

**SUPERIOR COURT OF JUSTICE**

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Date: October 20, 2009

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From: The Honourable Madam Justice Pepall

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Message: Please find enclosed Endorsement.

Re: Court File No.: CV-09-7966-00CL

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COURT FILE NO.: CV-09-7966-00CL

DATE: 20091020

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

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

AND IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C. 1985, c. B-3, AS AMENDED

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
SMURFIT-STONE CONTAINER CANADA INC. AND OTHER APPLICANTS
LISTED ON SCHEDULE "A"

BEFORE: Pepall, J.

COUNSEL: *Kevin McElcheran and Heather Meredith* for the Moving Parties
Sean F. Dunphy and Alexander Rose for the Respondents/Applicants
Robert J. Chadwick and Christopher G. Armstrong for the Monitor
Kevin Zych for the Official Committee of Unsecured Creditors
R. Thornton and S. Aggarwal for Manufacturers and Traders Trust
Company as Indenture Trustee

ENDORSEMENT

Relief Requested

[1] Aurelius Capital Management, LP and Columbus Hill Capital Management, L.P. are Fund Managers for notes issued by Stone Container Finance Company of Canada II ("Finance II") in the amount of US\$200 million. Amongst other things, they request an order declaring that the interests of Finance II and its creditors are adverse to those of Smurfit-Stone Container Enterprises Inc. ("Enterprises") and Smurfit-Stone Container Canada Inc. ("Smurfit Canada") and directing the officers and directors of Finance II to file an assignment in bankruptcy appointing a trustee in bankruptcy and discharging Deloitte & Touche Inc. as Monitor of Finance II. They are supported by the indenture trustee for the noteholders, Manufacturers and Traders Trust Company.

- 2 -

Facts

[2] Finance II is an unlimited company formed under the laws of Nova Scotia and is a wholly owned subsidiary of Enterprises. Smurfit Canada, one of the two operating entities in Canada, is also a wholly owned subsidiary of Enterprises.

[3] On January 26, 2009, Smurfit Canada, Finance II, Enterprises and others filed for relief pursuant to Chapter 11 of the U.S. Bankruptcy Code. Later that day, Smurfit Canada, Finance II and others (but not including Enterprises) (the “applicants”) were granted CCAA protection.

[4] Finance II is not an operating company and carries on no trade. It is a special purpose financing entity that is subject to a series of complementary agreements entered into in 2004 to facilitate tax efficient financing. That year, Finance II raised funds in the public debt market by issuing unsecured senior notes due in 2014 in the principal amount of US\$200 million. The notes are guaranteed by Enterprises.

[5] Finance II then lent the proceeds to Smurfit Canada pursuant to an intercompany loan agreement dated July 20, 2004. The loan is unsecured. The obligation to pay interest on the loan is satisfied by the issuance of class C shares of Smurfit Canada to Finance II. The loan agreement states that on an event of default such as the adjudication of insolvency by the borrower, Smurfit Canada, Finance II as the lender “may exercise any and all of its rights and recourses under this agreement, provided, however, that the Borrower shall perform its obligations in this regard hereunder by the issuance to the Lender of Class B shares having a value no less than the dividend or other amount that otherwise would be received by the Lender”.

[6] According to the affidavit filed by the moving parties, this intercompany loan was not publicly disclosed. The prospectus pursuant to which the notes were issued confirms that Finance II has no significant assets and will depend on the guarantor to make all payments under the notes. As the sole shareholder of Finance II, Enterprises may have an obligation pursuant to section 135 of the *Companies' Act* (Nova Scotia) to

- 3 -

contribute amounts sufficient to satisfy all creditor claims against Finance II in the event of a winding up of Finance II.

[7] The assets of Finance II are:

- (a) a claim against Smurfit Canada for approximately US\$200 million;
- (b) a claim against Smurfit Canada relating to 68,413 Class C Shares of Smurfit Canada; and
- (c) a claim against Enterprises for contribution pursuant to the provisions of the Companies' Act (Nova Scotia).

[8] The only disclosed obligations of Finance II at the date of filing were:

- (a) the US\$200 million plus accrued interest owing under the notes to the holders of the notes;
- (b) an intercompany note of approximately US\$66.1 million owed to Enterprises for funds advanced to Finance II to enable it to pay interest on the notes; and
- (c) unspecified income tax obligations.

[9] Finance II is a guarantor of the DIP facility but is not a borrower under that facility nor did it receive any proceeds under it.

[10] The creditors of Finance II are the noteholders and possibly the federal government for unspecified income tax obligations. The only other disclosed creditor of Finance II as of the filing date was the sole shareholder of Finance II, Enterprises. The moving parties hold approximately 61.3% of the principal amount due on the notes. The moving parties state that they are veto creditors with respect to Finance II, or put differently, Finance II cannot implement a plan of arrangement without their affirmative vote.

[11] Finance II and Smurfit Canada have overlapping directors and officers and are represented by the same counsel. The moving parties' concerns have been raised with the respondents but only in the context of requesting cooperation and document production.

- 4 -

[12] The CCAA and Chapter 11 proceedings are obviously ongoing. The applicants have worked diligently to stabilize their operations and have engaged in a number of restructuring efforts including negotiating the sale of non-core assets and engaging in ongoing discussions regarding their potential tax liabilities with taxation authorities at the federal and provincial government levels. At this stage, a claims procedure in the CCAA and Chapter 11 proceedings has been implemented. Both court orders treat intercompany claims as excluded claims for claims bar date purposes. Therefore, Finance II was not required to file any claim prior to the claims bar date. The applicants have presented an operational plan and preliminary plan of reorganization term sheet to the Official Committee of Unsecured Creditors ("UCC"). The indenture trustee is an ex officio member of the UCC in the US bankruptcy proceedings which in turn has standing in the CCAA proceedings by virtue of the court ordered protocol.

[13] A stay was imposed as part of the Initial Order dated January 26, 2009 and there have been subsequent extensions of the stay. When the applicants were seeking an extension of the stay to December 24, 2009 and the moving parties were scheduling this motion, it was agreed that any extension of the stay was without prejudice to the rights and interests of the moving parties on this motion.

Issues

[14] There are two issues to consider. Is there a conflict of interest that merits relief being granted and should the stay be lifted to appoint a trustee in bankruptcy with respect to Finance II?

Positions of Parties

[15] In brief, the moving parties take the position that the Monitor, the directors of Finance II and counsel for the applicants are in a position of irreconcilable conflict the result of which is that no one is in a position to advance the interests of Finance II in the CCAA or the Chapter 11 proceedings. The interests of Finance II and the noteholders are to ensure that Finance II obtains maximum recovery from Smurfit Canada and from

- 5 -

Enterprises and as such, Finance II is adverse in interest to those entities. The recovery of the noteholders is entirely dependent on Finance II's recovery from Smurfit Canada and Enterprises in their plans of arrangement or reorganization. The problems are compounded because there are overlapping directors and officers amongst Finance II, Smurfit Canada and Enterprises; they are represented by the same counsel; and are under the oversight of the same court Monitor as Smurfit Canada. The moving parties submit that there are conflicting fiduciary duties and there is a need for someone to advance the interests of Finance II. They argue that causing the directors and officers to make an assignment into bankruptcy will eliminate the conflict issues because such a procedure requires a bankruptcy trustee to be installed. The trustee, being an independent court officer, could assert and negotiate the claims on behalf of Finance II. In addition, the contribution claim against Enterprises would be crystallized. The assignment in bankruptcy would not impair the restructuring proceedings because while a guarantor of the DIP facility, Finance II was not an operating company and its only assets were claims against the other applicants and the contribution claim against Enterprises.

[16] The indenture trustee supports the moving parties on this motion.

[17] The respondents are opposed to the motion. They take the position that there is no conflict of interest and the nature of Finance II's claim has not been determined. Furthermore, one should not presume that the plan is doomed to fail. They submit that appointment of a trustee in bankruptcy is premature and significantly there would be real prejudice to the applicants in that a bankruptcy of Finance II would constitute an event of default under the DIP facility. In contrast, the prejudice to the noteholders is speculative. Furthermore, Finance II's claims are preserved and those having an economic interest will have input either before or after the plan is tabled. In addition, the indenture trustee is an ex officio member of the UCC and the noteholders are represented by those entities.

[18] The Official Committee of Unsecured Creditors is also opposed to the motion.

[19] The Monitor supports the position of the respondents.

- 6 -

Discussion

[20] It is not unusual for restructurings to involve consolidated plans that address intercompany claims. Indeed, section 3(1) of the CCAA contemplates group filings. By their nature, these often involve intercompany claims. In its seventh report, the Monitor notes: "It is common in large, integrated, cross-border reorganizations for CCAA and Chapter 11 proceedings to be dealt with on a consolidated basis with a single CCAA Monitor appointed by the Court to oversee all aspects of the reorganization of an integrated group for the benefit of all stakeholders of the Canadian debtors. These restructurings will invariably include certain intercompany claims and interests which are addressed in a consolidated plan or plans."

[21] The moving parties acknowledge in their factum that intercompany debts are often found in CCAA proceedings. Consistent with that fact, in the various pieces of correspondence that predated this motion, the moving parties never asked counsel for the applicants to remove themselves from the record nor did they make such a suggestion to the Monitor. Conflicts are frequently found in CCAA proceedings particularly those involving corporate groups. If one were to insist on independent counsel and an independent court officer for every instance of perceived conflict of interest, restructuring proceedings of corporate groups would become completely unwieldy and unproductive. On the other hand, there may be instances of conflicts of interest that should be addressed. The court should adopt a case by case analysis to ascertain whether there is a conflict of interest that merits the granting of relief.

[22] In this case before me, there is a real issue as to whether Finance II's claims constitute debt or equity and it is unclear that Finance II has a claim entitling it to vote on any plan. This issue could be addressed in the plan itself or beforehand by way of a motion. No determination of the nature of Finance II's claims has been made yet. As such, the declaratory relief requested is premature. In the meantime, Finance II's assets consist of its intercompany claims and its ability to assert those claims has been preserved. There is no evidence that the applicants are not working on a plan in good faith for the benefit of all stakeholders including Finance II and the noteholders or that

- 7 -

the interests of Finance II and the noteholders are not being taken into account. Indeed, there is no evidence of any breach of any duty by any of the impugned parties.

[23] Even if I am wrong in this regard, I would not lift the stay of proceedings imposed in the Initial Order so that Finance II may be assigned into bankruptcy. In exercising discretion to lift the stay, the court should balance the interests of the creditors and debtors and consider the prejudice that may be suffered by each: *Re Canadian Airlines Corp.*¹ The court should also be mindful of the purposes underlying the CCAA and their application to the facts of the case. The former are described by Gibbs J.A. in *Hongkong Bank v. Chef Ready Foods*²:

“The purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to remain in business... When a company has recourse to the CCAA the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously, time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s.11.”

[24] The goals of the CCAA apply not only to individual companies but to interdependent corporate groups operating as a single enterprise, particularly when the treatment of the corporate group as an integrated system will result in greater value. The court may consider the implications of the corporate group's reorganization efforts as a whole: *Re SemCanada Crude Co.*³ and *Re Calpine Canada Energy Ltd.*⁴

[25] In my view and keeping these principles in mind, the stay should not be lifted at this time. There is real prejudice to the applicants in that a bankruptcy of Finance II would constitute an event of default under the DIP facility and could upset the applicants' ability to emerge successfully from CCAA protection. An event of default

¹ (2000), 19 C.B.R. (4th) 1.

² (1990), 4 C.B.R. (3d) 311 at para. 10 (B.C.C.A.).

³ [2009] A.J.No.129 at para. 29.

⁴ [2006] A.J.No. 412 at para.32.

- 8 -

allows for termination of the commitments under the DIP facility and a declaration that outstanding amounts are due and payable. The applicants rely on the DIP facility and forecast draws of \$29.4 million during the next three months.

[26] Counsel for the moving parties advance seven reasons in support of their position that a bankruptcy is unlikely to cause any prejudice and they are outlined in their factum. They complain that Finance II should never have been a guarantor of the DIP loan; there is no reason to assume the DIP lenders will accelerate the loan or enforce the security; the guarantee of Finance II adds no incremental value; supervision of the restructuring should not be delegated to the DIP lenders; the applicants should seek a default waiver from the DIP lenders or refinance or repay the DIP loan. In argument counsel for the moving parties also noted the absence of counsel for the DIP lender and asked that I infer from such absence that the default under the DIP facility would be of no consequence.

[27] While one may argue that Finance II should not have been a party to the DIP loan agreement, it is and certain remedies flow in the event of a default. There is no certainty that the DIP lenders would enforce the agreement but there is some risk and the absence of their counsel at the motion does not serve to eliminate that risk. While I agree that a DIP loan agreement should not be the only driver in CCAA proceedings, it is a factor to consider. Even if one were to disregard its significance, as stated by the Monitor, assigning Finance II into bankruptcy would disrupt the consolidated, cross-border restructuring efforts being undertaken. I agree with the Monitor that such a disruption is not warranted at this stage of the proceedings. In addition, the bankruptcy could upset the applicants' tax structure. There would also be the administrative burden and expense associated with the appointment of a trustee in bankruptcy and likely delay.

[28] In my view the potential prejudice to the applicants outweighs that to the moving parties. Accordingly, I am dismissing the request to have Finance II assigned into bankruptcy.

- 9 -

[29] I have no doubt that the Monitor will attend not just to the interests of the group of stakeholders but to the needs of individual creditors as well. That said, even though I am dismissing the remedy requested by the moving parties, I do accept that there is some basis to their complaint of a need for "a seat at the table". During argument, counsel for the applicants and the indenture trustee raised different means of addressing this problem. Both the applicants and the moving parties indicated that the characterization of Finance II's claims is a threshold issue. Stakeholders should with some dispatch turn their minds to an appropriate process to address that issue. If counsel require any assistance or further direction from the court in this regard, they may arrange for a 9:30 appointment before me.



Pepall, J.

DATE: October 20, 2009