developed by DSC and its counsel, Ogilvy Renault.

Povl had to build confidence quickly and establish a sense of purpose and urgency immediately. This can be a difficult process to pull off in any circumstance, but was especially challenging given the complexity of providing an appropriate framework to give him and Glass appropriate legal authority needed to manage operations still owned by the seller, still also the legal employer of the work force.

As an operator, Povl relied on his knowledge of the industry from both the producing and selling ends to move rapidly and establish the credibility needed to convince people to follow his lead so they in fact would follow. At the same time he needed to maintain his own sense of proportion, while developing operating plans in a legal and financial environment still unclear and often changing as the complex negotiations with various parties continued.

As he moved along, communicating with many parties and establishing a sense of order and purpose, he worked to identify and inspire the key personnel the operation would need to emerge as a company of its own and carry out its ambitious plan. With no clear path yet to achieve the end game goal of an independent company from a legal and financial perspective, Povl gambled with his personal credibility every day to keep the prospects alive.

LEGAL CONSIDERATIONS

While Povl was pulling the operating organization together and working with the union, counsel in the person of Mario Forte of Ogilvy Renault and Andy Bluhm and Gary Katz of Delaware Street were working on legal and financial structures. For various structural and other considerations, the lender group was unable to permit funding into Slater's Companies' Creditors

Arrangement Act proceedings directly, even on a subordinated basis. Not surprisingly, funding was absolutely essential in order to continue the business for a period of time to deal with resolving certain conditions including environmental issues and pension and retiree medical benefit responsibilities and to continue maintaining the business' operational capacity.

As all parties recognized the need for ongoing funding in order to accomplish the foregoing objectives, Forte as counsel devised a mechanism which would permit DSC to fund the Hamilton Specialty Bar division while at the same time not running afoul of the lender group's concerns, nor exposing the funder or the potential acquirer to risks which they otherwise would not have been exposed to had they been permitted to fund into the Slater CCAA. The structure was as follows:

1. The relevant assets of the Hamilton Specialty Bar division were sold down to a wholly-owned newly incorporated company still owned by Slater Inc. in exchange for security and a promissory note.
2. The promissory note and security were acquired by a DSC affiliate at a price reflecting the liquidation value of the Hamilton Specialty Bar assets, helping DSC to protect against downside risk if the recovery could not be achieved.
3. At the same time, the Newco was immediately placed into its own Companies' Creditors Arrangement Act proceeding.

It is important to note that the asset rolldown, the granting of the security, and the sale of the security and the promissory note were all approved in a single hearing within the Slater Companies' Creditors Arrangement Act proceeding. Immediately following the making of that Order, protection was granted to the Newco in its own Companies' Creditors Arrangement Act filing. The proceedings were themselves connected through the condition that the Newco, itself, be granted CCAA protection. The result of this structure was to isolate the operating assets of Hamilton Specialty Bar division from Slater's general CCAA proceedings, and to enable DSC to fund on a debtor-in-possession financing basis the ongoing operations of the Hamilton Specialty Bar division in the Newco.

In addition to placing the Newco into its own CCAA proceeding, the Court approved a form of Asset Purchase Agreement between the acquiring corporation and the Newco, which agreement was subject to a number of conditions. The Court was clearly advised of the con-

ditions involved in the agreement and that it was possible that the conditions may not be fulfilled in which case the Newco itself would be liquidated and its proceeds used to retire the Newco indebtedness, now held by DSC rather than the Slater bank group.

By utilizing this innovative structure, it was possible to continue funding the operations of the Hamilton Specialty Bar business, pursue satisfaction of the conditions precedent to closing the ultimate transaction, and to assess the viability of the business throughout that period of time, while exposing the funder and acquirer to no greater risks than they would have faced if direct funding of the Slater CCAA had been permitted.

In addition, arrangements were put into place to second employees from Slater to the Newco, whereby Newco was able to fund Slater to pay Slater employees at the Hamilton plant while Newco actually operated the business. At no time did Newco employ any employees in the operations, thereby avoiding the potential for liability that could arise from successor employer status. Such liabilities can be quite significant under Canadian law. It was contemplated that should a liquidation be necessary, Slater would terminate all its employees and arrangements would be made through further legal proceedings to initiate a liquidation process in respect of the Hamilton Specialty Bar business. The directors and officers of Slater Inc. were also granted continuing protection during this interim period in respect of this employee secondment arrangement by virtue of various securities granted to them in respect of the assets. These obligations were ultimately vested out with the exception of certain statutory liabilities when the assets were ultimately acquired by the acquiring corporation, approximately 60 days after the initiation of the Newco CCAA proceeding.

In another unusual step made possible by the use of a CCAA proceeding for Newco itself, the unambiguous operating authority needed to take immediate definitive action to manage operations, employee and labor relations, customer and vendor confidence, Glass was granted authority to direct the affairs of Newco through the authority granted by the Court to an entity frequently used in Canada: a court-appointed Monitor, in this case Richter and Company.

At this writing, Hamilton Specialty Bar has emerged from CCAA protection, with funds controlled by DSC in the ownership position and Povl Jorgensen and Glass at the helm. The operation, now a company in its own right, is making good progress on a number of fronts. Though far from certain and much depends on the rela-

tionship the Company is attempting to build with a very strong-willed union, if the operational flexibility built into the new union contract can be successfully put into effect, the future appears bright indeed.

Much can be learned from this ambitious undertaking by Delaware Street, which has set a number of interesting precedents that may become more common. Delaware Street, Glass, and Ogilvy Renault have persisted along with Company employees, the union, the courts, the lenders, and government authorities in structuring an operation that preserves jobs in the often treacherous waters of the specialty steel industry. Together they found a way to retrieve a business from the edge of extinction, and restore it using creative financing and legal techniques and the steady hands of a seasoned operator. With little leverage on its new balance sheet and the wind at its back, the venture that required an unusual degree of vision, determination, creativity, and tenacity is moving forward rapidly.

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