

**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 OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF  
SMURFIT-STONE CONTAINER CORPORATION, *et al***

**(Returnable December 11, 2009)**

Dated: December 10, 2009

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**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"**

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**PART I: OVERVIEW**

1. In July 2004, Stone Container Finance Company of Canada ("**Finance II**"), a special purpose financing vehicle, issued US\$200 million 7.375% Senior Notes due 2014 (the "**Senior Notes**") as part of a complex refinancing transaction of the Smurfit Group (as defined herein).
2. Immediately thereafter, Finance II advanced US\$200 million to Smurfit-Stone Container Canada Inc. ("**SSC Canada**") on an unsecured basis pursuant to a "Loan Agreement" (as defined in the Applicants' Factum).
3. On January 26, 2009, an Event of Default occurred under the Loan Agreement upon SSC Canada's filing under the *Companies' Creditors Arrangement Act*, R.S.C. c. C-36, as amended ("**CCAA**").
4. The terms of the Loan Agreement are clear and unambiguous that upon an Event of Default resulting from an insolvency, Finance II may only be repaid through the issuance of Class B Shares of SSC Canada.
5. The Applicants have brought this motion for directions regarding the nature of any intercompany claim of Finance II against SSC Canada as at the date of the Event of Default.

6. The terms of the Loan Agreement are clear and unambiguous that the advance was intended to be an equity investment in the event of insolvency. They direct that upon the insolvency of SSC Canada, all interest payments and principal repayments to Finance II are to be made exclusively by the issuance of shares, not by cash. These shares carry ordinary characteristics consistent with equity ownership.

7. To the extent there is any ambiguity in the clear words of the Loan Agreement, the surrounding commercial circumstances confirm that the claim is an equity interest. None of the various documents related to the refinancing transaction (the "**Financing Documents**") made any mention of the advance of funds by Finance II to SSC Canada. Nor did the Financing Documents mention any potential debt claim Finance II may have against SSC Canada.

8. Furthermore, whether Finance II's claim against SSC Canada is in the nature of equity or debt, the quantum of the provable claim is \$0.

9. If the claim is in the nature of equity, Canadian Courts have consistently held that equity claims are subordinate to the claims of all creditors.

10. If, in the alternative, the claim is determined to be in the nature of debt, SSC Canada may only satisfy the claim with the issuance of Class B Shares, which have no value.

11. Therefore, a declaration by this Court that Finance II's intercompany claim has value that ranks *pari passu* with the claims of unsecured creditors would place the creditors of Finance II in a position that was never contemplated by those creditors, Finance II, SSC Canada, or any other stakeholder. It would also prejudice all other unsecured creditors in these proceedings, including the Official Committee of Unsecured Creditors of Smurfit-Stone Container Corporation, *et al* (the "UCC").

## PART II: FACTS

### *Parties*

12. Finance II is a wholly owned subsidiary of Smurfit-Stone Container Enterprises Inc. ("SSCE"<sup>1</sup>, and collectively with all its subsidiaries, the "**Smurfit Group**").<sup>2</sup> Finance II is a special purpose financing vehicle that was used to finance certain Canadian operations of the Smurfit Group.

13. SSC Canada is also a wholly owned subsidiary of SSCE and is part of the Smurfit Group.

14. On January 26, 2009, the Applicants applied for, and obtained protection from their creditors pursuant to the CCAA pursuant to an order of this Court, as subsequently amended and restated.<sup>3</sup> Finance II and SSC Canada are among the Applicants in these proceedings.

15. The UCC has been appointed in the Chapter 11 proceedings of the Smurfit Group (which includes all of the CCAA Applicants) and has standing in these proceedings pursuant to an Order of this Court dated March 12, 2009 approving the Cross-Border Protocol.

### *Refinancing Transaction*

16. In regards to all elements applicable to this motion, the UCC adopts the facts as set out in the Applicants' Factum, with the following additions.

17. The underwriter of the Senior Notes, Morgan Stanley, prepared a summary thereof (the "**Greensheet**") which specifically referenced "Key Selling Points" and "Potential Investor Concerns".<sup>4</sup>

18. Nothing in the Greensheet suggests that the holders of the Senior Notes would have any claim against anyone other than Finance II or SSCE. In fact, in the section entitled "Potential Investor Concerns", the Greensheet states that "[Finance II] is a Holding Company with No Assets. As an SPE [special purpose entity], [Finance II] may present a higher degree of risk for

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<sup>1</sup> SSCE is the successor by amalgamation to Smurfit Container Corporation. The two companies are referred to interchangeably herein.

<sup>2</sup> Affidavit of Melissa Paz, sworn December 2, 2009 (the "Paz Affidavit"), Applicants' Motion Record, Tab 2, p. 11, para 6.

<sup>3</sup> Paz Affidavit, Applicants' Motion Record, Tab 2, p. 10, para. 3.

<sup>4</sup> Paz Affidavit, Applicants' Motion Record, Tab 21.

bond holders than does parent [SSCE]. [Finance II] enjoys a parent guarantee on a senior basis and will, as a result rank *pari passu* with existing [SSCE] Senior Notes."<sup>5</sup>

19. Also, as detailed at paragraph 19 of the Applicants' Factum, the Class B Shares carry certain dividend and liquidation rights that are calculated based on a term called the "Class B Amount".<sup>6</sup>

20. The Class B Amount, a term that is defined in SSC Canada's Memorandum of Association (the "**Memorandum of Association**"), is a notional accounting of the consideration received by SSC Canada for the issuance of the Class B Shares and corresponds with the amount that SSC Canada would record on its books as equity with respect to any Class B Shares issued. Its calculation is critical in order to quantify the dividend and liquidation rights of the Class B Share holders, as illustrated by the description of those rights in the Applicants' Factum. As a notional amount, it is not intended to represent the true value of the shares.<sup>7</sup>

### **PART III: ISSUES**

21. There are two issues before the court: (i) As at January 26, 2009, was Finance II's intercompany claim against SSC Canada equity or debt?; and, (ii) What is the quantum of the claim?

### **PART IV: LAW AND ARGUMENT**

#### ***The Intercompany Claim is Equity***

22. The critical issue to be determined on this motion is whether the advance is to be treated as equity as at the date of SSC Canada's filing under the CCAA on January 26, 2009.

23. When determining whether an advance should be classified as equity or debt, the Court must determine the intention of the parties having regard primarily for the wording used, and where that is not determinative, for the surrounding circumstances:

This task... depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a

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<sup>5</sup> Paz Affidavit, Applicants' Motion Record, Tab 2I, p. 395.

<sup>6</sup> Applicants' Factum, pp. 10-11, para. 19.

<sup>7</sup> Paz Affidavit, Applicants' Motion Record, Tab 2J, p. 402, para. 2(g).

conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required a consideration of admissible surrounding circumstances may be appropriate.<sup>8</sup>

24. The parties for the Loan Agreement clearly turned their minds to the issue, and chose to treat the advance as equity. Whether the advance was debt or equity prior to the event of insolvency is not relevant to the determination of this motion. A claim provable in a CCAA proceeding is determined as at the date of the filing.<sup>9</sup>

*The Loan Agreement Demonstrates Intention of an Equity Investment Upon Insolvency*

25. The Loan Agreement is clear and sets out in unambiguous language that the advance was intended to be treated as equity in the event of insolvency.

26. Section 7.2 of the Loan Agreement demonstrates that the intention of the parties was that if an Event of Default occurs as a result of an insolvency proceeding pursuant to section 6.3, the advance is to be treated as equity. Section 7.2 explicitly eliminates any obligation of SSC Canada to make a cash payment to Finance II.<sup>10</sup>

27. Upon the Event of Default, the only entitlement Finance II had was the issuance of shares by SSC Canada. Therefore, the only interest Finance II had on the date of filing was an equity interest.

28. The Class B Shares that Finance II became entitled to pursuant to section 7.2 of the Loan Agreement would only be issued upon the occurrence of an Event of Default (i.e. insolvency), and in addition to plainly being equity, carry ordinary characteristics which are consistent with equity ownership. The Class B Shares entitle the holders thereof to vote at all meetings of shareholders of SSC Canada and carry a redemption right for SSC Canada, both common features of equity interests.<sup>11</sup>

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<sup>8</sup> *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 ("*Canada Deposit Insurance Corp.*"), Applicants' Brief of Authorities, Tab 2, p. 588.

<sup>9</sup> *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 121(1); *Central Capital Corp., Re* (1996), 38 C.B.R. (3d) 1 (sub nom. *Royal Bank v. Central Capital Corp.*) (Ont. C.A.) ("*Central Capital Corp.*"), Applicants' Brief of Authorities, Tab 1, para. 67.

<sup>10</sup> Paz Affidavit, Applicants' Motion Record, Tab 2E, p. 177, para. 7.2.

<sup>11</sup> Paz Affidavit, Applicants' Motion Record, Tab 2J, pp. 400-402, para. 2.

*The Surrounding Circumstances are also Consistent with an Equity Investment*

29. It is appropriate to consider the surrounding commercial circumstances surrounding the Loan Agreement only to the extent there is any ambiguity in the Loan Agreement.<sup>12</sup>

30. However, the surrounding commercial circumstances, including the Financing Documents, are consistent with the interpretation that the claim was to be treated as equity.

31. There is no support in any of the Financing Documents that any party intended for a debt claim to be made against SSC Canada by Finance II. There is not a single reference to any claim against SSC Canada in any of the Financing Documents, nor is there financial information with respect to SSC Canada in the Offering Memorandum. The Financing Documents do not even mention the advance of funds to SSC Canada.<sup>13</sup>

32. In fact, when the Financing Documents are read together, it is evident that payment to Finance II was always intended to be funded in all respects by SSCE, not by SSC Canada.<sup>14</sup>

*Any Indicia of Debt are Incidental or Secondary in Nature*

33. In *Canada Deposit Insurance Corp.*, The Supreme Court of Canada held that "When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement."<sup>15</sup>

34. Although it is true that the document governing the advance is titled a "Loan Agreement", the true substance of the advance is plainly in the nature of equity. The title of the document is merely incidental or secondary in nature.

35. Further, the fact that the Loan Agreement was characterized by Finance II as debt for accounting and tax purposes is not determinative of the true characterization of the advance. In fact, the characterization of the advance prior to January 26, 2009 is entirely irrelevant given the fundamental change in the nature of Finance II's interest as a result of section 7.2 of the Loan Agreement on an event of insolvency.

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<sup>12</sup> *Canadian Deposit Insurance Corp.*, Applicants' Brief of Authorities, Tab 2, p. 588.

<sup>13</sup> Applicants' Factum, paras. 2, 6 and 12.

<sup>14</sup> Applicants' Factum, p. 20, para. 37.

<sup>15</sup> *Canadian Deposit Insurance Corp.*, Applicants' Brief of Authorities, Tab 2, p. 590.

***The Value of the Claim is \$0***

36. Regardless of whether the claim is classified as equity or debt, the claim's value is \$0.

***Equity Claim***

37. Section 2(1) of the CCAA provides that a "claim" for the purposes of the CCAA "means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* (the "BIA")."<sup>16</sup>

38. Section 121(1) of the BIA defines a "debt provable in bankruptcy". A debt provable in bankruptcy is defined as:

All debts and liabilities, present and future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge...<sup>17</sup>

39. An equity claim as at the time of the insolvency is not a debt provable in bankruptcy within the meaning of the BIA. According to the Ontario Court of Appeal, "On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies."<sup>18</sup>

40. Therefore, the equity interest held by Finance II should rank below the claims of all unsecured creditors, resulting in a value of \$0. It would be prejudicial to all unsecured creditors if Finance II's equity claim was permitted to rank *pari passu* with the claims of unsecured creditors.

41. Further, it would grant the holders of the Senior Notes a claim which could have been anticipated when the Senior Notes were originally issued, but was not bargained for. The Financing Documents contemplated the presence of a guarantee by SSCE – it is clear that this financing was "sold" as an SSCE credit investment. The Financing Documents also contemplated that the funds advanced would be used to satisfy inter-company indebtedness. The

<sup>16</sup> *Companies' Creditors Arrangement Act*, R.S., 1985, c. C-36, s. 2(1).

<sup>17</sup> *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 121(1).

<sup>18</sup> *Central Capital Corp.*, Applicants' Brief of Authorities, Tab 1, para. 149.

Financing Documents did not, however, contemplate any potential claim against SSC Canada or include any covenants or protections to create such a claim. None of the Financing Documents even mentioned that the funds would be advanced to SSC Canada.<sup>19</sup>

42. The Court should not now re-write the contract to favour Finance II and the holders of the Senior Notes.

*Debt Claim*

43. An Event of Default occurred upon SSC Canada's CCAA filing. As a result, SSC Canada "... shall perform its obligations... by the issuance to [Finance II] of Class B Shares..." [*emphasis added*].<sup>20</sup>

44. It is clear that the Loan Agreement precludes SSC Canada from making any payment to Finance II in cash; any payments must now be in the form of Class B Shares (which, in accordance with the Memorandum of Association, can only be issued upon an Event of Default – i.e. upon the insolvency of SSC Canada).

45. Therefore, given that any debt claim Finance II might have against SSC Canada is only payable in shares, the quantum of the claim is the value of the shares.

46. Finance II may believe that the words "Class B Shares having a value of no less than the dividend or other amount that otherwise would be received by the Lender"<sup>21</sup> in section 7.2 of the Loan Agreement suggest that the shares must have some value. However, when read together with the provisions of the Memorandum of Association, that is clearly not the case.

47. In order for SSC Canada to calculate dividend payments and liquidation rights, there is a notional concept called the "Class B Amount" defined at paragraph 2(g) of the Memorandum of Association.<sup>22</sup> The determination of the Class B Amount therefore impacts various rights and entitlements of the Class B Share holders.

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<sup>19</sup> Applicants' Factum, p. 2, para. 2.

<sup>20</sup> Paz Affidavit, Applicants' Motion Record, Tab 2E, p. 177, para. 7.2.

<sup>21</sup> Paz Affidavit, Applicants' Motion Record, Tab 2E, p. 177, para. 7.2.

<sup>22</sup> Paz Affidavit, Applicants' Motion Record, Tab 2J, p. 402, para. 2(g).

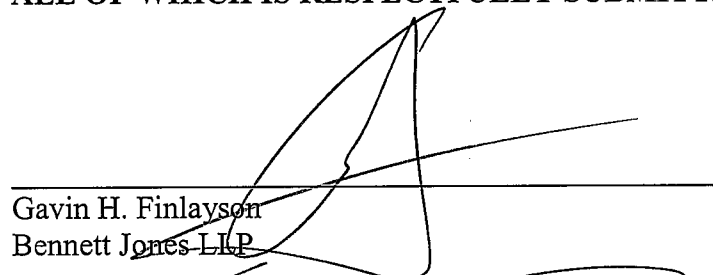
48. When the Loan Agreement and the Memorandum of Association together are read together, it is clear that "having a value" simply means "having a Class B Amount". The words "Class B Shares having a value of no less than the dividend or other amount that otherwise would be received by the Lender" do not guarantee Finance II a minimum value on the shares received from SSC Canada. Rather, the words assist in establishing the Class B Amount, a concept that is necessary in order to calculate dividend payments, and liquidation rights.

49. The wording of section 7.2 simply sets the notional Class B Amount; it does not guarantee that the shares will have any economic value.


50. Accordingly, if Finance II does in fact have a "debt" claim, that claim has a value of \$0.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED.**

Date: December 10, 2009



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**SCHEDULE "A"**

**LIST OF AUTHORITIES**

1. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558
2. *Central Capital Corp., Re* (1996), 38 C.B.R. (3d) 1 (sub nom. *Royal Bank v. Central Capital Corp.*) (Ont. C.A.)

**SCHEDULE "B"**

**RELEVANT STATUTES**

Section 121(1), *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankruptcy becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

Section 2(1), *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36

2(1) "claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the Bankruptcy and Insolvency Act;

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"

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

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(Commercial List)**

Proceeding commenced at Toronto

**FACTUM OF THE OFFICIAL COMMITTEE OF  
UNSECURED CREDITORS OF SMURFIT-  
STONE CONTAINER CORPORATION, ET AL**  
(Returnable December 11, 2009)

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