

**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

FACTUM OF THE RESPONDENTS

THE FACTS

1. On January 26, 2009, the Applicants, including Smurfit-Stone Container Canada, Inc. ("Smurfit Canada") and Stone Container Finance Company of Canada II ("Finance II"), were granted protection under the *Companies' Creditors Arrangement Act* (the "CCAA") pursuant to an initial order (the "Initial Order") made by this Court (the "CCAA Proceeding").
2. Finance II is an unlimited company formed under the laws of Nova Scotia (a "ULC").
3. Finance II is not an operating company and carries on no trade. The only assets of Finance II are claims it has against other Applicants or its US parent, Smurfit-Stone Container Enterprises, Inc. ("Enterprises").

4. Finance II's only disclosed obligations are the 7 3/8% Senior Notes due July 15, 2014 (the "Notes"), a potential unquantified tax claim and a claim of Enterprises in the amount of \$66 million.
5. Aurelius Capital Management, LP and Columbus Hill Capital Management, L.P. (the "Fund Managers") manage funds (the "Funds") that collectively own more than 60% of the Notes.
6. The Funds dispute that any amount is owing to Enterprises under its alleged claim.
7. All of the directors and officers of Finance II are also employees and/or officers or directors of other Applicants, including Smurfit Canada, the debtor of Finance II under a \$200 million Loan Agreement.
8. The interests of Finance II have been undermined for the benefit of the other Applicants and Enterprises because of the inherent conflicts between Finance II and Smurfit Canada as joint Applicants and because of the overlapping directors and officers with other Applicants including Smurfit Canada.
9. Without discussion with the Fund Managers, the Applicants have filed a draft Plan of Arrangement in the related US Chapter 11 bankruptcy proceedings (the "Plan"). The Plan makes clear that the assets of Smurfit Canada will be sold, that Finance II will receive nothing under the Plan and that Finance II is not entitled to vote on the Plan.
10. There is no plan to restructure Finance II nor have there been any efforts to do so with diligence or otherwise. The Plan provides benefits to holders of the Notes which they can access

only if they vote in favour of the Plan and are successful in contested litigation over the nature of Finance II's loan to Smurfit Canada (the "Characterization Issue").

11. In respect of the Characterization Issue, Smurfit Canada has brought a motion in these proceedings for a declaration that Finance II's claims against Smurfit Canada are not provable as debt claims and should be treated as equity for the purpose of the Plan (the "Characterization Motion"). No counsel has been appointed to represent Finance II in the Characterization Motion and Stikeman Elliott LLP ("Stikemans") continues to act as counsel for Smurfit Canada and Finance II.

12. In its role as counsel to the Applicants including both antagonists in the Characterization Motion, Stikemans was responsible for investigating the facts and circumstances of the Characterization Issue and providing Fund Managers' counsel with all documents and information that may be relevant to the dispute, as per Judge Pepall's order of November 23, 2009. As counsel for Finance II, before commencing the proceedings to attack its debt claim, Stikemans should have made the same inquiries as unconflicted counsel for Finance II would have made in order to assert its claims under the Loan Agreement.

13. The failure to properly investigate and the refusal to provide information and access to information that was available to Finance II at the time of the issuance of the Notes are indicative of a failure to properly respect and pursue the position of Finance II in this restructuring.

14. The Plan put forward by the Applicants seems to be designed to eradicate the influence of Finance II and its stakeholders in the plan process.

THE ISSUES

15. The issue raised in this motion is whether the Stay should be extended for the Applicants.

THE LAW

Each Debtor Company Must Qualify for a Stay Extension Separately

16. Section 11.02(2) permits a court, on an application *in respect of a debtor company*, make an order staying all proceedings taken in respect of *that company*. The Court shall not make such an order unless the applicant satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence, and that circumstances exist to make the order appropriate.¹

17. Where the interests of different creditors of various corporate entities come into play, the courts should be careful to respect the principle regarding separate corporate existence articulated by the House of Lords in *Salomon v. A. Salomon & Co.*, [1897] A.C. 22 (U.K. H.L.).²

18. This principle was underscored in *Re. Polly Peck International Plc (In Administration) (No. 4)*,³ a case with similar facts to the case at bar. In *Polly Peck*, a special purpose subsidiary ("PPIF") had been used as a financial vehicle for the raising of funds for a large multi-national group of companies (the "PPI Group") through a series of bond issues. These funds were "on-loaned" from PPIF to the parent ("PPI"). Later, both the parent company and the special purpose subsidiary became insolvent. PPIF's liquidators submitted a claim against PPI for the sums on-loaned. PPI's counsel argued that PPIF, as a special purpose subsidiary, had no separate corporate existence and was in effect an agent or nominee of the parent, or, that it was a mere

¹ Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 at s. 11

² *Re. Olympia & York Developments Ltd.* (1998), 4 C.B.R. (4th) 189 (Ont. Gen. Div.) at para. 27

³ [1996] 2 All E.R. 433; [1996] B.C.C. 486; [1996] 1 B.C.L.C. 428

façade. It was further argued that in the context of insolvency, a closely-integrated group of companies should be considered as a single economic unit. Robert Walker J. rejected these arguments on the basis of *Salomon v. A. Salomon & Co.*, stating that the Court was not justified in disregarding the separate corporate existence of the PPIF, and reiterating that “the separate legal existence of group companies is particularly important when creditors become involved.”⁴

19. In accordance with the *Salomon* principle, for the Stay to be extended for Finance II, that company must, as a separate corporation, satisfy the court that it has acted, and is acting, in good faith and with due diligence.

Good Faith is a Prerequisite for a Stay Extension

20. CCAA s. 11.02(b) provides that the Court shall make a stay extension order only if the applicant satisfies the court that the applicant has acted, and is acting, in *good faith*.

21. “Good faith”, according to *Black’s Law Dictionary* means:

A state of mind consisting of: (1) honesty in belief or purpose, (2) faithfulness to one’s duty or obligation, (3) observance of reasonable commercial standards of fair dealings in a given trade or business, or (4) absence of intent to defraud or seek unconscionable advantage.⁵ (emphasis added)

22. It is impossible for the Applicants to have been faithful to their duties and obligations due to the inherent conflicts between Finance II and Smurfit Canada and the overlapping directors, officers, and counsel those companies share.

23. Given the lack of any effort to avoid these conflicts, and the resulting unconscionable plan of arrangement, it is difficult to see how Finance II could establish its good faith and due diligence.

⁴ *Polly Peck, supra*, at p. 448

⁵ *Black’s Law Dictionary*, 7th ed. (St. Paul, Minnesota: West Group, 1999), p. 701.

Stay Should not be Extended if There Is No Serious Possibility of a Successful Restructuring

24. A stay of proceedings freezes the rights of creditors, and should only be granted in furtherance of the CCAA's fundamental purpose.⁶ Accordingly, one factor to be considered in the context of s. 11(6) is whether the attempt to reach a compromise is realistic or whether it is doomed to failure.⁷

25. The Funds are owners of more than 60% of the Notes issued by Finance II and thus have a veto over any plan of arrangement that may be filed by Finance II. Despite this, the Plan filed by the Applicants provides for the assets of Smurfit Canada to be sold and nothing to be received by Finance II.

26. It is clear that the Funds could never support such a plan, and that the Applicants have no intention of reaching a compromise with the Funds. Accordingly, the Plan as it relates to Finance II is doomed to failure.

27. This factor should be considered under s. 11(6) and the stay of proceedings for Finance II should not be extended.

ORDER SOUGHT

28. The Respondents therefore submit that an extension of the Stay of Proceedings should not be granted.

⁶ *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*, 2008 CarswellBC 1758 at para. 26 (C.A.)

⁷ *Re. Hunters Trailer & Marine Ltd.*, 2000 ABQB 952 at para. 20-1; *Starcom International Optics Corp.*, Re (1998), 3 C.B.R. (4th) 177 (B.C. S.C. [In Chambers]) at p. 184, para. 22.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

December 10, 2009

McCarthy Tétrault LLP

Suite 5300, Toronto Dominion Bank Tower
Toronto ON M5K 1E6

Kevin McElcheran LSUC# 22119H

Tel. (416) 601-7730

Fax: (416) 868-0673

Malcolm Mercer LSUC# 23812W

Tel: (416) 601-7659

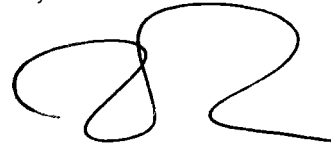
Fax: (416) 868-0673

Heather L. Meredith LSUC# 48354R

Tel: (416) 601-8342

Fax: (416) 868-0673

Lawyers for the Respondents, Aurelius Capital
Management, LP and Columbus Hill Capital
Management, L.P.

A handwritten signature in black ink, consisting of a large, stylized 'R' followed by a horizontal line extending to the right.

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36
AND IN THE MATTER OF THE BANKRUPTCY AND INSOLVENCY ACT, R.S.C. 1985, c. B-3 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"

Court of Appeal Court File No. M-38251
Court File No. CV-09-7966-00CL

ONTARIO

**SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceeding commenced at Toronto

FACTUM OF THE RESPONDENTS

McCarthy Tétrault LLP

Suite 5300, Toronto Dominion Bank Tower
Toronto ON M5K 1E6

Kevin McElcheran LSUC# 22119H

Tel: (416) 601-7730

Fax: (416) 868-0673

Malcolm M. Mercer LSUC#: 23812W

Tel: (416) 601-7659

Fax: (416) 868-0673

Heather L. Meredith LSUC# 48354R

Tel: (416) 601-8342

Fax: (416) 868-0673

Lawyers for the Respondents, Aurelius Capital
Management, LP and Columbus Hill Capital
Management, L.P.