IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In Re:	Chapter 11
ABITIBIBOWATER, INC., *et al.*,	Case No. 09-11296 (KJC)
Debtors.	(Jointly Administered)
	Re: Docket Nos. 13 and 18

OBJECTION OF AURELIUS CAPITAL MANAGEMENT, LP TO THE DEBTORS' MOTIONS FOR ORDERS (A) APPROVING POST-PETITION FINANCING AND USE OF CASH COLLATERAL AND (B) AUTHORIZING CONTINUED USE OF THEIR CASH MANAGEMENT SYSTEM

Aurelius Capital Management, LP ("Aurelius"), on behalf of its managed fund entities, as and for its objection to the above-captioned Debtors'[1] Motions for Orders (a) approving post-petition financing and use of cash collateral and (b) authorizing continued use of their cash management system, respectfully states as follows:

Background

1. In 2001, Bowater Canada Finance Corporation ("BCFC") issued unsecured notes due 2011 having an aggregate face value of $600 million (the "2011 Notes"), supported by a guarantee from Bowater Incorporated. Aurelius, through its managed fund entities, is a holder of the 2011 Notes. BCFC has no independent operations; its only material liabilities consist of the 2011 Notes and its only material assets consist of intercompany obligations or ownership interests in Bowater Inc. or its subsidiaries. Thus, BCFC does not appear to require direct financing in order to maintain the value of its assets.

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[1] Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the DIP Motion.

2. Through the DIP Motion, the Debtors are seeking to put in place a complex post-petition financing facility that contemplates both US and Canadian borrowings. Under the proposed DIP Facility, BCFC would guarantee and secure all Canadian borrowings, though it has minimal, if any, cash needs and would receive no direct economic benefit from any of those borrowings.

3. Accordingly the financing seeks to impose substantial obligations upon BCFC and its creditors without demonstrating a measurable benefit. This attempt amounts to *de facto* substantive consolidation of the Canadian Debtors. Since the Canadian Debtors are all independent legal entities, for the DIP Motion to be approved, BCFC's liabilities under the DIP Facility must be limited to those instances where it individually actually utilizes or otherwise directly benefits from the cash borrowed under the DIP Facility. Additionally, the DIP Motion provides adequate protection to the Prepetition Lienholders even though they are unaffected by the DIP Facility since they are not primed and already have a sufficient equity cushion to protect them in the event of a decline in value of their collateral.

4. This court should also deny the proposed Cash Management System unless the estates are protected from the diminution in value caused by intercompany transfers which result in subordination of the transferred amounts to existing security interests.

5. Aurelius therefore requests that the Court deny the DIP Motion and the Cash Management Motion unless the Final Orders approving each are modified to assure such limitations.

Argument

I. BCFC Cannot Be Liable For More Than The Benefit It Obtains Under the DIP Facility

6. In order to satisfy the requirement that entry into the DIP Facility is an appropriate exercise of its business judgment, each Debtor must show that there is a benefit to its estate. *See Trans World Airlines, Inc. v. Travellers International AG (In Re Trans World Airlines, Inc.)*, 163 B.R. 964, 974 (Bankr. D. Del. 1994); *see also RSL COM Primecall, Inc. v. Beckoff (In re RSL COM Primecall, Inc*.), 2003 Bankr. LEXIS 1635 (Bankr. S.D.N.Y. Dec. 11, 2003) (Gropper, J.) (citing *Federal Deposit Ins. Co. v. Sea Pines Co.*, 692 F.2d 973 (4th Cir. 1982), *cert. denied*, 461 U.S. 928, 77 L. Ed. 2d 299, 103 S. Ct. 2089 (1983)); *Clarkson v. Shaheen Co. Ltd.*, 660 F.2d 506 (2d Cir. 1981), *cert. denied*, 455 U.S. 990, 71 L. Ed. 2d 850, 102 S. Ct. 1614 (1982); *Automatic Canteen Co. of Am. v. Wharton*, 358 F.2d 587 (2d Cir. 1966).

7. While the benefits of BCFC's intercompany guarantees need not be direct, those indirect benefits must nonetheless be concrete, and cannot simply be presumed. *Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide, Ltd.)*, 139 F.3d 574, 578-79 (7th Cir. 1998) (citing *Heritage Bank Tinley Park v. Steinberg (In re Grabill Corp.)*, 121 B.R. 983, 995 (N.D. Ill. 1990)); *Official Comm. of Unsecured Creditors v. JP Morgan Chase Bank, N.A. (In re M. Fabrikant & Sons, Inc.)*, 394 B.R. 721, 738 (Bankr. S.D.N.Y. 2008) ("indirect benefits may include synergy, increased access to capital, safeguarding a source of supply and protecting customer relationships").

8. In the absence of such benefits, the terms of the DIP Facility as currently drafted effect a *de facto* substantive consolidation for the purposes of financing. Each and every US Debtor would be required to guarantee the entirety of borrowings by the

US Borrowers, and each and every Canadian Debtor would be required to guarantee the entirety of borrowings by Bowater Canada, pooling the estates' assets by making each Debtor jointly and severally liable for the borrowings of, as applicable, the US Borrowers and Bowater Canada regardless of whether it receives any actual benefit from those loans. Such a result thwarts the reasonable expectations of the existing creditors of each individual estate. *See In re Owens Corning*, 419 F.3d 195, 210-11 (3d Cir. 2005) ("If an objecting creditor relied on the separateness of the entities, consolidation cannot be justified *vis-à-vis* the claims of that creditor."); *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988) (substantive consolidation "is no mere instrument of procedural convenience . . . but a measure vitally affecting substantive rights," quoting *Flora Mir Candy Corp. v. R.S. Dickson & Co.*, 432 F.2d 1060, 1062 (2d Cir. 1970)); and *compare Bergemann v. The Babcock and Wilcox Co. (In re The Babcock and Wilcox Company*, 250 F.3d 955 (5th Cir. 2001) (declining to invalidate DIP financing as *de facto* substantive consolidation because the facility maintained a distinction among the debtors' assets and liabilities).

9. Additionally, without value to each individual debtor, those guarantees would be avoidable as fraudulent transfers outside of bankruptcy. *See, e.g.*, *In re Bay Plastics, Inc.*, 187 B.R. 315, 335 (Bankr. C.D. Cal. 1995) (invalidating as a fraudulent transfer a prepetition LBO transaction that inappropriately shifted the risks to creditors who were not parties to transaction).

10. Here, the Debtors have not made a specific showing as to the benefits accorded to each of the Debtors, and minimal showing as to the benefits to the business as a whole. The Court should hold the Debtors to their statutory burden of proof and

require each Debtor's liability under the DIP Facility to correspond to such entity's actual individual cash requirements or other cognizable and quantifiable benefit. 11 U.S.C. § 364(d)(2); *see In re Mosello*, 195 B.R. 277, 288 (Bankr. S.D.N.Y. 1996) ("A finding of adequate protection should be premised on fact or on projections grounded on a firm evidentiary basis").

II. The Proposed Adequate Protection for the Prepetition Lienholders is Inappropriate Under the Circumstances

11. The Debtors have proposed to grant the Prepetition Lienholders extensive adequate protection, notwithstanding that those secured creditors are not being primed by the DIP Facility. Specifically, the Prepetition Lienholders would receive, among other things, catch-up payments on account of accrued but unpaid prepetition interest, current payment of post-petition interest during the cases and Adequate Protection Liens.[2] Adequate protection of that type is inappropriate where, as here, the secured lenders are protected by a substantial equity cushion. Without priming of their security interests, the Prepetition Lienholders are in exactly the same place, or even better off, by virtue of the additionally financing provided to the entities that own their collateral.

12. The purpose of adequate protection is to ensure that a secured creditor is protected from a diminution in the value of its collateral during the bankruptcy case. *In re Pine Lake Vill. Apartment Co.*, 19 B.R. 819, 824 (Bankr. S.D.N.Y. 1982) ("Neither the

[2] The US Adequate Protection Liens include (i) first liens on, among other things, all pre-and postpetition accounts, cash and currency; (ii) first liens on the Shared Real Estate Assets, *pari passu* with the liens securing the Canadian Adequate Protection Obligations; and (iii) second priority liens on all US Lender Priority Collateral, immediately junior to the DIP Liens. The Canadian Adequate Protection Liens include (i) the Canadian Replacement Liens on the Canadian Prepetition Collateral (including first liens *pari passu* with the liens securing the US Adequate Protection Obligations) on the Shared Real Estate Assets); (ii) postpetition junior liens on certain DIP Collateral; (iii) third liens on Canadian Prepetition Collateral; and (iv) junior liens on US DIP Collateral.

legislative history nor the [Bankruptcy] Code indicate that Congress intended the concept of adequate protection to go beyond the scope of protecting the secured claim holder from a diminution in the value of the collateral securing the debt."); see also *In re George Ruggiere Chrysler-Plymouth, Inc.*, 727 F.2d 1017, 1019 (11th Cir. 1984). Courts must be especially wary of consensual cash collateral arrangements with DIP Lenders as a debtor has limited negotiating leverage against such creditors. *See*, *e.g.*, *In re Defender Drug Stores, Inc.*, 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992); *In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 40 (Bankr. S.D.N.Y. 1990). Section 363(p)(1) establishes that the Debtors have the burden of proof on the issue of adequate protection. See 11 U.S.C. § 363(p)(1); *Save Power Ltd. v. Pursuit Athletic Footwear (In re Pursuit Athletic Footwear, Inc.)*, 193 B.R. 713, 716 (Bankr. D. Del. 1996); *In re Donato*, 170 B.R. 247, 254-55 (Bankr. D.N.J. 1994); *In re O.P. Held Inc.*, 74 B.R. 777, 782 (Bankr. N.D.N.Y. 1987).

13. Where a creditor is oversecured, courts commonly hold that the creditor's equity cushion alone provides adequate protection – thereby obviating the need for granting periodic payments or replacement liens to the secured creditor. *See Shaw Indus. v. First Nat'l Bank (In re Shaw Indus., Inc.)*, 300 B.R. 861, 865 (Bankr. W.D. Pa. 2003) ("The existence of an equity cushion alone can constitute adequate protection."); *Donato*, 170 B.R. at 254-55; *Sharon Steel Corp. v. Citibank, N.A. (In re Sharon Steel Corp.)*, 159 B.R. 165, 169 (Bankr. W.D. Pa. 1993) ("The existence of an equity cushion alone can constitute adequate protection."); *In re Continental Airlines, Inc.*, 146 B.R. 536, 539 (Bankr. D. Del. 1992); *In re Reading Tube Indus.*, 72 B.R. 329, 333 (Bankr. E.D. Pa. 1987) ("A debtor may demonstrate adequate protection by proving the existence of . . . an equity cushion."); *In re Automatic Voting Machine Corp.*, 26 B.R. 970, 972 (Bankr.

W.D.N.Y. 1983) ("One basis for finding adequate protection may be the existence of an `equity cushion.'); *In re Tucker*, 5 B.R. 180, 182 (Bankr. S.D.N.Y. 1980) ("An `equity cushion' in and of itself may constitute adequate protection ...."); *see also In re Elmira Litho Inc.*, 174 B.R. 892, 904 (Bankr. S.D.N.Y. 1994) ("An equity cushion . . . provides adequate protection if it is sufficiently large to ensure that the secured creditor will be able to recover its entire debt from the security at the completion of the case."); *In re Dunes Casino Motel*, 69 B.R. 784, 793-95 (Bankr. D.N.J. 1986) (where prepetition debt against the subject property was $17.5 million and the collateral was valued at $26.2 million, the equity cushion was more than adequate under the circumstances).

14. Significantly, even where an equity cushion is decreasing in size as a result of the accrual of postpetition interest under Section 506(b), an oversecured creditor is nevertheless not entitled to receive periodic postpetition interest payments in order to preserve the value of this cushion. *See Orix Alliance v. Delta Res. (In re Delta Res., Inc.)*, 54 F.3d 722, 727-28 (11th Cir. 1995). The oversecured creditor's interest in property that must be adequately protected encompasses only the decline in the value of the collateral, "rather than perpetuating the ratio of the collateral to the debt." *See id.* at 730; *see also In re Gallegos Research Group, Corp.*, 193 B.R. 577, 584 (Bankr. D. Colo. 1995) ("Oversecured creditors may not be entitled to cash payments or postpetition liens because they are adequately protected through the existence of a value cushion.").

15. Here, the Debtors have made no express showing as to the value of their estates or of the Prepetition Lienholders' security interests. However, given that the DIP Facility does not seek to prime their liens, it is fair to assume that the Prepetition Lienholders are oversecured by a substantial margin. In any event, since the new

financing is junior to the Prepetition Lienholders, it cannot, by itself, be a basis for adequate protection. Accordingly, Aurelius submits that the Prepetition Lienholders are not entitled to any adequate protection beyond their equity cushion.

III. The Debtors Fail to Meet Their Burden to Show Need for the Full Amount of the DIP Facility

16. As described in the DIP Motion and the Zelin Declaration, the Debtors originally sought $600 million in post-petition financing that would have, in addition to satisfying the Debtors' immediate liquidity needs, refinanced the Existing Secured Indebtedness. After that financing fell through, the Debtors ultimately negotiated a DIP Facility that provided immediate access to $206 million on an interim basis, with the potential, through uncommitted Incremental Advances and an uncommitted ABL Facility, to increase to a total of $600 million. Coincidentally, the additional $394 million in potential availability roughly equals the aggregate amount of the Existing Secured Indebtedness, including $121 million in indebtedness of the Canadian Debtors, $30 million of which was borrowed in February 2009. In fact, the DIP Facility expressly contemplates that the ABL Facility would be used to pay off the Existing Secured Indebtedness.

17. Despite that stated purpose, the Debtors have made no showing whatsoever concerning what benefit, if any, they would receive from refinancing the Existing Secured Indebtedness. Indeed, it is impossible to make such a showing at this time, as the DIP Facility is effectively silent as to the terms of any ABL Facility; that facility would be made only "on terms reasonably acceptable to the Required Lenders." Approval of the ABL Facility and the Incremental Advances absent explicit evidence as

to their terms and the Debtors' needs for such financing is both premature and inappropriate.

IV. Cash Management

18. As currently contemplated in the Interim Cash Management Order, the Debtors' proposed cash management procedures significantly prejudice the interests of Aurelius and other creditors of the Debtors' estates. Cash management should not be used as a back door route to effectively siphon value from individual Debtor estates for the benefit of creditors of non-debtor affiliates or from the Canadian Debtor estates for the benefit of creditors of the US Debtors.

19. The Interim Cash Management Order confers administrative superpriority status to ordinary course intercompany claims between and among the Debtors. That order also permits Intercompany Transactions (as such term is defined in the Interim Cash Management Order) with non-debtor affiliates or from Canadian Debtors to US Debtors, and provides that any such transaction "shall give rise to claims for contribution, indemnification, reimbursement and/or subrogation in favor of the Debtor against such non-debtor affiliate to which the Intercompany Transaction was made (a) secured by a lien on any and all property owned by the non-debtor affiliate, to the extent such lien is not prohibited by any of the non-debtor affiliate's existing or postpetition secured credit facilities, or (b) otherwise to the fullest extent permitted under applicable law; provided, further, that any investments, loans or advances made by any Debtor in or to any non-debtor affiliate shall be subject to any limitations set forth in any postpetition lending facility or securitization facility of the Debtors."

20. Notwithstanding that language, the proposed order would still allow for situations where the interests of the Aurelius and other creditors of individual Debtors

would be harmed. Specifically, funds transferred to non-debtor affiliates (or from the Canadian Debtors to the US Debtors) would immediately become subject to a superior lien in favor of the lenders under any credit facility at such affiliates. Accordingly, transfers under the current cash management system may result in significant value transfers from individual, solvent estates to the other, potentially less solvent, Debtors and non-debtor affiliates within the AbitibiBowater corporate family. None of the safeguards offered protect against these very real possibilities.

21. In order to protect against such transfers of value, the Final Cash Management Order should provide that the liens securing the Intercompany Transactions are junior only to the claims of the DIP Lenders, but senior to all other claims, including any claims on account of the Adequate Protection Obligations.

Conclusion

WHEREFORE, Aurelius respectfully requests that the Court enter an order consistent with this Objection and grant such other and further relief as is just and proper.

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Wilmington, DE

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