Court File No. CV-11-9367-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

INTERNATIONAL FOREST PRODUCTS CORPORATION

Applicants

- and -

ST. MARYS PAPER CORP.

Respondent

APPLICATION UNDER SUBSECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c.B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT,* R.S.O. 1990, C. C.43, AS AMENDED

FACTUM
OF THE APPLICANTS, INTERNATIONAL FOREST PRODUCTS CORPORATION

(Motion Returnable October 17, 2011)

October 14, 2011

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PART I - OVERVIEW

1. International Forest Products Corporation ("**IFPC**") is bringing a motion for certain interim relief, including, if necessary, the appointment of Ernst & Young Inc. ("**E&Y**") as interim receiver (the "**Interim Receiver**"), without security, of all of the assets, undertakings and properties of St. Marys Paper Corp. (the "**Debtor**"), or such other interim relief as this court may deem just and reasonable, for the purposes of, among other things: (i) obtaining information concerning the Debtor's business, (ii)

monitoring the Debtor's business and (iii) controlling the Debtor's receipts and disbursements pending the return of IFPC's application for the appointment of E&Y as receiver on October 27, 2011 (the "**Receivership Application**").

2. The order is necessary for the protection of IFPC's interests. The relief requested is just and convenient in the circumstances as: (i) IFPC has a prima facie case for a permanent receivership order against the Debtor, (ii) the relief being sought is moderate and non-intrusive, and (iii) the relief will not cause prejudice to the Debtor, but will ensure IFPC is not prejudiced prior to the hearing of the Receivership motion.

PART II - FACTS

Background

3. As at October 11, 2011, the Debtor is indebted to IFPC in the aggregate amount of $6,927,139 (which includes interest and offsets to October 11, 2011) plus expenses, fees and other amounts which may be owing (collectively, the "**Current Indebtedness**") including pursuant to a Loan Agreement between the Debtor and IFPC dated December 8, 2010 (the "**Loan Agreement**").[1]

4. The Debtor granted personal property and real property security to IFPC to secure all obligations owing to IFPC, including the Current Indebtedness.[2]

5. Given that the Debtor has been in default of its obligations to IFPC since April 1, 2010 and has not made a single payment of principal or interest to IFPC under the Loan Agreement,[3] by letter dated July 28, 2011, IFPC demanded payment in full of all outstanding indebtedness owing by the Debtor to IFPC. The demand letter enclosed a Notice of Intention to Enforce Security under subsection 244(1) of the *Bankruptcy and Insolvency Act* (the "**BIA**"). An amended notice was delivered to IFPC on August 4, 2011.[4]

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[1] Affidavit of Daniel J. Moore sworn August 31, 2011 ["August 31 Affidavit"] at para 10.
[2] August 31 Affidavit at para 21.
[3] Third Supplemental Affidavit of Daniel Moore sworn October 14, 2011 [the "October 14 Affidavit"] at para 23.
[4] August 31 Affidavit at para 62.

6. IFPC refrained from immediately enforcing its security in order to provide the Debtor with an opportunity to secure additional financing to re-start the mill (the "**Mill**"), and to attempt to raise capital to complete a co-generation facility.[5]

7. On August 31, 2011, IFPC delivered a notice of application returnable on September 7, 2011 requesting the appointment of a receiver.[6] IFPC's counsel adjourned the receivership application on several occasions to allow settlement discussions to continue.[7]

8. Unfortunately, although the material terms were agreed upon, settlement discussions did not result in a resolution between the parties. On September 28, 2011, counsel for IFPC and the Debtor attended before The Honourable Mr. Justice Brown to set a date and timetable for the return of IFPC's receivership application.[8]

9. On September 29, 2011, counsel for IFPC requested confirmation that the Debtor would immediately advise IFPC if and when pending HST and real estate tax refunds are received. IFPC has concerned that such proceeds have been and may continued to be used to maintain the idled Mill or to pay other creditors, which would result in a further erosion of IFPC's collateral. IFPC further requested that E&Y be provided with access to the Debtor's business operations, assets, and books and records.[9]

10. This request was a reasonable one, as the Debtor already has an obligation to provide financial disclosure by IFPC pursuant to section 9.6 of the Loan Agreement and s.6.1(k) of the General Security Agreement between the Debtor and IFPC dated December 8, 2010.[10] The Debtor also previously consented to E&Y's appointment as financial advisor to IFPC and agreed and did provide E&Y with access to its books, records, assets and business operations.

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[5] August 31 Affidavit at para 11.
[6] Supplemental Affidavit of Daniel J. Moore sworn September 17, 2011 [the "September 17 Affidavit"] at para 4.
[7] September 17 Affidavit at paras 10-13.
[8] Second Supplemental Affidavit of Daniel J. Moore sworn October 6, 2011 [the "October 6 Affidavit"] at para 4.
[9] October 6 Affidavit at para 6.
[10] October 6 Affidavit at paras 7-8.

11. Notwithstanding follow up by IFPC's counsel, the Debtor did not respond to the September 29 Letter until October 5, 2011, after being advised by IFPC's counsel that IFPC intended to bring a motion for interim relief.[11]

Interim Relief Motion

12. As a result of the lack of financial disclosure described above, on October 7, 2011, counsel for IFPC and the Debtor, among other interested parties, appeared before the Honourable Mr. Justice Campbell of the Ontario Superior Court (the "**Court**") in respect of this motion by IFPC for certain interim relief (the "**Interim Relief Motion**").[12]

13. As set out in Justice Campbell's Endorsement dated October 7, 2011 (the "**Endorsement**"), the Interim Relief Motion was adjourned to October 17, 2011 on terms agreed to between the Debtor and IFPC. Those terms required, among other things: (i) the Debtor to provide its current cash balance to E&Y and to provide E&Y with its cash balance at the close of business on each business day until the Receivership Application is heard and finally disposed of; (ii) the Debtor to provide to E&Y by 5:00 p.m. on October 8, 2011 a reconciliation of its cash balance from August 15, 2011 to October 5, 2011 showing receipts and disbursements for this period, including an explanation of the source of the current cash balance, and details of all projected expenditures between October 6, 2011 and October 17, 2011 (inclusive); (iii) the Debtor to confirm and undertake not to transfer, dispose of, remove or encumber any assets until the Receivership Application is heard and finally disposed of; and (iv) that the Debtor not make disbursements between the date of the Endorsement and the return of the Receivership Application in excess of $81,000.[13]

14. The Endorsement also scheduled a further hearing for October 27, 2011 to hear the Receivership Application in the event that matters were not substantially

[11] October 6 Affidavit at paras 9-10.
[12] October 14 Affidavit at para 5.
[13] October 14 Affidavit at para 8.

resolved by October 17, 2011 and provided that counsel would outline but may not finalize a timetable until October 17.[14]

15. In accordance with the Endorsement, the Debtor provided a reconciliation of its cash balance from August 15, 2011 to October 7, 2011 showing receipts and disbursements for this period, and details of all projected expenditures between October 8, 2011 and October 17, 2011 (the "**Reconciliation**"). The Reconciliation shows a cash balance as of October 7, 2011 of $164,460. The Reconciliation demonstrates that St. Marys had approximately $320,000 less in cash as of October 7, 2011 than the $484,000 which the court was advised it had on that day.

16. IFPC did not find this out until it received the Reconciliation on October 8, 2011.

17. Receipts since August 15, 2011 total $833,000. Of this total, $647,000 is attributed to the HST Refund which was received during the week of September 25, 2011. The HST Refund represents a refund of funds paid by IFPC on behalf of St. Marys. IFPC has repeatedly communicated its entitlement to the HST Refund to St. Marys, including in the course of the settlement discussions. As discussed above, St. Marys and IFPC had reached a material agreement on terms of settlement and forbearance, which agreement included the requirement of St. Marys to pay the HST Refund to IFPC when received. These settlement discussions were extended until September 26, 2011, when St. Marys advised IFPC that the new financier had walked away from the deal. Despite numerous discussions between the parties during the week of September 25, St. Marys did not disclose that it had received the HST Refund. St. Marys further made a final settlement proposal on September 27, 2011, which did not disclose that St. Marys had received the HST Refund.

18. Total disbursements set out in the Reconciliation total $932,000, and include, among other things, a retainer for $100,000 for legal fees, a retainer of $61,000 for a Mill sale consultant, and $470,000 for employee-related costs for payroll, benefits, expense reports and similar items.

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[14] October 14 Affidavit at para 9.

19. Disbursements between August 28, 2011 to October 7, 2011 total $697,000. IFPC advised St. Marys as early as August 23, 2011 that IFPC would no longer forbear from exercising its remedies against St. Marys and would be seeking the appointment of a Receiver. As such, the value of IFPC's collateral has declined by at least $697,000 during this period. Moreover, St. Marys have taken advantage of Court scheduling issues and other delays out of the control of IFPC to make additional disbursements to the detriment of IFPC.

PART III - ISSUES

20. The only issue to be determined is whether or not this Honourable Court should grant interim relief pending the return of the receivership application scheduled for October 27, 2011.

PART IV - ARGUMENT

A. THIS HONOURABLE COURT HAS THE AUTHORITY TO APPOINT AN INTERIM RECEIVER

21. This Honourable Court has authority to grant interim relief pursuant to section 47 of the BIA, section 101 of the *Courts of Justice Act* (the "**CJA**") and section 67 of the *Personal Property Security Act* (the "**PPSA**").

22. Section 47 of the BIA provides the court with the authority to appoint an interim receiver if it is satisfied that a notice is about to be sent or was sent under section 244(1).[15] An appointment under section 47 of the BIA may only be made if it is shown to the court to be necessary for the protection of (a) the debtor's estate; or (b) the interest of the creditor who sent the notice under subsection 244(1).[16]

23. This Honourable Court may also appoint a receiver pursuant to section 101 of the CJA where it is just and convenient to do so.[17]

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[15] *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended [the "BIA"], s.47(1).
[16] BIA, s.47(3).
[17] *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended, s.101.

24. Alternatively, in the event that this Honourable Court deems that the appointment of an interim receiver is not appropriate or necessary, the PPSA provides this Honourable Court with very broad authority make *any order necessary to ensure protection of the interests of any person in the collateral*, but only on terms that are just for all parties concerned.[18] Courts have also confirmed the appointment of a receiver pursuant to a secured creditor's security agreement.[19]

B. <u>**THIS COURT OUGHT TO GRANT THE INTERIM RELIEF REQUESTED IN THE CIRCUMSTANCES OF THIS CASE**</u>

25. The order is necessary for the protection of IFPC's interests. Moreover, the relief requested is just and convenient in the circumstances as (i) IFPC has a prima facie case for a permanent receivership order against the Debtor, (ii) the relief being sought is moderate and non-intrusive, and (iii) the relief will not cause prejudice to the Debtor, but will ensure IFPC is not prejudiced prior to the hearing of the Receivership motion.

<u>**(i) IFPC Has a Strong Prima Facie Case**</u>

26. In *Royal Bank v. Canadian Print Music Distributors Inc.*, upon granting an order appointing an interim receiver, Cumming J. held that the bank had met the onus of establishing a strong *prima facie* case of bankruptcy inasmuch as the debtors could not meet their liabilities as they fell due, and that the evidence established on a balance of probabilities that the bank would likely succeed in obtaining an order for a permanent receivership on the return of the application.[20] IFPC has valid and enforceable security against the Debtor's assets, and the Debtor is in default of its obligations under the Loan Agreement. IFPC therefore has a strong *prima facie* case against the Debtor.

27. While the facts in *Royal Bank* are not identical to the case at hand, there are similarities: (i) the section 244 notice was sent to the debtors, (ii) the notice period

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[18] *Personal Property Security Act,* R.S.O. 1990, c. P.10, as amended, s. 67(1)(e).

[19] See for example: *Cargill Ltd. v. Farr-Mor II Supply Inc.* (1998), 171 Sask. R. 187 (Q.B.); *STN Labs Inc. v. Saffron Rouge Inc.* (2010) 68 C.B.R. (5^{th}) 287 (Ont. Sup Ct.).

[20] *Royal Bank v. Canadian Print Music Distributors Inc.* (2006), 23 C.B.R. (5^{th}) 42 ["*Royal Bank*"] at para 14.

had expired, and (iii) the parties had attempted, albeit unsuccessfully, to negotiate a formal forbearance agreement. There are no allegations of wrongdoing against the Debtor in this case; however, Cumming J. held in *Royal Bank* that proof of actual misfeasance and wrongdoing is not a prerequisite to appointing an interim receiver.[21]

(ii) The Interim Relief Being Sought is Moderate

28. The moderate and temporary nature of the interim relief being sought by IFPC favours the granting of such relief.[22] The interim relief being sought is temporary and will terminate once the receivership application is heard and determined. Moreover, the relief being sought is moderate in nature as it seeks only to ensure that (i) IFPC has access to appropriate and adequate financial information to which it is contractually entitled to receive, and (ii) that its collateral position will not substantially deteriorate pending the hearing of the Receivership Application. Given that the Mill is idled, the relief sought is not prejudicial.

29. As described above, IFPC has experienced great difficulty in obtaining disclosure of St. Marys cash position which has now been reduced to \$164,000, \$320,000 less than advised on October 7, 2011. The value of IFP's collateral has declined by at least \$697,000 since the end of August 2011.[23]

30. IFPC does not seek to take control of the Debtor's business, but only seeks to monitor and control the receipts and disbursements to ensure that only minimal and necessary disbursements are being made for the purposes of maintaining the Mill and the other assets until the receivership application can be heard.

(iii) The Relief Will Not Prejudice the Debtor, but will avoid Prejudice to IFPC

31. The Mill is no longer operating, and as such, this interim and limited relief is not prejudicial to the Debtor. In fact, the relief will ensure that IFPC's collateral will not unnecessarily erode until the receivership application is heard for the benefit of all stakeholders.

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[21] *Royal Bank* at para 16.
[22] *P. O'Rourke & Partners Inc. v. Niagara Broadcasting Corp.*, 2003 CarswellOnt 54.
[23] October 14 Affidavit at paras 12 and 17.

32. IFPC is concerned that certain tax refunds subject to its security, one of which represents a repayment of funds advanced by IFPC, were used by the Debtor to pay other creditors without IFPC's knowledge. There are also additional refunds forthcoming. IFPC is the stakeholder with the greatest economic interest and as such has a direct interest in how cash is spent, particularly in light of the pending receivership application. As such, IFPC should be involved in determining what expenses are reasonable in the circumstances. The Mill is not operating, the Debtor is clearly in financial distress and IFPC is owed over $7 million. A court order requiring financial disclosure and limited control over the Debtor's non-operating expenses is reasonable, just and convenient in the circumstances in order to assist in preserving IFPC's collateral.

Power Purchase Agreement

33. The Debtor claims that it will be prejudiced by the interim relief requested, as the appointment of a receiver or monitor will result in a breach of the Power Purchaser Agreement dated as of November 5, 2010 entered into by St. Marys Renewable Energy LP ("**Renewable Energy LP**") and the Ontario Power Authority (the "**Power Purchase Agreement**"). Renewable Energy LP is a related party to Renewable Energy Corp and the Debtor.

34. It is IFPC's position that a receivership of the Debtor is not a breach or an event of default under the Power Purchase Agreement. All events of default under the Power Purchase Agreement are triggered by actions or omissions of Renewable Energy LP. Likewise, the appointment of the Receiver would not cause a change of control of Renewable Energy LP.

35. The Debtor is not a party to the Power Purchase Agreement. The Debtor is merely the "Host" under the Power Purchase Agreement, and its obligations as Host are assignable pursuant to Section 2.12(b) of the Power Purchase Agreement, including upon a sale of the Debtor to a third party.

36. Renewable Energy LP is financed by the Debtor, either directly or indirectly through Renewable Energy Corp.

37. St. Marys asserts that several institutional or chartered bank lenders are prepared to provide $75 million in debt financing to the Co-Generation Facility. No commitment letter, term sheet, comfort letter or other evidence has been provided to substantiate this assertion.

38. Pursuant to Section 6.1 of the Power Purchase Agreement, Renewable Energy LP is also required to post additional security for the performance of its obligations under the Power Purchase Agreement on October 31, 2011, which may be as much as $1,200,000. There is a concern that the Debtor will be required to provide additional capital to Renewable Energy LP in order to make this payment.

39. The failure of Renewable Energy LP to make any payment when due or deliver performance security when required is an event of default under the Power Purchase Agreement.

40. St. Marys further asserts that the potential financiers and potential partners in the Co-Generation Facility will no longer support the project if a Receiver is appointed over the Debtor. There is no evidence provided to support this assertion and, as mentioned, the receivership is not a breach or event of default under the Power Purchase Agreement.

41. Even if the Power Purchase Agreement entitled the Ontario Power Authority or any financier or partner to terminate their agreements with the Debtor, they would be subject to a stay of proceedings upon the appointment of the Receiver.

Correspondence with Ontario Power Authority

42. Counsel to IFPC have provided copies of each of the application and motion records served in the proceedings to the Ontario Power Authority and have asked the Ontario Power Authority to advise of their position on the relief sought by IFPC in the Receivership Application and the Interim Relief Motion. The Ontario Power Authority has now retained counsel who will advise of their position in the coming days.

Prosperity Fund Agreement

43. It is asserted that the $25 million prosperity fund grant to St. Marys granted pursuant to an agreement entered into with the Province (i.e., Her Majesty the Queen in Right of the Province of Ontario, as represented by the Minister of Northern Development, Mines and Forestry) would be canceled if the Receiver is appointed. St. Marys asserts that it presently has a commitment of a $25 million prosperity fund grant and an additional $25 million subordinated loan guarantee from the Province.

44. Despite requests by Blakes to St. Marys' counsel, IFPC has not been provided with an executed copy of the Prosperity Fund Agreement. The agreement set out in Exhibit G of the Acton Affidavit is an unexecuted template agreement which does not reference St. Marys or any of its related parties. Counsel to IFPC has also asked counsel to St. Marys to confirm that St. Marys is a party to the Prosperity Fund Agreement.

45. The Province has been served with copies of the application and motion records served in the proceedings and counsel to IFPC have asked the Province to advise of their position on the relief sought by IFPC in the Receivership Application and the Interim Relief Motion.

46. Counsel for the Province has advised that no Power Purchase Agreement has been entered into with St. Marys or any of its affiliates. They have also advised that there is no commitment by the Province to provide a $25 million prosperity fund grant or a $25 million loan guarantee to St. Marys.

47. It is IFPC's position that a receivership of St. Marys is not a breach or event of default or does not otherwise threaten a prosperity fund grant or subordinated loan from the Province.

PART V - ORDER REQUESTED

48. As such, IFPC requests that this Honourable Court grant interim relief pending the hearing of the receivership application on October 27, 2011.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Date: October 14, 2011

Michael McGraw / Jackie Moher
Lawyers for International Forest Products Corporation

SCHEDULE "A"

LIST OF AUTHORITIES

Cargill Ltd. v. Farr-Mor II Supply Inc. (1998), 171 Sask. R. 187 (Q.B.).

STN Labs Inc. v. Saffron Rouge Inc. (2010) 68 C.B.R. (5^{th}) 287 (Ont. Sup Ct.).

Royal Bank v. Canadian Print Music Distributors Inc. (2006), 23 C.B.R. (5^{th}) 42 (Ont. Sup. Ct.).

P. O'Rourke & Partners Inc. v. Niagara Broadcasting Corp., 2003 CarswellOnt 54 (Sup. Ct.).

SCHEDULE "B"

LEGISLATION

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended

Appointment of interim receiver

47. (1) If the court is satisfied that a notice is about to be sent or was sent under subsection 244(1), it may, subject to subsection (3), appoint a trustee as interim receiver of all or any part of the debtor's property that is subject to the security to which the notice relates until the earliest of

(*a*) the taking of possession by a receiver, within the meaning of subsection 243(2), of the debtor's property over which the interim receiver was appointed,

(*b*) the taking of possession by a trustee of the debtor's property over which the interim receiver was appointed, and

(*c*) the expiry of 30 days after the day on which the interim receiver was appointed or of any period specified by the court.

Directions to interim receiver

(2) The court may direct an interim receiver appointed under subsection (1) to do any or all of the following:

(*a*) take possession of all or part of the debtor's property mentioned in the appointment;

(*b*) exercise such control over that property, and over the debtor's business, as the court considers advisable;

(*c*) take conservatory measures; and

(*d*) summarily dispose of property that is perishable or likely to depreciate rapidly in value.

When appointment may be made

(3) An appointment of an interim receiver may be made under subsection (1) only if it is shown to the court to be necessary for the protection of

(*a*) the debtor's estate; or

(*b*) the interests of the creditor who sent the notice under subsection 244(1).

(4) An application under subsection (1) is to be filed in a court having jurisdiction in the judicial district of the locality of the debtor.

* * *

Courts of Justice Act, R.S.O. 1990, c. C.43, as amended

Injunctions and receivers

101.(1) In the Superior Court of Justice, an interlocutory injunction or mandatory order may be granted or a receiver or receiver and manager may be appointed by an interlocutory order, where it appears to a judge of the court to be just or convenient to do so. R.S.O. 1990, c. C.43, s. 101 (1); 1994, c. 12, s. 40; 1996, c. 25, s. 9 (17).

* * *

Personal Property Security Act, R.S.O. 1990, c. P.10, as amended

67. (1) Upon application to the Superior Court of Justice by a debtor, a creditor of a debtor, a secured party, an obligor who may owe payment or performance of the obligation secured or any person who has an interest in collateral which may be affected by an order under this section, the court may,

(a) make any order, including binding declarations of right and injunctive relief, that is necessary to ensure compliance with Part V, section 17 or subsection 34 (3) or 35 (4);

(b) give directions to any party regarding the exercise of the party's rights or the discharge of the party's obligations under Part V, section 17 or subsection 34 (3) or 35 (4);

(c) make any order necessary to determine questions of priority or entitlement in or to the collateral or its proceeds;

(d) relieve any party from compliance with the requirements of Part V, section 17 or subsection 34 (3) or 35 (4), but only on terms that are just for all parties concerned;

(e) make any order necessary to ensure protection of the interests of any person in the collateral, but only on terms that are just for all parties concerned;

(f) make an order requiring a secured party to make good any default in connection with the secured party's custody, management or disposition of the collateral of the debtor or to relieve the secured party from any default on such terms as the court considers just, and to confirm any act of the secured party; and

(g) despite subsection 59 (6), if the secured party has taken security in both real and personal property to secure payment or performance of the debtor's obligation, make any order necessary to enable the secured party to accept both the real and personal property in satisfaction of the obligation secured or to enable the secured party to enforce any of its other remedies against both the real and personal property, including an order requiring notice to be given to certain persons and governing the notice, an order permitting and governing redemption of the real and personal property, and an order requiring the secured party to account to persons with an interest in the real property or personal property for any surplus. R.S.O. 1990, c. P.10, s. 67 (1); 2000, c. 26, Sched. B, s. 16 (1); 2006, c. 34, Sched. E, s. 22.

Compensation for loss or damages

(2) Where a person fails to discharge any duties or obligations imposed upon the person by Part V, section 17 or subsection 34 (3) or 35 (4), the person to whom the duty or obligation is owed has a right to recover compensation for any loss or damage suffered because of the failure and which was reasonably foreseeable, and, where the collateral is consumer goods, the debtor has a right to recover in any event an amount equal to the greater of $500 or the actual loss or damages. R.S.O. 1990, c. P.10, s. 67 (2).

Void provisions

(3) Except as otherwise provided in this Act, any provision in any security agreement which purports to exclude any duty or obligation imposed under this Act or to exclude or limit liability for failure to discharge duties or obligations imposed by this Act is void. R.S.O. 1990, c. P.10, s. 67 (3).

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(COMMERCIAL LIST)

Proceeding commenced at Toronto

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