CANADA

PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

N°: 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)

**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 in Schedules A, B and C**

Petitioners-Debtors

and

**ERNST & YOUNG INC.**

Monitor

and

**AURELIUS CAPITAL MANAGEMENT, LP,** having its head office at 535 Madison Avenue, 22nd Floor, New York, NY, 10022

and

**CONTRARIAN CAPITAL MANAGEMENT, L.L.C.**
having its head office at 411 West Putnam Avenue, Greenwich, CT 06830

Petitioner-Noteholders

# AMENDED REPLY TO PETITIONERS-DEBTORS' CONTESTATION OF THE MOTION FOR THE ISSUANCE OF AN ORDER DIRECTING BOWATER CANADA FINANCE CORPORATION TO FILE AN ASSIGNMENT IN BANKRUPTCY OR ALTERNATIVELY, AN ORDER SEEKING THE APPOINTMENT OF AN INDEPENDENT AND DISINTERESTED THIRD PARTY TO INVESTIGATE, ASSERT, PROTECT AND PURSUE THE CLAIMS AND REMEDIES OF BOWATER CANADA FINANCE CORPORATION

**IN REPLY TO PETITIONERS-DEBTORS' CONTESTATION, AURELIUS CAPITAL MANAGEMENT, LP ("AURELIUS") AND CONTRARIAN CAPITAL MANAGEMENT, L.L.C. ("CONTRARIAN") RESPECTFULLY SUBMIT THE FOLLOWING:**

1. Unless otherwise indicated, all capitalized terms in this reply (the "**Reply**") shall have the meaning attributed to them in the *Motion for the Issuance of an Order Directing Bowater Canada Finance Corporation to file an Assignment in Bankruptcy or Alternatively, an Order Seeking the Appointment of an Independent and Disinterested Third Party to Investigate, Assert, Protect and Pursue the Claims and Remedies of Bowater Canada Finance Corporation* (the "**Motion**") filed by Aurelius and by Contrarian, and in the Contestation.

**I. Contestation Incorrectly Characterizes the Motion**

2. The Petitioners-Debtors' Contestation incorrectly presents the purpose of the Motion and the remedies sought by Aurelius and Contrarian.

3. The Motion seeks an Order requiring the officers and directors of BCFC to file an assignment in bankruptcy under the BIA and other ancillary relief. Alternatively, Aurelius and Contrarian seek the appointment of an independent and disinterested third party at Petitioners-Debtors' cost to investigate, assert, protect and pursue the assets and liabilities of BCFC, including intercompany claims and claims against directors and officers of BCFC and to report its findings to BCFC's creditors and to this Honourable Court.

4. The remedies sought in the Motion are based, *inter alia*, on the following:

    4.1 BCFC has no business to restructure, does not carry on any active business and has no employees;

    4.2 BCFC's material liabilities consist of the Notes, and its material assets appear to consist of its preferred shares in BCHI and the Contribution Claim against BI, which its directors and officers should be actively seeking to maximize for the benefit of BCFC and its creditors;

    4.3 There has been a consistent lack of transparency and unwillingness to provide information with respect to the internal corporate transactions in which BCFC has been involved which ultimately resulted in its owning the preferred shares of BCHI;

    4.4 While admitting BCFC's insolvency, the Petitioners-Debtors have failed to provide any financial information to BCFC's creditors regarding BCFC's assets, liabilities and intercompany transactions;

    4.5 Although the Petitioners-Debtors including BCFC have been under the protection of the CCAA for exactly one year, they have failed to justify the refusal to provide any information other than to suggest that it is onerous and will be a distraction;

4.6 BCFC has, to date, failed and refused to make full disclosure of the intercompany transactions or to investigate whether any of those transactions give rise to potential claims against either other Petitioners-Debtors or BCFC's officers and directors.

## II. Contestation Confirms the Immediate Need for the Requested Relief

5. Petitioner-Debtors' Contestation merely confirms the need for the appointment of a trustee in bankruptcy for BCFC or alternatively the appointment of another independent and disinterested third party to investigate, assert, protect and pursue the claims and remedies of BCFC and to report to BCFC's creditors and to this Honourable Court.

6. More than one year into the restructuring process, Petitioners-Debtors' Contestation demonstrates that (i) no one has assessed BCFC's assets; (ii) no effort has been made to review or provide the particulars of the intercompany transactions; (iii) no effort has been made to produce any documents pertaining to the intercompany transactions; (iv) no steps have been taken to prosecute BCFC's valuable Contribution Claim under s.135 of the *Companies Act* (Nova Scotia), which is a claim in excess of US$600 million; (v) no steps have been taken to maximize the value of the preferred shares of BCHI that BCFC owns; and (vi) Petitioners-Debtors continue to claim they do not have the time to address these issues and that such issues are a distraction.

7. The Contestation further demonstrates that Petitioners-Debtors are not giving any consideration to the interests of BCFC during the course of the restructuring process: Petitioners-Debtors' assertion that the relief sought pursuant to the Motion could potentially trigger an Event of Default under the BI DIP Agreement (Exhibit D-3) is patently inaccurate, as BCFC is specifically carved out of any obligations as a Debtor or Guarantor under the BI DIP Agreement, as a result of the objections of Aurelius that there was no reason to include BCFC in the DIP as appears from the DIP Objection dated May 28, 2009 produced as **Exhibit R-15** and the DIP Order dated June 4, 2009 produced as **Exhibit R-16.**

8. Petitioners-Debtors make no attempt to dispute the characteristics of BCFC that Aurelius and Contrarian highlight as making conflicts more likely:

8.1 Petitioners-Debtors acknowledge that BCFC is not an operating company, carries on no trade, and is merely a special purpose financing entity, with no business to restructure under the CCAA;

8.2 While Petitioners-Debtors admit that BCFC's material assets consist of preferred shares of BCHI and an indirect equity interest in BCFPI they fail to disclose how BCFC came to acquire those interests;

8.3 BCFC's material assets are claims against or interests in related companies.

9. The Contestation does not indicate that anyone is advocating for BCFC, even in the days and weeks before Petitioners-Debtors file a plan of arrangement that will determine the ability of BCFC and its creditors to recover what is rightly due to them:

9.1 BCFC's directors and counsel have taken no steps to prosecute the Contribution Claim, realize on the preferred stock, or investigate BCFC's intercompany transactions;

9.2 Remarkably, one year into the CCAA proceedings, neither the Petitioners-Debtors nor the Monitor have provided any detailed information to BCFC's creditors with respect to BCFC's assets, liabilities and intercompany transactions;

9.3 Furthermore, there is no suggestion in the materials filed with the Contestation nor in the various Monitor's reports that BCFC will disclose all relevant and material information in order for BCFC's creditors to properly assess whether to approve an eventual plan of arrangement or whether bankruptcy would give rise to a better outcome.

10. Furthermore, while BCFC does not carry on any active business, Petitioners-Debtors' Contestation suggests that the investigation of the assets and liabilities of BCFC and all intercompany transactions having taken place in the last three years preceding the date of the Petition relating to BCFC will require a costly and extensive forensic investigation, which is even more disturbing given that BCFC should easily be able to produce documents relating to the likely very few intercompany transactions to which it was party.

**III. Lack of Transparency Continues Unabated**

11. Petitioners-Debtors' Contestation further demonstrates Petitioners-Debtors' lack of transparency in the CCAA proceedings with respect to BCFC and their failure to communicate all pertinent information to BCFC's creditors to allow them to consider and vote on an eventual plan of arrangement.

12. This lack of transparency is very disconcerting since it is Petitioners-Debtors' burden of proof to establish that the extraordinary protection and remedies available under the CCAA were and remain justified insofar as BCFC is concerned throughout the restructuring process.

13. Petitioners-Debtors do not in any way address how an eventual plan of arrangement could be jeopardized if BCFC is subject to BIA proceedings or an independent and disinterested third party is appointed to investigate assert, protect and pursue the assets and liabilities of BCFC including intercompany transactions and claims against the directors and officers of BCFC, and to report such findings to BCFC's creditors and to this Honourable Court.

14. In its capacity as a member of the official Unsecured Creditors Committee in the AbitibiBowater chapter 11 cases, the Indenture Trustee has not received any specific information relating to BCFC, details of its assets or liabilities or any information that BCFC is prosecuting the Contribution Claim under s. 135 of the *Companies Act* (Nova Scotia), any Intercompany Claims or the Preferred Stock Claim.

15. Furthermore, the Indenture Trustee has not received any information relating to the issues raised in the Motion despite multiple request to meet, as appears from the Indenture Trustee counsel's letter of April 16, 2010 produced as **Exhibit R-17**.

16. The Indenture Trustee has reviewed the Motion and does not object to the relief being sought by Aurelius and Contrarian, as set out in the Indenture Trustee's counsel's letter dated April 16, 2010, **Exhibit R-17**.

## IV Developments since the filing of the Motion

16.1 In response to the Petitioners-Noteholders Motion, the Debtors have requested the Monitor to prepare a report on BCFC intercompany transactions, including those raised in the Petioners-Noteholders Motion. Such report will be served on the Service List and filed with this Honourable Court.

16.2 The Board of Directors of BCFC passed a resolution on May 6, 2010 authorizing Jacques Vachon, Senior Vice-President, Corporate Affairs and Chief Legal Officer of AbitibiBowater Inc. and Vice-President and Secretary of BCFC to take such actions as may be necessary or appropriate in BCFC's interest in connection with the Contribution Claim or other BCFC Claims. A copy of the resolution and minutes of meeting of the Board of Directors is attached as **Exhibit R-18.**

16.3 Mr. Vachon is Senior Vice-President Corporate Affairs and Chief Legal Officer of AbitibiBowater inc. and Bowater inc.

16.4 Mr. Vachon is remunerated by other AbitibiBowater companies.

16.5 Considering the foregoing, Mr. Vachon is not truly "independent" as he clearly continues to have conflicting duties and loyalties to the other Petitioners-Debtors.

16.6 Furthermore, BCFC sought authority from the US Bankruptcy Court to retain Al Togut of the law firm Togut, Segal & Segal, LLP as conflicts counsel for BCFC in the Chapter 11 cases. A motion before the US Bankruptcy Court to approve the retention of Togut, Segal& Segal LLP. was heard on June 25, 2010. A copy of the motion is attached as **Exhibit R-19.**

16.7 To date no independent Canadian counsel has been retained for BCFC.

16.8 BCFC also sought to employ and retain AP Services, LLC as its special advisor and designate Lisa Donahue to serve as BCFC's Vice-President–Restructuring. BCFC's motion to appoint AP Services and Donahue was heard by the US Bankruptcy Court on June 25, 2010. A copy of the motion is attached as **Exhibit R-20.**

16.9 While the Togut and Donahue motions recognize the appearance of impropriety and inherent conflicts of interest resulting from BCFC's claims against its related companies, the terms of their proposed retainers prevent them from truly being independent advocates for BCFC.

16.10 Among other things, Donahue's retainer does not permit her to assert any claims, commence any proceedings or assign BCFC into bankruptcy. Rather, she is limited to recommending to BCFC's conflicted Board of Directors the course of action to be taken in connection with the Contribution Claim or any other claim in connection with the use of the proceeds from the issuance of the BCFC Notes. Togut and Donahue's retainers remain problematic and do not resolve the underlying conflict problems as they leave the ultimate decision of how and whether to protect and advance BCFC's interests in the hands of its conflicted Board of Directors.

16.11 Further, the proposed terms of Donahue's retainer prohibit her from investigating or considering the filing by BCFC of any objection to the US or Canadian Plans, US Disclosure Statement or Canadian Information Circular. This restriction is particularly harmful to BCFC and clearly illustrates the continued attempt by the Petitioners to prevent BCFC from being able to act in its best interests and those of its creditors, as opposed to being sacrificed to the interests of other AbitibiBowater companies. BCFC's Board of Directors cannot be left to instruct Togut and Donahue given their abdication of their duties to BCFC to date, as evidenced by the admissions of William Harvey that they:

(a) never assessed whether a CCAA/Chapter-11 filing was preferable to a bankruptcy/Chapter 7 filing;

(b) had no independent advice relating to the insolvency filings;

(c) never investigated the Contribution Claim or any other potential claims of BCFC;

(d) never discussed how to maximize BCFC's assets;

(e) did not represent BCFC's interests in Plan negotiations;

(f) never met to consider the US and Canadian Plans;

(g) have no opinion on whether walking away from the Contribution Claim and cancelling the preferred shares of BCHI is in the best interests of BCFC.

16.12 The foregoing admissions are truly remarkable and clearly evidence gross neglect of the business and affairs of BCFC in as much as BCFC's Board of Directors has no opinion with respect to compromising the only two disclosed material assets that BCFC has. Accordingly, Aurelius and Contrarian, as well as the Indenture Trustee objected to the retainer of both Togut and Donohue. Copies of the objections are attached as **Exhibit R-21.**

16.13 On June 25, 2010 Judge Carey approved the retention of Togut and Donahue and required Donahue to investigate the Contribution Claim, claims against Directors and Officers relating to the Notes, claims relating to the use of the Note Proceeds, any assets subsequently acquired by BCFC and whether conversion of BCFC's Chapter 11/CCAA cases to Chapter 7/BIA is in BCFC's best interests, and prepare a report to be shared with counsel for Aurelius and Contrarian. Copies of the Togut and final draft Donahue Orders are produced respectively as **Exhibits R-22** and **R-23**.

16.14 Most recently, the debtors continued failure to protect the interests of BCFC and on-going attempts to compromise its interests manifested itself in the creation of an August 18, 2010 deadline to participate in the valuable Rights Offering. Only unsecured claims allowed or temporarily allowed by that date will be permitted to participate. BCFC's failure to assert the Contribution Claim and the Preferred Share Claim in a timely manner may well result in BCFC and its creditors being denied an opportunity to participate in the valuable Rights Offering, if these claims are not permitted to be asserted and allowed by that date.

16.15 Peter Wedlake, a trustee in bankruptcy with Green, Hunt, Wedlake, insolvency consultants and bankruptcy trustees has consented to act as trustee in bankruptcy, or as an independent Director or Litigation Monitor to BCFC and has no conflict, as appears from Mr. Wedlake's letter dated May 26, 2010 produced as **Exhibit R-24**. Mr. Wedlake practices in Nova Scotia and is currently the trustee in bankruptcy for General Motors Nova Scotia Finance Company and Stone Container Finance Company of Canada II, both of which, like BCFC, are single purpose Nova Scotia unlimited liability financing vehicles.

17. Aurelius and Contrarian have reviewed the Plan of Reorganization and Compromise of AbitibiBowater and its subsidiaries, including BCFC. Aurelius and Contrarian will vote against the Plan given that it appears to provide for no recovery on either the Contribution Claim or the Preferred-Share claim. Given that collectively Aurelius and Contrarian own in excess of one-third of the value of the unsecured claims against BCFC, the Plan in respect of BCFC is doomed to fail and inevitably BCFC will be either assigned or petitioned into bankruptcy.

18. The Petitioner-Noteholders reiterate the allegations and conclusions of the Motion.

19. The Petitioners-Noteholders respectfully submit that the Contestation should be dismissed and that the Motion should be granted, with costs.

**WHEREFORE, MAY THIS HONOURABLE COURT:**

**DISMISS** the Petitioners-Debtors' Contestation;

**GRANT** the Motion;

**THE WHOLE WITH COSTS.**

Montreal, this 2nd of July, 2010

Fraser Milner Casgrain LLP

**FRASER MILNER CASGRAIN LLP**
Attorneys for Petitioner-Noteholders Aurelius Capital Management, LP and Contrarian Capital Management, L.L.C.

**AFFIDAVIT**

I, the undersigned, DAN GROPPER, Managing Director, exercising my profession at 535 Madison Avenue, 22nd Floor, New York, New York, USA 10022, solemnly declare as follows:

1. I am a duly authorized representative of Aurelius Capital Management, LP;

2. The facts alleged in the present *Amended Reply to Petitioners-Debtors' Contestation of the Motion for the Issuance of an Order directing Bowater Canada Finance Corporation to File an Assignment in Bankruptcy or Alternatively, an Order Seeking the Appointment of an Independent and Disinterested Third Party to Investigate, Assert, Protect and Pursue the Claims and Remedies of Bowater Canada Finance Corporation* are true.

**AND I HAVE SIGNED:**

DAN GROPPER

MALESSA SMITH
NOTARY PUBLIC-STATE OF NEW YORK
No. 01SM6160103
Qualified In New York County
My Commission Expires January 29, 20 11

**SOLEMNLY AFFIRMED** before me at New York, this 2nd day of July, 2010

**AFFIDAVIT**

I, the undersigned, Ethan Schwartz, exercising my profession at 411 West Putnam Avenue, Greenwich, CT 06830, solemnly declare as follows:

3. I am a duly authorized representative of Contrarian Capital Management, L.L.C.;

4. The facts alleged in the present *Amended Reply to Petitioners-Debtors' Contestation of the Motion for the Issuance of an Order directing Bowater Canada Finance Corporation to File an Assignment in Bankruptcy or Alternatively, an Order Seeking the Appointment of an Independent and Disinterested Third Party to Investigate, Assert, Protect and Pursue the Claims and Remedies of Bowater Canada Finance Corporation* are true.

**AND I HAVE SIGNED:**

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**ETHAN SCHWARTZ**

**SOLEMNLY AFFIRMED** before me at
Greenwich, CT, this 2nd day of July, 2010

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CANADA

PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

N°: 500-11-036133-094

**S U P E R I O R C O U R T**
Commercial Division
(Sitting as a Court designated pursuant to the *Companies' Creditors Arrangement Act*, R.S.C., c. C-36)

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

**ABITIBIBOWATER INC.**
and
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**And the other Petitioners listed in Schedules A, B and C**

Petitioners-Debtors

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and

**CONTRARIAN CAPITAL MANAGEMENT, L.L.C..**
having its head office at 411 West Putnam Avenue, Greenwich, CT 06830

Petitioner-Noteholders

## REAMENDED LIST OF EXHIBITS

Exhibit R-1 *En liasse*, Purchase Agreement and an Indenture Agreement, dated as of October 31, 2001;

Exhibit R-2 *En liasse*, Charts of BAH, ACID and BI (produced with the Petition);

Exhibit R-3 Bowater Entities Bond Indebtedness (produced with the Petition);

Exhibit R-4 BCFC Notes Prospectus dated December 10, 2001;

Exhibit R-5 *En liasse*, BHPI Consolidated statements for the year ended December 31, 2001 and 2000;

Exhibit R-6 Order of the Supreme Court of Nova Scotia dated May 17, 2002;

Exhibit R-7 BCFPI Management's Discussion and Analysis of Financial Condition and Results of Operations dated April 26, 2007;

Exhibit R-8 BCHI Resolution dated January 19, 2007;

Exhibit R-9 BCFPI Interim Financial Statements, Three and Six Months Ended June 30, 2007;

Exhibit R-10 Letter from Aurelius dated September 2, 2009 addressed to the Directors of BCFC;

Exhibit R-11 Letter from the Monitor to Aurelius dated October 5, 2009;

Exhibit R-12 Letter to the Monitor dated September 15, 2009 requesting financial information;

Exhibit R-13 Letter to the Monitor dated October 29, 2009 reiterating the request for financial information;

Exhibit R-14 Monitor's letter dated November 12, 2009 to Aurelius's former attorneys;

Exhibit R-15 DIP Objection dated May 28, 2009;

Exhibit R-16 DIP Order dated June 4, 2009;

Exhibit R-17 Letter of the Indenture Trustee counsel's letter dated April 16, 2010;

Exhibit R-18 Resolution and minutes of meeting of the Board of Directors dated May 6, 2010;

Exhibit R-19 Motion before US Bankruptcy Court to approve the retention of Togut, Segal & Segal LLP heard June on 25, 2010;

Exhibit R-20 BCFC's motion before US Bankruptcy Court to appoint AP Services and Donahue heard on June 25, 2010;

Exhibit R-21 Objections of Aurelius and Contrarian as well as the Indenture Trustee;

<u>Exhibit R-22</u> <u>Togut Order dated June 25, 2010;</u>

<u>Exhibit R-23</u> <u>Donahue Order dated June 25, 2010;</u>

<u>Exhibit R-24</u> <u>Letter from Mr. Wedlake dated May 26, 2010 and resume of Peter Wedlake.</u>

Montreal, this 2nd day of July, 2010

Fraser Milner Casgrain LLP

**FRASER MILNER CASGRAIN LLP**
Attorneys for Petitioner-Noteholders
Aurelius Capital Management, LP and
Contrarian Capital Management, L.L.C.

*No.* 500-11-036133-094

SUPERIOR COURT

DISTRICT OF MONTREAL

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AURELIUS CAPITAL MANAGEMENT, LP

and

CONTRARIAN CAPITAL MANAGEMENT, L.L.C.

Petitioner-Noteholders

Me Louis Dumont (N/d : 541555-2)

**Amended Reply to Petitioners-Debtors Contestation of Motion for the Issuance of an Order Directing Bowater Canada Finance Corporation to file an Assignment in Bankruptcy or Alternatively, an Order Seeking the Appointment of an Independent and Disinterested Third Party to Investigate, Assert, Protect and Pursue the Claims and Remedies of Bowater Canada Finance Corporation, Affidavits, Reamended list of exhibits**

ORIGINAL

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