CANADA
PROVINCE OF **QUEBEC**
DISTRICT OF **MONTREAL**

File No: **500-11-036133-094**

SUPERIOR COURT
Commercial Division
(sitting as the court designated pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended)

IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF:

ABITIBIBOWATER INC.

- and -

ABITIBI-CONSOLIDATED INC.

- and -

BOWATER CANADIAN HOLDINGS INC.

- and -

the other Petitioners listed on Appendices A,B and C

Petitioners

- and -

ERNST & YOUNG INC.

Monitor

- and -

THE AD HOC UNSECURED NOTEHOLDER COMMITTEE OF ABITIBIBOWATER INC. AND CERTAIN OF ITS AFFILIATES

Respondent

OUTLINE OF ARGUMENT OF THE AD HOC UNSECURED NOTEHOLDER COMMITTEE OF ABITIBIBOWATER INC. AND CERTAIN OF ITS AFFILIATES IN RESPONSE TO PETITIONERS' MOTION TO APPROVE A DIP FUNDING AGREEMENT AND A $200 MILLION DISTRIBUTION TO SENIOR SECURED NOTEHOLDERS

IN *SUPPORT* OF THE PETITIONERS' MOTION TO APPROVE A DIP FUNDING AGREEMENT AND IN *OPPOSITION* TO PETITIONERS' MOTION TO APPROVE A $200 MILLION DISTRIBUTION TO SENIOR SECURED NOTEHOLDERS, THE AD HOC UNSECURED NOTEHOLDER COMMITTEE OF ABITIBIBOWATER INC. AND CERTAIN OF ITS AFFILIATES (THE "AD HOC COMMITTEE") SUBMITS THE FOLLOWING:

A. THE PETITION

1. By Amended Motion dated October 28, 2009, the Petitioners seek Orders of this Honourable Court:

   (a) approving the proposed $230 million ULC DIP Facility[1] and making amendments to the Initial Order to better give effect thereto; and

   (b) approving a $200 million distribution to the Senior Secured Noteholders.

2. The Ad Hoc Committee respectfully supports the approval of the ULC DIP Facility on additional terms set out below and it respectfully opposes the making of the Proposed Senior Secured Noteholder Distribution at this time. The Petitioners and the Monitor outline the Petitioners' need for the DIP Facility based upon, among other things, the current difficult market conditions facing the Petitioners, the high degree of variability of the Petitioners' liquidity needs, the high risk of variability of financial forecasts and the potentially negative results if the Petitioners do not have a sufficient liquidity cushion. Given the Petitioners' need for liquidity, the proposed payment of substantial proceeds to one group of creditors raises important issues of both propriety and timing and brings into

[1] Capitalized terms used herein are defined in the Petitioners' Amended Motion dated October 28, 2009 or the Nineteenth Report of the Monitor dated October 27, 2009.

focus the need for this CCAA process to move forward efficiently and effectively toward the goal of the timely negotiation and implementation of a plan of arrangement that is acceptable to the creditors and is sanctioned by this Honourable Court.

3. It is submitted that the Proposed Senior Secured Noteholder Distribution violates the CCAA. Nothing in the statute authorizes a distribution of cash to a creditor group prior to approval of a plan of compromise or arrangement by the requisite majorities of creditors and this Honourable Court. By proposing a distribution to one class of creditors, the Petitioners deny to the other classes of creditors the ability to negotiate a compromise with the Senior Secured Noteholders. They are immunizing one class of creditors from the exercise of the very bargaining leverage required by the statute. Instead of bringing forward their proposed plan and creating options for the creditors for negotiation and voting purposes, they are eliminating bargaining options and confiscating the other creditors' leverage and voting rights. Courts routinely approve asset sale transactions in CCAA cases on the basis that the creditors will retain the right to vote on the distribution of the proceeds of sale. By distributing the proceeds, however, the Petitioners diminish their patrimony without the requisite approvals of the creditors or the statutory sanction of a plan of compromise or arrangement by this Honourable Court required under the CCAA.

4. In its 19th Report, the Monitor recommends that this Honourable Court approve the ULC DIP. It makes no such recommendation in respect of the Proposed Senior Secured Noteholder Distribution. The division of the assets of the CCAA debtor is not a matter for the Monitor, but is a matter for inter-creditor negotiations and a plan of arrangement or compromise. The Monitor reports, expressly, that the Petitioners bargained to obtain the support of the Senior Secured Noteholders for the ULC DIP by agreeing to the Proposed Senior Secured Noteholder Distribution. In doing so, the Petitioners bargained with the other creditors' currency. This has left the Petitioners in the incongruous position of pleading for a DIP loan on the basis of their dire need for liquidity but then

proposing to use as much as $65 million of borrowed ULC DIP funds to pay a distribution to a single creditor group. Borrowing for distributions is not the role of a DIP loan but, rather, is done by way of exit financing after the creditors and the Court have approved a plan of arrangement or compromise. The Court exercises its extraordinary authority to grant super-priority DIP charges to create options and protect a debtor's ability to survive during the period of the CCAA stay so that the debtor can propose a plan in the interests of all stakeholders. The Court respectfully ought not to exercise its authority to grant extraordinary DIP relief to enable a debtor to distribute funds to a single creditor group in the absence of an approved plan of arrangement or compromise or the consent of all parties.

5. The Ad Hoc Committee submits that this cross-border CCAA proceeding involves complex corporate structures and equally complex relationships among a number of creditor groups. The goal of the proceeding is to enable the Petitioners to complete a restructuring that is acceptable to the creditors and this Honourable Court for the benefit of all stakeholders. It is clear from the Petitioners' statements throughout and the analysis of asset values contained in the Monitor's 19th Report, that the Senior Secured Noteholders and the Term Lenders will both likely be substantially re-paid upon implementation of a refinancing or restructuring of the Petitioners. They have no need to focus on anything other than their own short term repayment goals. In Canada, it is the Ad Hoc Committee and the Petitioners themselves who have a real stake in the longer term health and stability of the Petitioners in the interest of all of the other stakeholders who rely on the Petitioners survival and upon their successful emergence from these proceedings.

6. To best achieve the goal of a successful restructuring, the Petitioners need to proceed efficiently and effectively toward proposing and negotiating a plan of compromise or arrangement that will enable it to emerge from these proceedings and will deal with all of the stakeholders' rights and distributions. The request for the Senior Secured Noteholder Distribution is premature. The Monitor notes the

many issues of instability that still compel the Petitioners to require an extraordinary DIP Facility. In order to best support the interests of all stakeholders, in the complex structure of this cross-border enterprise, the Ad Hoc Committee submits that the Petitioners should proceed as quickly as possible toward the presentation of a business plan and term sheet to allow the CCAA process to move forward efficiently and effectively. Once a plan is proposed, negotiations can commence between those with short term needs and those with longer term goals and across the border as necessary, so that the final basis for the recapitalization of the Petitioners can be agreed upon and brought forward under the statute.

B. THE AD HOC COMMITTEE'S POSITION

7. The Ad Hoc Committee is acknowledged by the Petitioners to represent the interests of the vast bulk of unsecured creditors of the Petitioners. The Ad Hoc Committee supports the Petitioners' efforts to restructure in these proceedings and expects its members to be the owners of the Petitioners at the end of the day.

8. The Ad Hoc Committee supports the granting of the Orders sought to enable the Petitioners to enter into the ULC DIP Facility generally and has proposed to the Petitioners certain additional provisions which it seeks by way of Order of this Honourable Court to ensure that these proceedings move quickly toward a conclusion of these proceedings in the interests of all stakeholders. In supporting the requested ULC DIP, the Ad Hoc Committee also respectfully requests that this Honourbale Court do so on the following conditions to assist in focusing the parties on the need to proceed efficiently and effectively toward the Petitioners' emergence from CCAA protection:

(a) That the Proposed Senior Secured Noteholder Distribution not be considered until after the creditors have had an opportunity to negotiate a plan of compromise or arrangement with the Senior Secured Noteholders;

(b) That the approval of the Petitioners' entry in to the ULC DIP Agreement be made subject to the remaining terms of the proposed Order;

(c) That the Petitioners comply with the terms and conditions set forth in the ULC DIP Documents and the 13 week cash flow forecast (the "Budget"), as provided to the financial advisors to the Ad Hoc Unsecured Noteholder Committee;

(d) That in accordance with the terms and conditions of the ULC DIP Documents, the Petitioners shall use the proceeds of the ULC DIP Facility in material compliance with the Budget. The Monitor will monitor the ongoing disbursements of the Petitioners under the Budget and shall forthwith advise the legal and financial advisors to Ad Hoc Unsecured Noteholder Committee of the Monitor's understanding of any pending or anticipated substantial non-compliance with the Budget and/or any other pending or anticipated event of default or termination event under any of the ULC DIP Documents;

(e) That the Petitioners provide a business plan to the legal and financial advisors to Ad Hoc Unsecured Noteholder Committee by no later than 5:00 p.m. (Montreal time) on November 6, 2009;

(f) That the Petitioners provide a restructuring and recapitalization term sheet (the "Recapitalization Term Sheet") on terms acceptable to the Ad Hoc Unsecured Noteholder Committee, to the legal and financial advisors to the Ad Hoc Unsecured Noteholder Committee by no later than 5:00 p.m. (Montreal time) on December 11, 2009;

(g) That paragraph 88(b) of the Amended Motion be amended to read, "notwithstanding the terms of paragraphs 10 and 11 of the <u>Initial Order,</u> upon the occurrence of an <u>Event of Default or</u> a Termination Event...";

(h) That paragraph 91 of the Amended Motion be amended to read, "**ORDER** that the ULC DIP Lender shall not take any enforcement steps under the

ULC DIP Documents or the ACI DIP Charge without further order of this Court"; and

(i) That the Ad Hoc Unsecured Noteholder Committee be added to the list of stakeholders entitled to receive notice under paragraph 92 of the Amended Motion.

C. THE PETITIONERS NEED FOR LIQUIDITY

9. The Monitor and the Petitioners have presented substantial reasons to support the Petitioners need for liquidity by way of a DIP loan including, without limitation:

(a) The Petitioners' "high risk of default" under it securitization program absent a DIP loan; (Monitor's 19th Report at paragraph 32);

(b) The Petitioners have yet to complete their business plan and it is premature to predict the length of these proceedings; (Monitor's 19th Report at paragraphs 47 and 48);

(c) The ULC DIP is forecast to provide a cushion of liquidity above the Petitioners' requirements for its securitization program, but with adverse exchange rate fluctuations and further adverse price declines in the market, the Petitioners' liquidity could be insufficient to meet the requirements of its securitization program. The Monitor expressly cautions that given the length of time at issue and the number of uncontrollable factors at play, "...any forecast with such a time horizon is subject to significant variability"; (Monitor's 19th Report at paragraphs 49, 50 and chart at paragraph 61);

Despite Petitioners' best efforts at forecasting, the Monitor notes that weekly cash flow forecasts have varied by as much as $26 million; each 1¢ variation in the foreign exchange rate as against the US dollar could produce a $17 million negative cash flow variation; and the Petitioners ultimate cash flow requirements will be highly dependent on variables that they cannot control. Weekly disbursements have varied by 100% (US$33 million to US$65 million); (Monitor's 19th Report at paragraphs 54, 60 and 61; Amended Motion at paragraph 44));

(d) The market decline has eroded the Petitioners' liquidity; foreign exchange fluctuations are placing further strain on the Petitioners' liquidity; and even if prices increase, the resulting need for additional working capital to increase production will paradoxically put yet further strain on the Petitioners' liquidity; (Amended Motion at paragraphs 39 and 47);

(e) Without the ULC DIP Facility, the Petitioners would lack access to sufficient operating credit to maintain normal operations; they would be significantly impaired in their ability to operate in the ordinary course; and they would face an increase in the risk of unexpected interruptions. (Amended Motion at paragraph 63); and

(f) The Monitor concludes that based upon its sensitivity analysis, the inter-month variability of the Petitioners' cash flows, the minimum liquidity requirements under the securitization program, and the requirement to repay the ACI DIP, the Petitioners "**need the new ULC DIP Facility to ensure that ACI has sufficient liquidity to complete its restructuring**". (Monitor's 19th Report at paragraph 123) [emphasis added]

10. The Petitioners' need for liquidity is thus well explained and supports extraordinary relief of a DIP Charge in the submission of the Ad Hoc Committee. The borrowing and extraordinary charge are required to preserve and protect the Petitioners' undertaking and operations pending the delivery and approval of a restructuring plan. Therefore, the Ad Hoc Committee submits that the Petitioners have met the tests for the granting of a DIP charge and it has proposed conditions above to attempt to help focus and speed up the process to focus the parties on obtaining the earliest agreement and implementation of a plan of arrangement or compromise in the interests of the Petitioners and all stakeholders.

D. THE PROPOSED SENIOR SECURED NOTEHOLDER DISTRIBUTION

11. Having acknowledged the serious risks that face the Petitioners to support the need for substantial borrowing on an extraordinary DIP charge basis to protect the survival of the business while under CCAA protection, it is contradictory to utilize the Petitioners' cash and a significant portion of its propose DIP Facility to make a distribution of $200 million to a single creditor group.

12. The Senior Secured Noteholders are subject to a stay like all other creditors. Nothing in the CCAA authorizes an interim distribution to creditors before the conduct of a claims process and the implementation of an approved plan. Aspects of the claims of the Senior Secured Noteholders are disputed by the Petitioners. That is, there are negotiations that have yet to occur. The proposed payment utilizes DIP funding to favour one creditor group and reduces the liquidity cushion which the Petitioners need.

13. The Monitor notes that interest savings of $27 million per month may be available by re-paying the Senior Secured Noteholders now. Interest savings could also be achieved by repaying other creditors now. Other savings may be available through negotiations. As noted above, at a time when the Petitioners find themselves in need of liquidity to the degree demonstrated by the Petitioners and the Monitor, it is premature at best to consider making distributions to creditors. That is the role of the plan of compromise and the Ad Hoc Committee therefore seeks to assist the Petitioners to move as quickly as possible towards presentation of a plan in the interests of all stakeholders including those with shorter term and longer term horizons.

14. Rather than leaving the creditors to negotiate the terms of an acceptable distribution plan among themselves, the Petitioners have admittedly pre-empted the creditors' negotiations by purporting to agree to link the distribution to the Senior Secured Noteholders with their proposed DIP loan. The Petitioners confirm in paragraph 66 of the Amended Motion that their agreement to the quantum of the distribution is tied to the quantum of the DIP loan.

15. In *Menegon* v. *Phillip Services Corp.* Blair J. (as he then was) refused to approve a settlement and a proposed plan agreement that excluded a party from exercising its negotiating rights and bargaining leverage. In that case, the excluded creditor was precluded from voting on the proposed plan in Canada and was sent to the US to be dealt with under *Chapter 11* proceedings. The Petitioners will say that they have not denied any creditor a vote in these proceedings. But if the Petitioners distribute the proceeds of their assets, what is left to vote upon? As noted above, a distribution is not the same as a sale of assets in which proceeds are held pending a vote. A distribution makes a permanent diminution of the assets of the debtor by favouring one creditor. As was noted by Blair J., the CCAA focuses on compromises among creditors:

> In the bare-knuckled ring of commercial restructuring negotiations, this [compromise] cannot be accomplished if one group of unsecured claimants is given an unwarranted advantage over another.
>
> *Menegon* v. *Phillip Services Corp.* (1999), 11 C.B.R. (4th) 262 (Ont. S.C.) at paragraph 29

16. In the next paragraph Blair J. commented that it is inappropriate to immunize one group from negotiation and compromise. In that case, the creditor who was the recipient of the debtor's largesse noted that it was the first priority secured creditor and claimed that in a liquidation the other creditors would receive no recovery. Blair J. rejected the argument as follows:

> Philip, the Lenders, and counsel for the class action plaintiffs have mounted an adamant chorus that if the proposed Settlement is not approved the U.S. and Canadian class action plaintiffs will get nothing because Philip will be liquidated and, in addition, that there is simply no room for the class action plaintiffs to receive anything more than the 1.5% share distribution in the restructured

Philip which is currently on the table. The Lenders point out that they are fully secured and that they need not leave available even that 1.5% interest (not to mention the 9% equity interest which they have agreed to leave available to other stakeholders generally). These pronouncements may well reflect the final reality of the situation. However, I am somewhat less inclined to accept them at face value than the parties are to make them, particularly at this stage of the proceedings. It would not be the first time in restructuring negotiations where an adamant chorus turned into a more harmonious melody before the end of the day. Only the final moments of the process will tell the tale. In the meantime, as many negotiating options as possible should be kept open as amongst claimants of equal status in the restructuring, in my view.

[33] I do not say that this proposed Settlement, in its present or some other form, will not ultimately be approved. It is simply premature at this stage in the restructuring process to give it that imprimatur, in my opinion—if the imprimatur is to be given—for the reasons I have articulated. Accordingly, the question of approval of the proposed Settlement is adjourned to a date to be fixed which is more contemporaneous with the sanctioning hearing. In the meantime, Notice of certification and of the pending motion for approval is to be sent to all members of the classes 32

Menegon, supra, at paragraphs 32 and 33

17. Thus, in order to preserve optionality for the stakeholders, the Court will not approve a settlement negotiated between the debtor and even the first priority creditor group that advantages one group because doing so is contrary to the very heart of the CCAA's purpose to facilitate the negotiation of compromises and arrangements among creditors. Rather, the Court will assist the debtor and its

creditors to implement steps to maintain stability so that the debtor can propose a plan to its creditors in an effort to emerge from the proceedings as quickly as possible in the interests of all.

> *Re Mecachrome Canada Inc.* (unreported, Quebec Superior Court, July 16, 2009 at paragraphs 28, 30 and 75)

18. The Senior Secured Noteholders seek an early distribution without consideration of the instability of the Petitioners' liquidity position noted by the Petitioners and the Monitor. It seeks payments prior to the negotiation or implementation of a plan of arrangement or compromise. It seeks to assert its short term interests, despite its apparent over-collateralization, ongoing accrual of interest and the subrogation rights according to it to protect it while the Petitioners focus on the complex and necessary steps to redesign their business model and propose a recapitalization. Steps which help the Petitioners move forward in their restructuring facilitate a successful negotiation of a plan of compromise or arrangement and are consistent with the CCAA. The Proposed Senior Secured Noteholder Distribution is inconsistent with the Petitioners' liquidity needs and hinders the negotiation of a successful plan by favouring one creditor group prematurely. It is not consistent with the goals and purposes of the CCAA.

E. <u>CONCLUSION</u>

19. The Ad Hoc Committee supports the granting of the ULC DIP on the additional terms described above which are designed to help focus the Petitioners and all stakeholders on the need to move the process forward expeditiously and effectively. The key goal of these CCAA proceedings is to enable the Petitioners and the Ad Hoc Committee to agree upon a longer term plan which will allow the Petitioners to refinance and pay the shorter term creditors and emerge from these proceedings on terms acceptable to the other creditors and this Honourable Court.

20. The Ad Hoc Committee opposes the granting of the Proposed Senior Secured Noteholder Distribution at this time. The distribution is inconsistent with the liquidity needs of the Petitioners which underlies the very granting of the ULC

DIP. It is inconsistent to advance a serious and pressing case for the need for liquidity to support borrowing protected by an extraordinary Court-ordered charge, and to also propose to use the scarce and needed cash to make a distribution to a stayed creditor who is over-secured and cannot conceivably be prejudiced by the proposed DIP Charge.

21. The Ad Hoc Committee submits that the Court ought to be guided by the overriding consideration of the CCAA – to facilitate the negotiation of a plan of compromise or arrangement among creditors. The Petitioners require the ULC DIP for stability pending their ability to successfully restructure. The Monitor is clear that there is no realistic and practical prejudice to any secured creditor of granting the ULC DIP Charge as sought. However, the Proposed Secured Noteholder Distribution is antithetical to the goals of the CCAA in that it undermines the Petitioners' liquidity cushion and it represents a premature settlement that gives benefit to a single party to the exclusion of the others well prior to the commencement of discussions or the implementation of a plan of compromise or arrangement.

22. The Ad Hoc Committee respectfully submits that the Court focus the parties on efforts to assist the Petitioners to move forward efficiently and effectively toward the negotiation and implementation of a restructuring plan under the statute. To that end, the milestones sought by the Ad Hoc Committee for the presentation of a business plan and an acceptable term sheet are important measures to aid the process.

WHEREFORE, MAY IT PLEASE THIS COURT TO:

GRANT the Petitioners' Amended Motion for an Order approving the ULC DIP only in accordance with the terms outlined above; and

REJECT as premature, the Amended Motion for the Proposed Senior Secured Noteholder Distribution.

Montréal, October 29, 2009

Goodmans

Goodmans LLP

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Co-Counsel for the Ad Hoc Committee of
Unsecured Noteholders of Abitibibowater Inc.
and certain of its Affiliates.

NO.: 500-11-036133-094

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