CANADA

PROVINCE OF QUÉBEC
DISTRICT OF MONTREAL

No: 500-11-036133-094

SUPERIOR COURT
(Commercial Division)
(Sitting as a court designated pursuant to the *Companies' Creditors Arrangement Act,* R.S.C., 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 Debtors listed on Schedules "A", "B" and "C",

Petitioners

and

ERNST & YOUNG INC.,

Monitor

and

WELLS FARGO BANK, N.A, ADMINSTRATIVE AGENT UNDER THE *CREDIT AND GUARANTEE AGREEMENT* DATED APRIL 1, 2008

Respondent, *Ès Qualités*

TERM LENDERS' OUTLINE OF ARGUMENTS

I. OVERVIEW

1. The Petitioners seek orders authorizing Abitibi Consolidated Inc. ("**ACI**") and Abitibi Consolidated Company of Canada Inc. ("**ACCC**") to enter into a Loan Agreement (the "**ULC DIP Agreement**") with 3239432 Nova Scotia Company ("**ULC**"), as lender, providing for a CAD$230 million super-priority secured debtor in possession credit facility (the "**ULC DIP Facility**") as well as an order authorizing the distribution to the Trustee of the Senior Notes of up to CAD$200 million upon completion of the sale of ACCC's 60% interest in the Manicouagan Power Company ("**MPCo**").

2. The Petitioners' motion seeks the approval of a proposed DIP facility of CAD$230 million which would provide the debtors with incremental liquidity of CAD$167.6 million (US$150.8 million) and a *pro forma* cash balance of CAD$349.7 million (US$314.7 million) as of October 18, 2009.

3. The Petitioners intend to draw the entire CAD$230 million immediately. While described as a "facility", the ULC DIP Facility would in fact be a new DIP loan that would inundate the insolvent Abitibi Petitioners with cash.

4. The Term Lenders contest the Petitioners' motion (the "**Second DIP Loan Motion**") on the following grounds:

   (a) The allegations of the Second DIP Loan Motion do not demonstrate the need for a CAD$230 million DIP facility, which is more than double the size of the current ACI DIP facility, much less for an unconditional advance of the entire amount of a CAD$230 DIP Facility;

   (b) The ULC DIP Facility, and an immediate advance of CAD$230 million thereunder, would materially prejudice the Term Lenders because:

      (i) the Petitioners' assessment of the value of the Term Lenders' collateral is inaccurate and unrealistic and, among other things, does not take into account the Term Lenders' position in a liquidation scenario;

      (ii) the Term Lenders' collateral position would be seriously undermined by the creation of a further CAD$230 million super-priority charge; and

   (c) The total amount of the revised ACI DIP Charge should not exceed CAD$165:

      (i) CAD$200 million of the proceeds of the MPCo transaction should be paid to the Senior Secured Noteholders;

      (ii) The CAD$34.8 million of the net proceeds from the MPCo Transaction not used to repay the debt of the Senior Secured Noteholders should be used to repay the ACI DIP Facility in part. The Senior Secured Noteholders would be subrogated to the ACI DIP charge pursuant to paragraph 61.10 of the Initial Order, as amended and restated, and paragraph [11] of the Order Approving the MPCo Transaction, to the extent of this amount;

(iii) CAD$20 million of the ULC DIP Facility should be drawn and used to repay the balance of the ACI DIP Facility. The Senior Secured Noteholders should not be subrogated to the ACI DIP charge to the extent of this amount because the repayment of the ACI DIP Facility is not a "repayment from proceeds of or as part of the [MPCo Transaction]" within the meaning of paragraph [11] of the Order Approving the MPCo Transaction; and

(iv) The remainder of the ULC DIP Facility would be fully sufficient to satisfy the immediately foreseeable liquidity and working capital purposes of the Abitibi Petitioners, subject to the DIP draw down conditions proposed by the Term Lenders;

II. LEGAL PRINCIPLES

5. Although the CCAA (as in effect for cases commenced prior to September 18, 2009) makes no provision for DIP financing, it has come to be accepted that the Court may give priority for such financing in connection with the working out of a CCAA plan. However, for the Court to authorize priority DIP financing, there must be cogent evidence that the benefit of the financing clearly outweighs the risk of prejudice to the secured lenders whose security would be subordinated to the financing. It is not enough to ask for a cash cushion for the purpose of buying additional time to "try to pull something out of the hat".

- ***Re Marine Drive Properties Ltd.* [2009] B.C.J. No. 207 (Tab 1).**

6. DIP financing, while necessary in many large and complex restructurings, should never be granted as a matter of course and without adequate demonstration of the need for it, co-extensive with its size. Whether and to what extent DIP financing should be approved should be decided only after considering at least the following factors:

(a) Creating a super-priority charge for a DIP financing is an extraordinary measure that should be used sparingly and only in clear cases;

(b) Before allowing a DIP financing on a super-priority basis, the Court should be satisfied on proper evidence that the benefits to all stakeholders clearly outweigh the potential prejudice to some creditors;

(c) It is not sufficient for a debtor to establish that a super-priority charge would merely be beneficial; it must, rather, establish that it is critical for the ability of the debtor's business to continue operating and to successfully restructure its affairs;

(d) The debtor normally should establish an urgent need for the creation of the super-priority charge;

(e) For the Court to decide to create such a priority charge, there must be a reasonable prospect of successful restructuring;

(f) As it is an extraordinary remedy, a super-priority charge should be available only for a limited amount, for a brief period during the workout process, to allow the debtor to "keep the lights on";

(g) As the creation of a super-priority charge is an extraordinary remedy, the Court should be satisfied that it is just and equitable to do so in the given circumstances; and

(h) The onus is squarely on the debtor to prove that subjecting its existing creditors to the risks of ranking behind a court-ordered priming charge is warranted.

- ***Re MEI Computer Technology Group Inc.*, (2005), 19 C.B.R. (5th) 257 (Que. S.C.) (Tab 2), at para. 25.**

- ***Les Boutiques San Francisco incorporées et Richter & Associés inc.* [2003] Q.J. No. 18940 (Tab 3), at para. 32.**

7. While none of these factors taken individually are determinative, some effort must be made to assess the need for DIP financing to the extent requested. The approval of DIP financing has been described as a "balancing act", which may comprise limitations on the draw down of any DIP facility until the need for further liquidity becomes clear. Indeed, the imposition of conditions on drawing down is a classic way for Courts to balance the prejudice of a DIP loan against the benefits to be obtained and to address the fact that no one can predict the future.

- ***Re Manderley Corp.*, (2005), 10 C.B.R. (5th) 48 (Ont. S.C.J.) (Tab 4), at para. 27.**

- ***Les Boutiques San Francisco incorporées et Richter & Associés inc.* [2003] Q.J. No. 18940 (Tab 4), at para. 32.**

8. The Term Lenders submit that the Petitioners have not made a sufficient effort to balance the prejudice that would be occasioned by the proposed ULC DIP Facility against any tangible benefit to be obtained by the significant (and, in the Term Lenders' submission, unwarranted) increase in the Abitibi Petitioners' liquidity as a result of the new facility, for the following reasons:

(a) The Petitioners have not provided the Court or its creditors with any business plan for 2009 or 2010;

(b) The Petitioners' own forecasts show ample liquidity through the end of 2009 and into 2010, without the assistance of a CAD$230 million DIP loan;

(c) The Petitioners have not demonstrated any *need* to put to use the proceeds of the ULC DIP Facility in the entire amount requested. The Petitioners offer only soft and unverifiable assertions that it would be beneficial for them to be able to demonstrate access to significant liquidity over and above amounts required to satisfy demonstrated working capital and liquidity requirements; and

(d) For the reasons explained in the expert report of Jefferies & Company, Inc., the Term Lenders' financial advisors, (the "**Jefferies Report**"), the proposed ULC DIP Facility would seriously prejudice the Term Lenders by leaving them significantly under-secured.

III. THE PROPOSED ULC DIP LOAN WOULD NOT MEET THE NEW TEST FOR DIP FINANCING

9. The new amendments to the CCAA providing a statutory basis for DIP financing have been proclaimed in force. While the new amendments are not directly applicable to this case, they are an expression of current public policy by Parliament and do provide meaningful guidance. The legislation directly links the provision of a secured charged in favour of a DIP lender to the *need* demonstrated by the debtor:

> 11.2 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company ***an amount approved by the court as being required by the company, having regard to its cash-flow statement.*** The security or charge may not secure an obligation that exists before the order is made. [emphasis added]

- **CCAA, Section 11.2(1).**

10. A charge in favour of a DIP lender is to be provided under the new legislation only where an amount is "required" by the debtor, "having regard to its cash flow statement." The condition precedent for the provision of a secured charge in favour of a DIP lender under the new legislation is a demonstrated need specifically in light of the debtor's cash flow. A charge securing DIP financing is not to be granted simply because it would be convenient for the company to have more money than it needs: rather, it must be demonstrated that the debtor needs the amount advanced.

11. Even if an amount meets the condition precedent of being "required" by the debtor in light of its cash flow, a separate decision whether or not to allow a DIP charge must be made. This is a discretionary decision and, according to Section 11.2(4), it must take into account the following factors:

(a) The period during which the company is expected to be subject to proceedings under this Act;

(b) How the company's business and financial affairs are to be managed during the proceedings;

(c) Whether the company's management has the confidence of its major creditors;

(d) Whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) The nature and value of the company's property;

(f) Whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) The monitor's report referred to in paragraph 23(1)(b), if any.

12. For all of the reasons discussed, above, the Petitioners have not satisfied the foregoing requirements. Fundamentally, the Petitioners have not satisfied the condition precedent for an advance of the full CAD$230 million, because they have not demonstrated how the cash flow forecasts they have provided *require* an advance of CAD$230 million now.

13. Indeed, the Monitor expressly notes in his Nineteenth Report that the cash flows do not show such a requirement, except perhaps if the Petitioners cannot put forward a viable plan of arrangement before late in 2010. Even that apparently would require that, in the meantime, every worst case scenario imagined by the Petitioners actually occurs.

14. While the Petitioners have demonstrated the need for some measure of liquidity, a consideration of the Section 11.2(4) factors militates against granting the Petitioners indiscriminate relief:

(a) It is impossible to assess factor (a) because no timetable has been provided for the preparation of a realistic plan of arrangement;

(b) Apart from cash flow forecasts, the creditors have been given no reliable indication in the form of a business plan as to how they can expect the business to be run in the interim;

(c) The Term Lenders are significant creditors and oppose the granting of the ULC DIP to the extent sought;

(d) There is no evidence that an advance of CAD$230 million would enhance the prospects of a viable plan of arrangement in light of the lack of a demonstrated immediate need for such an amount;

(e) With respect to the property of the debtor, while it is proposed that the Term Lenders would benefit from a right of subrogation against certain unencumbered assets, the Petitioners have not provided adequate information concerning the value of these assets, particularly in a liquidation scenario; and

(f) As demonstrated in the Jefferies Report, the Term Lenders would suffer significant prejudice to their position if the relief sought by the Petitioners were to be granted in the form of an advance of a CAD$230 DIP loan.

IV. CONCLUSION

15. In light of the foregoing, and for the reasons described in the Jeffries Report and the Respondents' contestation, it would be unwarranted for the Petitioners to borrow on the UCL DIP Facility to the extent of CAD$230 million. Whether anything more than CAD$130 million of liquidity will be required should be evaluated in light of the actual future evolution of the financial situation of the Petitioners.

16. Therefore, the ULC DIP Facility should not exceed in the aggregate CAD$130.2 million, to be used as follows:

    (a) CAD$20 million to repay the balance of the ACI DIP Facility; and

    (b) the balance of CAD$110.2 million to be used for liquidity and working capital purposes of the Petitioners, subject to and in accordance with the DIP draw conditions set forth in Schedule A attached to the Term Lenders' Contestation.

17. The Term Lenders submit that a facility of this more restrained magnitude, coupled with protections for the Term Lenders in the form of the amendments to the Initial Order's subrogation terms set out at pp. 12-13 of the Respondents' Contestation and the DIP draw conditions set forth in Schedule A to the Contestation, would fully address any current requirement for liquidity and any projected requirements until well into 2010.

THE WHOLE RESPECTFULLY SUBMITTED.

Montréal, this November 6, 2009

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Attorneys for the Term Lenders

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TERM LENDERS' OUTLINE OF ARGUMENTS

ORIGINAL

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