

Court of Appeal Court File No. _____
Court File No. CV-09-7966-00CL

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

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

Applicants

NOTICE OF MOTION
(motion for leave to appeal)

**AURELIUS CAPITAL MANAGEMENT, LP and COLUMBUS HILL
CAPITAL MANAGEMENT, L.P.** (together, the "Fund Managers" or the "Moving
Parties"), will make a motion, which will be heard by the court in writing 36 days after
service of the Fund Managers' motion record, factum and transcripts, if any, or on the filing
of the Fund Managers' reply factum, if any, whichever is earlier (unless otherwise directed by
order of a judge of this court).

PROPOSED METHOD OF HEARING: The motion is to be heard in writing (unless
otherwise directed by order of a judge of this court).

THE MOTION IS FOR:

- (a) an order granting leave to appeal the order of the Honourable Madam Justice Pepall dated November 23, 2009;
- (b) costs of this motion; and
- (c) such further and other relief as this Honourable Court considers just.

THE GROUNDS FOR THE MOTION ARE:

1. Stone Container Finance Company of Canada II (“Finance II”) is an unlimited company formed under the laws of Nova Scotia (a “ULC”) and a wholly owned subsidiary of Smurfit-Stone Container Enterprises, Inc. (“Enterprises”).
2. Smurfit-Stone Container Canada Inc. (“Smurfit Canada”) is a Nova Scotia corporation, which is also a wholly-owned subsidiary of Enterprises.
3. Finance II and Smurfit Canada are both applicants in these CCAA proceedings (together with the other applicants in these proceedings, the “Applicants”) and debtors in the related proceedings under chapter 11 of Title 11 of the United States Bankruptcy Code (the “US Proceedings”).
4. Enterprises, the US parent company of Finance II and Smurfit Canada, is a debtor in the US Proceedings.
5. Finance II issued certain 7 3/8% Senior Notes due July 15, 2014 (the “Notes”) pursuant to an Indenture dated as of July 20, 2004. The Fund Managers manage funds (the “Funds”) that hold a majority of the Notes.

6. Holders of the Notes including the Funds (the “Noteholders”) are the principal creditors of Finance II and its only arms-length financial creditors as of the filing date other than, possibly, the Federal Government for unspecified income tax obligations.
7. McCarthy Tétrault LLP represents the Fund Managers in these proceedings.
8. Stikeman Elliot LLP (“Stikemans”) represents both Finance II and Smurfit Canada in the CCAA proceedings, as well as all of the other Applicants.

BACKGROUND: IRRECONCILABLE CONFLICTS

9. Finance II’s only disclosed assets are:
 - (a) Claims against the other Applicants for (i) recovery of substantial intercompany loans owed by the other Applicants to Finance II, including obligations owing by Smurfit Canada (the “Intercompany Loan”) under a US\$200 million intercompany loan agreement (the “Intercompany Loan Agreement”); and (ii) recovery on Class C shares of Smurfit Canada owned by Finance II; and,
 - (b) Claims against Enterprises for contribution in accordance with its obligations pursuant to the *Companies’ Act* (Nova Scotia) (the “Contribution Claim”).
10. Noteholders of Finance II also have a claim against Enterprises for recovery under its guarantee of the Notes.
11. With respect to each of the claims described above, Finance II is directly adverse in interest to the other Applicants (most directly Smurfit Canada) and Enterprises. Accordingly,

Finance II is directly adverse in interest to the other Applicants and Enterprises with respect to recovery on all of its disclosed assets.

12. However, in these CCAA proceedings, Stikemans acts for all the Applicants, including both Smurfit Canada and Finance II. Therefore, Stikemans owes professional and fiduciary duties to adverse parties, namely Smurfit Canada (among other Applicants) and Finance II, simultaneously.

13. This conflict has prevented and continues to prevent the arms-length negotiation that is essential to the development of successful and fair plans of arrangement, impairs disclosure regarding intercompany claims and raises privilege and confidentiality issues since all of the Applicants are represented by the same lawyers and the information provided to Stikemans by any of the Applicants has been treated as neither confidential nor privileged as between the Applicants.

14. The problems caused by Stikemans' conflict are compounded by the fact that all of the Finance II directors and officers overlap with Smurfit Canada and/or Enterprises. The directors and officers of Finance II have opposing fiduciary obligations to Finance II on the one hand and to Smurfit Canada and Enterprises on the other.

15. Accordingly, Stikemans does not even have a client whose objective is to single-mindedly advance the interests of Finance II from whom it can take instructions, which means that no party is capable of adequately representing the interests of Finance II in these proceedings, without conflict.

PREVIOUS ATTEMPTS TO ADDRESS CONFLICTS

16. On October 7, 2009, the Fund Managers brought a motion to address the multiple conflicting duties faced by the overlapping directors and officers of Finance II and Smurfit Canada, Stikemans as counsel for both Finance II and Smurfit Canada, and Deloitte & Touche Inc. as monitor for all the Applicants (the “Conflicts Motion”).

17. In response to that motion, Stikemans, for the first time, suggested that there was a “threshold issue” in relation to one of Finance II’s claims: the claim of Finance II against Smurfit Canada in relation to the Intercompany Loan. The then-introduced “threshold issue” was whether the claims of one Stikemans’ client, Finance II, against another Stikemans’ client, Smurfit Canada, under the Intercompany Loan Agreement was debt or equity (the “Characterization Issue”).

18. The allegation that the Intercompany Loan could somehow be equity is entirely new and completely inconsistent with prior treatment of the Intercompany Loan by the Smurfit Group. Specifically, it is inconsistent with representations by Smurfit Canada, Finance II and Enterprises in their respective tax filings in which they represented that the Intercompany Loan was debt and enjoyed tax benefits as a result of that characterization. This new characterization could, therefore, create negative tax implications for the Smurfit Group and is harmful to Finance II specifically as it could serve to significantly reduce the value of one of its assets and potentially eliminate its vote on Smurfit Canada’s CCAA plan.

19. On October 20, 2009, the Honourable Madam Justice Pepall issued an endorsement on the Conflicts Motion. Her Honour found that the relief requested, including directions to Finance II that it should file an assignment in bankruptcy, appointing an independent Trustee

in bankruptcy to represent the interests of Finance II in the restructuring of the other Applicants, was “premature” and noted that “[c]onflicts are frequently found in CCAA proceedings...” and that “[t]he court should adopt a case by case analysis to ascertain whether there is a conflict of interest that merits the granting of relief.”

20. Her Honour also found that “there is a real issue as to whether Finance II’s claims constitute debt or equity” and directed the parties to turn their minds to an appropriate process to address, among other things, the Characterization Issue.

21. Stikemans proposed that the Characterization Issue could be determined by a form of “moot court” motion in which Stikemans would argue the position of Smurfit Canada that claims under the Intercompany Loan Agreement are in the nature of equity and McCarthy Tétrault, while not counsel for Finance II, would argue the position of Finance II that the Intercompany Loan was debt.

22. McCarthy Tétrault did not agree with the process proposed by Stikemans. McCarthy Tétrault objected that it did not, and was not in a position to, represent Finance II, and that it would be a conflict of interest for Stikemans to advance an argument on the proposed motion that was directly contrary to the interests of its present client, Finance II. As a result, the parties returned before Justice Pepall for further direction.

23. At a 9:30 appointment on November 6, 2009, Justice Pepall allowed the process suggested by Stikemans to continue. Justice Pepall’s endorsement provided that Stikemans would produce documents and materials to McCarthy Tétrault by November 16, 2009, that counsel would re-attend before her at a 9:30 appointment on November 23, 2009 and that a hearing would tentatively commence on December 11, 2009.

24. Justice Pepall noted to counsel that McCarthy Tétrault should be provided with access to documents and people for discovery as if it were Finance II and that McCarthy Tétrault should not be prejudiced by any technical arguments arising from the fact that its client is not Finance II.

EVENTS LEADING TO THE ORDER FOR WHICH LEAVE TO APPEAL IS SOUGHT

25. On November 16, 2009, Stikemans was prepared to produce some documents but required McCarthy Tétrault to agree to restrictions on its use by analogy to the restrictions under the deemed undertaking rule, 30.1.01(3) of the Rules of Civil Procedure. McCarthy Tétrault was not prepared to agree to the restrictions put to McCarthy Tétrault that morning. Subsequently, the documents were provided under a protective order made in the US Chapter 11 proceedings of the Applicants which permits disclosure to counsel for the Fund Managers on a restricted basis.

26. McCarthy Tétrault objected to restrictions being placed on the production of documents that were supposed to be produced to them as if they were counsel for Finance II – the owner of those documents.

27. The parties returned before Justice Pepall for further direction on November 23, 2009.

28. At that time, McCarthy Tétrault advised it could not consent to the process suggested, namely purporting to represent Finance II against Finance II's own counsel, Stikemans, in a mock-trial exercise that, despite not affording the protections inherent in our legal system, would still be binding upon the parties.

29. However, Justice Pepall allowed the process to continue and granted an order (the “Order”) allowing Stikemans to represent Smurfit Canada and requiring McCarthy Tétrault to represent the interests of Finance II in the proposed motion. Justice Pepall also declined to appoint separate counsel for Finance II and directed as follows with respect to the motion scheduled for December 11, 2009:

- (a) “Mr. McElcheran’s clients shall have the identical interests and rights of Finance II for access to information.
- (b) There shall be no restrictions on communication of information to Mr. McElcheran’s clients.
- (c) The use of the information is for the motion on December 11, 2009.
- (d) These provisions plus items (e) and (f) apply equally to the Indenture Trustee. Any of these provisions plus items (e) and (f) may be amended by and are subject to further order of this court.
- (e) Mr. McElcheran will deliver to the Applicants a letter containing any additional information he requires.
- (f) The cross-examinations, if any, will take place by no later than December 4, 2009.”

IMPORTANT ISSUES FOR APPEAL

30. By this Order, Justice Pepall required the parties to follow a process whereby Stikemans will represent Smurfit Canada against another of its present clients, Finance II, in a motion in which those two parties are directly adverse in immediate interest.

31. This conflict, particularly with respect to the issue of whether Finance II has a creditor claim against Smurfit Canada, could not be clearer or more blatant. Stikemans will be representing one client in a matter directly adverse to another client and will have confidential information related to both. That is equivalent to Stikemans defending a \$200 million lawsuit brought by one client against another of its existing clients that Stikemans represents in a related case based on the very same facts, in which Stikemans has already gained privileged and confidential information.

32. The Supreme Court has been crystal clear in *R v. Neil*, 2002 SCC 70 (S.C.C.) (“*R v. Neil*”), among other cases, that a lawyer may not represent one client whose interests are directly adverse to the immediate interest of another current client where, as here, there is a substantial risk that the lawyer’s representation of the client would be materially and adversely affected by its duties to the other client.

33. The Supreme Court was equally clear in *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235, among other cases, that a lawyer who has relevant confidential information cannot act against his client or former client and that in such a case, disqualification is automatic.

34. The process allowed by the Order not only purports to allow Stikemans to represent Smurfit Canada, whose interests are directly adverse to the immediate interests of another current client, Finance II, but also it allows them to go one step further to represent the interests of one client by arguing *directly, specifically and knowingly against* the interests of another current client knowing of relevant confidential information from that client, having acted for that client in respect of the same or related issues.

35. Indeed, it is offensive to the basic principles of our adversarial system and the duties of counsel to its client, including the duty of loyalty, that Stikemans is permitted by the process to agree to act for one client over the other; to agree to represent Smurfit Canada against its current client Finance II and to advocate a procedure in which its client Finance II does not have its own counsel.

36. There is a substantial risk that Stikemans' ongoing representation of Finance II will be materially and adversely affected by its representation of Smurfit Canada and other Applicants.

37. There is also a risk that confidential information attributable to the lawyer client relationship between Stikemans and Finance II will be used, or even withheld, to the prejudice of Finance II in Stikemans' representation of Smurfit Canada as against the interests of Finance II.

38. Canadian jurisprudence is clear that such conflicts are unacceptable and cannot be allowed by consent or waived by the client unless the lawyer is able to represent each client without adversely affecting the other. In any event, it cannot be said that Finance II has or can waive the conflicts inherent in the circumstances of this case.

39. In this situation, Stikemans cannot act for either Smurfit Canada or Finance II on a motion to resolve the Characterization Issue, without offending basic conflicts principles.

40. This process effectively leaves Finance II unrepresented. Requiring McCarthy Tétrault, which already has clients in these proceedings, to represent "the interests of Finance II" for purposes of the motion is not a permitted substitute for representation of Finance II.

41. This is unfair to both the Fund Managers and their counsel. The Fund Managers are claimants in the estate of Finance II. While they are aligned in interest with Finance II with respect to issues surrounding the Intercompany Loan Agreement, the Fund Managers are still creditors of Finance II and may be adverse in interest to Finance II in the future. As such, it is inappropriate and prejudicial for counsel to the Fund Managers to be compelled to represent Finance II over the objections of both the Fund Managers and their counsel.

42. In addition, McCarthy Tétrault does not have clients from whom to take instruction at Finance II other than the conflicted directors, who would also be instructing opposing counsel, Stikemans, as counsel for Smurfit Canada.

43. Finally, the situation is extremely unfair to Finance II and its stakeholders, again contrary to the clear principles set out by the Supreme Court of Canada in *R v. Neil*. Finance II is entitled to entrust the management and conduct of its case to counsel who will act on its behalf, with loyalty and dedication.

44. Moreover, true counsel for Finance II would have unfettered access to the documents in the possession of Finance II, the unconditional right to advise its client as to remedies and rights that may arise from such documents and information, and the right to consult with its client and interview potential witnesses to the depth and extent deemed necessary by counsel.

45. In the process prescribed by the Order, McCarthy Tétrault will not have unfettered access to documents and persons. It will receive whatever documents the conflicted directors and conflicted counsel of Smurfit Canada deem appropriate to comply with the Order.

46. Similarly, McCarthy Tétrault will have access to potential witnesses only under the strictures of a cross-examination process in which there is a limited timeframe and in which Stikemans can object to questions asked and thereby limit the unfettered scope of questioning that true counsel to Finance II would have.

47. Moreover, McCarthy Tétrault is not privy to the background information to which its clients, if it truly had clients in this process, would be privy. As such, it is left to rely upon the documents and information provided by Stikemans or, at best, ask questions on cross-examination based on the limited information available to it in an effort to somehow gain insight into the background of the key facts at issue to which true counsel to Finance II would have immediately available to it.

48. In any event, despite the fact that all of the facts underlying the Characterization Issue have been known to the Applicants for some time – and that the Characterization Issue was only disclosed to the Fund Managers for the first time in response to the recent Conflicts Motion – the Applicants apparently took no steps to address this issue previously. Still, despite the lack of any previous efforts to disclose or resolve the Characterization Issue, Smurfit Canada now claims that the issue is urgent. On that basis, it sought and was granted an expedited schedule, with exceedingly short deadlines that do not provide sufficient time for any unconflicted counsel of Finance II to appropriately investigate and respond to the issues of which they have only recently become aware. The result is that the Order sacrifices due process for expedience, without justification.

49. Accordingly, the process ordered by Justice Pepall is entirely unworkable, unfair and contrary to the clear principles set out in the well-established conflicts law.

50. These points are of significance generally and of particular significance to insolvency practice in Ontario and the proceeding itself.

- (a) **Importance generally.** The matter is of general importance because the existing Order is contrary to the decision of the Supreme Court of Canada in *R v. Neil* and, as such, the Order cannot be allowed to stand unchallenged in the face of Supreme Court jurisprudence to the contrary.
- (b) **Importance for insolvency practice.** It is extremely important for insolvency practitioners to understand how to recognize and treat situations of conflict in a CCAA proceeding involving multiple applicants. In a case such as this where one applicant is directly adverse in interest to the other applicants, appellate guidance is required to ensure that individual CCAA applicants are adequately represented in accordance with established conflicts law.

The situation seen in this case, of direct and absolute conflict between members of the same corporate group, is unusual among CCAA proceedings; however, that absolute conflict arises out of the nature and use of Finance II, a ULC, in the corporate financing structure of the Smurfit Group. Given the prevalence of ULC financing vehicles in cross-border corporate groups (see for example *Re Calpine* where the ULC creditor claims were settled), it is becoming even more important to have this issue addressed by an appellate court to provide guidance to the insolvency practice facing such cases.
- (c) **Importance for this proceeding.** This appeal is extremely important to the representation of Finance II in these proceedings and with respect to the characterization of the Intercompany Loan in particular. At stake is a key asset for Finance II, its claims under the Intercompany Loan Agreement in the

principal amount of US\$200 million plus accrued interest, as well as its treatment generally in the Smurfit Canada plan of arrangement.

51. The appeal is *prima facie* meritorious. There are strong legal grounds for the appeal including that the process approved by Justice Pepall in the Order is directly contrary to the principles set out by the Supreme Court of Canada in *R v. Neil* and other leading jurisprudence with respect to a lawyer's duty of loyalty, fiduciary duties and conflicts of interest. This is a demonstrable error.

52. The appeal will not unduly hinder the progress of the proceeding. The Applicants already consented to the flawed process involving an exchange of documents, cross-examinations and a motion to determine the Characterization Issue, which was scheduled to take until at least mid-December. If necessary, the appeal process can be expedited.

53. The Moving Parties also rely upon:

- (a) Section 14 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended
- (b) Rule 61.03.1 of the *Rules of Civil Procedure*.
- (c) Such further and other grounds as counsel may advise and this Honourable Court may permit.

THE FOLLOWING DOCUMENTARY EVIDENCE WILL BE USED AT THE HEARING OF THE MOTION:

1. Relevant excerpts from the record before Justice Pepall; and

2. Such further and other evidence as counsel may advise and this Honourable Court may permit.

November 30, 2009

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AND TO: SERVICE LIST

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Proceeding commenced at Toronto

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