Court File No. CV-12-9566-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TERRACE BAY PULP INC.

The Applicant

FACTUM OF BIRCHWOOD TRADING, INC.

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PART I - OVERVIEW

1. Terrace Bay is seeking Court approval of a Transaction in which AVTB will purchase all or substantially all of the Mill Assets of Terrace Bay for a purchase price of $2 million, plus a $25 million concession from the Province of Ontario. The Monitor has recommended that this Transaction be approved by this Honourable Court. In doing so, Terrace Bay and the Monitor have taken the position that a competing offer from Tangshan Sanyou Xingda Chemical Fiber Co. ("**Tangshan**") for a purchase price of $35 million should not be considered, notwithstanding that the Tangshan offer (i) is subject to terms and conditions which are as good or better than the Transaction, (ii) would provide dramatically greater recovery to the creditors of Terrace Bay, and (iii) offers significant benefits to other stakeholders, including the employees of the Terrace Bay mill.

2. Birchwood Trading, Inc. ("**Birchwood**") is a creditor of Terrace Bay. Birchwood holds a beneficial interest in the Subordinated Secured Plan Notes (the "**Notes**") and is also the fourth largest trade creditor of Terrace Bay according to the Creditor List published on the Monitor's website. If the Transaction is approved, Birchwood expects to receive less than 6% recovery on its holdings under the Notes and no recovery on its trade debt. If the Tangshan offer was accepted by Terrace Bay, Birchwood expects that it would

receive full recovery under the Notes, and may also receive a distribution with respect to its trade debts.

3. Moreover, the Tangshan offer provides substantial benefits to the creditors and other stakeholders of Terrace Bay which will not be realized under the Transaction. These include:

(a) An increase in the purchase price for the Mill Assets, from an "effective" purchase price of $27 million to a cash purchase price of $35 million;

(b) The potential for the Province of Ontario to be repaid in full or, if the Province is prepared to offer the same debt-forgiveness concession under the Tangshan offer, the potential to increase the "effective" purchase price of the Tangshan offer to $60 million;

(c) As a consequence of (a) and (b), additional proceeds available for distribution to creditors subordinate to the Province of Ontario of between $8 million and $33 million;

(d) Employment of approximately 75 additional employees, plus the existing management of the mill;

(e) Conversion of the mill into a dissolving pulp mill in 18 months, rather than 4 years, with a higher expected yield once the conversion is complete and a business plan which calls for the production of a more lucrative interim product during the conversion process.

The substantial increase in the consideration offered by the Tangshan offer, which is a binding offer with terms and conditions which are at least as favourable as the Transaction, is sufficient to call into question the integrity and efficacy of the Sales Process. It suggests that the market for the Mill Assets was not sufficiently canvassed, and it provides evidence to support a finding by this Honourable Court that the criteria for approval of a sale as set out in section 36(3) of the CCAA and *Soundair* have not been met.

4. Birchwood requests that this Honourable Court adjourn Terrace Bay's request for approval of the Transaction, or refuse approval outright, and vary the Sales Process to allow the Tangshan offer to be considered and, if appropriate, accepted by Terrace Bay. Birchwood is of the view that any small delay which might result from briefly re-opening the Sales Process would be substantially outweighed by the possibility of significantly increased consideration for the Mill Assets, and is essential to ensuring that the interests of creditors are protected and that the Sales Process achieves fair and reasonable value for the Mill Assets.

PART II - THE FACTS

5. The facts relevant to Birchwood's position in support of reopening the Sales Process are set out in the Sixth Report to the Court of the Monitor dated July 12, 2012 and in the Affidavit of Yu Hanjiang sworn July 15, 2012, and are not repeated in detail in this Factum.

PART III: THE ISSUES

6. Birchwood is responding to only two of the heads of relief sought in Terrace Bay's Notice of Motion – relating to approval of the Transaction and consideration of the Tangshan offer. The essential issue is whether the Transaction should be approved and whether Tangshan should be denied participation in the Sales Process, notwithstanding that Tangshan has proceeded in good faith and that the Tangshan offer is dramatically better than the Transaction for all stakeholders.

PART IV - LAW AND ARGUMENT

The Test For Approval of The Transaction

7. The criteria for approval of a sale transaction under section 36 of the CCAA and the criteria established in *Royal Bank v. Soundair Corp.* for the Court to consider when assessing whether to approve a transaction to sell assets are described in paragraphs 36-37 of Terrace Bay's Factum ("**Approval Criteria**").

> ***Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, as amended, ("CCAA") at s. 36.**
>
> ***Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 ("*Soundair Appeal*") at ¶ 16.**

8. The Approval Criteria are based on a line of decisions in which the Courts have held that there are two high-level considerations on a sale approval motion. The primary concern is the protection of the interests of the creditors. A secondary consideration is the integrity and efficacy of the process.

> ***Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 at 5.**
>
> ***Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87 ("*Crown Trust*") at p. 6.**
>
> ***Royal Bank v. Soundair Corp.*, [1991] O.J. No. 650 ("*Soundair*") at pp. 11-12.**

9. The need to protect the interests of creditors militates strongly in favour of refusing to approve a sale transaction in circumstances where there is another binding offer open for acceptance that would, on balance, provide substantially greater benefits to the creditors and all stakeholders. Considerations relating to the integrity and efficacy of the process are more complex. The Courts have two principal concerns when considering whether to re-open a Court-approved sale process:

   (a) The first concern is fairness. During the gap between acceptance and Court approval of an offer, there is the possibility that other potential purchasers will obtain information about the offer that will give them an unfair advantage over offeror.

(b) The second concern is a matter of policy. Prospective purchasers should have confidence in a Court-approved sale process and should not feel as though they need to hold something in reserve in case another purchaser appears in the moment before approval of an offer.

***Crown Trust* at pp. 7, 21-22.**

***Beauty Counsellors of Canada Ltd., Re* (1986), 58 C.B.R. (N.S.) 237 ("*Beauty*") at ¶ 26-27.**

10. The existence of a significantly better offer is a relevant consideration when measuring the efficacy and integrity of the sale process. Courts have routinely held that a substantially higher offer should be considered on a sale approval motion. Such an offer may be evidence that insufficient efforts have been made to obtain the best possible price for the assets. Such an offer may indicate a flaw in the sales process.

***Crown Trust at* pp. 6-7, 19.**

***Soundair at* pp. 11-12.**

***Beauty* at ¶ 28.**

11. The Court's role on a sale approval motion is to consider the propriety of the proposed sale in the context of the Approval Criteria. The Court is not a rubber stamp. It is not required to proceed on the recommendations of the Court officer where there are good reasons not to do so.

***Crown Trust* at p. 20.**

12. Even if the Court is satisfied that the party conducting the sale has acted reasonably, prudently and fairly, the Court may nonetheless intervene and proceed contrary to the recommendation of the Court officer in exceptional circumstances. For example:

(a) In *1587930 Ontario Ltd., Re* the Court was presented with a sale approval motion pursuant to which the senior secured creditor of the debtor would have purchased substantially all of the assets of the debtor. The sale approval motion was opposed by the unsecured creditors, who supported an alternative offer which, on the surface, appeared to offer the potential for greater recovery for unsecured creditors. The Court saw fit to reopen the sales process for a short period of 30 days to allow either party to put in a further offer, noting the potential for a much-improved return for unsecured creditors; and

(b) In *Toronto Dominion Bank v. Eastern Gypsum Inc.* the Court was faced with a sale approval motion in which a subsequent offeror was prepared to pay a purchase price 25% greater than the purchase price in the offer to be approved. The Court considered the importance of maintaining the integrity of the sale process, but concluded that the difference between purchase prices was so significant that approval of the lower offer would be improvident. On that basis, the Court refused to approve the sale.

***1587930 Ontario Ltd., Re* (2006), 25 C.B.R. (5th) 260 at ¶19.**

***Toronto Dominion Bank v. Eastern Gypsum Inc.* (1992), 129 N.B.R. (2d) 91 at ¶10.**

<u>Re-opening the Sales Process is Essential to Protect the Interests of the Creditors</u>

13. The Mill Assets are Terrace Bay's most significant assets. It is essential that every effort be made to receive the best possible consideration for the Mill Assets, or the chance of recovery for creditors other than the Province of Ontario will be significantly diminished. In view of the substantial difference in consideration between the Tangshan offer and the Transaction, it is apparent that the Transaction does not provide the best possible consideration for the assets.

14. Specifically, approving the Transaction and rejecting any consideration of Tangshan's offer will deprive the creditors and other stakeholders of the following advantages:

(a) An increase in the purchase price for the Mill Assets, from an "effective" purchase price of $27 million to a cash purchase price of $35 million;

(b) The potential for the Province of Ontario to be repaid in full or, if the Province is prepared to offer the same debt-forgiveness concession under the Tangshan offer, the potential to increase the "effective" purchase price of the Tangshan offer to $60 million;

(c) As a consequence of (a) and (b), additional proceeds available for distribution to creditors subordinate to the Province of Ontario of between $8 million and $33 million;

(d) Employment of approximately 75 additional employees, plus the existing management of the mill;

(e) Conversion of the mill into a dissolving pulp mill in 18 months, rather than 4 years, with a higher expected yield once the conversion is complete and a business plan which calls for the production of a more lucrative interim product during the conversion process.

Affidavit of Yu Hanjiang sworn July 15, 2012 ("Yu Affidavit") at ¶ 31.

15. These are not minor incremental advantages. The pool of proceeds available to creditors under the Tangshan offer, after payment in full of all indebtedness to the Province of Ontario, is at least $8 million higher than under the Transaction. The Tangshan offer would see an additional class of secured creditors, the Noteholders, paid out in full and would leave substantial proceeds for distribution to the construction lien claimants and/or the trade creditors of Terrace Bay. Furthermore, the Tangshan offer provides a number of benefits in the form of increased employment and operational advantages which increase the probability that the mill will be successful post-closing. These substantial benefits will be denied to the stakeholders in the event that the Transaction is approved.

The Efficacy and Integrity of the Sales Process is in Doubt

16. Tangshan is the third largest manufacturer of viscose staple fibre in the world. It has operations in 15 different countries. In these respects, Tangshan's business is similar to the business of AVTB and its parent. Tangshan was therefore a logical choice as a prospective purchaser of the Mill Assets. Yet Tangshan was not contacted by Terrace Bay or the Monitor to participate in the Sales Process. The failure to contact a prospective purchaser of the size and stature of Tangshan in the very same industry where the proposed purchaser operates reflects a failure to sufficiently canvass the market for the Mill Assets.

Yu Affidavit at ¶ 10, 17.

17. Moreover, on a sale approval motion the existence of a higher bid made after acceptance of the first offer should be considered by the Court. Where the difference between the bids is significant, the new bid may indicate that the vendor has not properly carried out its duty to endeavour to obtain the best price for the assets. As noted above, there are substantial differences between the consideration offered by the Transaction and the consideration offered by the Tangshan offer. The difference in "effective" purchase price is approximately 23%. The difference in the proceeds available for distribution to creditors other than the Province of Ontario is 500%. This substantial difference casts doubt on the Sales Process. Again, it suggests that the market for the Mill Assets was not sufficiently canvassed and that insufficient effort was made to obtain the best possible purchase price.

Tangshan is Proceeding in Good Faith

18. One of the principal reasons why Courts have historically refused to re-open a sales process is fairness. During the gap between acceptance and Court approval of an offer, there is the possibility that other potential purchasers will obtain information about the offer that will give them an unfair advantage over offeror. Another reason why Courts

have refused to re-open a sales process is a matter of policy. Participants in a sale process should not feel that they need to hold something in reserve in case of a last-minute offer which threatens to edge them out of the process.

19. These are muted concerns on the present motion. Between May 2012 when Tangshan first became aware of the sale of the Mill Assets and July 12, 2012 when Tangshan made its offer, Tangshan proceeded expeditiously and transparently to conduct its due diligence and submit its offer. Of particular significance is that Tangshan delivered its first letter of intent on July 5, 2012, offering a purchase price of $35 million. That letter was delivered before the details of the Transaction were disclosed in the motion materials served by Terrace Bay on July 12, 2012. Through a subsequent letter of intent and formal binding offer, Tangshan altered the proposed conditions of its offer to conform with the Transaction but the purchase price remained unchanged.

Yu Affidavit at ¶ 16, 30.

Sixth Report of the Monitor dated July 12, 2012 ("Sixth Report") at Appendix F, H and I.

20. Given the timelines and given the substantial difference between the purchase prices offered by Tangshan and AVTB, it is apparent that Tangshan was not engaged in any "gaming" of the Sales Process. This is not a case where a purchaser lay in the weeds, waiting to edge out a participant in the sales process with a slightly better offer, delivered moments before the sale approval motion. Moreover, Tangshan offered a substantially greater purchase price than AVTB, in good faith, as soon as it was able to do so and before knowing any of the details of the Transaction. Accordingly, issues of fairness relating to disclosure of information about the Transaction are not a significant reason to refuse to re-open the Sale Process in this proceeding. Furthermore, given the significant difference in price between the Transaction and the Tangshan offer and the manner in which the Tangshan offer was made, it is doubtful whether re-opening the Sales Process would encourage future purchasers to lie in the weeds or to hold in reserve a portion of their consideration against the possibility of future bidders "edging them out" at the end of the process.

The Approval Criteria Have Not Been Met

21. It is apparent that a number of the Approval Criteria have not been met by the Transaction. Among other things:

(a) Failure to advise Tangshan, a logical prospective purchaser for the Mill Assets, of the Sales Process, coupled with the significant difference in consideration between the Transaction and the Tangshan offer both indicate a failure to sufficiently canvass the market for the Mill Assets and a failure to make a sufficient effort to get the best price for the Mill Assets, contrary to section 36(3)(a) of the CCAA and criteria (c) and (d) of the *Soundair* criteria.

(b) It is apparent that there are purchasers, including Tangshan, that are prepared to offer substantially greater consideration for the Mill Assets than the Transaction would provide, such that the consideration received under the Transaction cannot be said to be fair and reasonable, taking into account the market value of the Mill Assets. This runs contrary to section 36(3)(f) of the CCAA and suggests an improvident sale under criteria (a) of the *Soundair* criteria.

(c) The effect of approving the Transaction will be to foreclose the possibility of negotiating an offer with Tangshan on the terms proposed in its latest offer, to the considerable detriment of creditors and other stakeholders, contrary to section 36(3)(e) of the CCAA and criteria (b) of the *Soundair* criteria.

CCAA at s. 36(3).

***Soundair Appeal* at ¶ 16.**

Conclusion

22. The circumstances of Tangshan's involvement in the Sales Process and the substantial increase in consideration offered by the Tangshan offer are sufficient to call into question the integrity and efficacy of the Sales Process. Furthermore, the Transaction has failed to meet a significant number of the Approval Criteria. Accordingly, it is essential for the protection of the interests of creditors that the Sales Process be re-opened to provide an opportunity for the Tangshan offer to be considered and, if appropriate, accepted by Terrace Bay.

23. Birchwood is of the view that the benefits of re-opening the Sales Process for a brief period will significantly outweigh any negative effects on Terrace Bay and the other stakeholders. The latest cash flows indicate that Terrace Bay has sufficient short-term liquidity to finance a brief extension of the Sales Process and Tangshan has offered to provide funding, if necessary, to maintain the status quo during any such extension.

Yu Affidavit at ¶ 33.

Sixth Report at Appendix J.

PART V - RELIEF REQUESTED

24. For the above reasons, Birchwood requests that this Honourable Court adjourn Terrace Bay's request for approval of the Transaction, or refuse approval outright, and vary the Sales Process to allow the Tangshan offer to be considered and, if appropriate, accepted by Terrace Bay.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

July 16, 2012

James Szumski

Lawyers for Birchwood Trading, Inc.

SCHEDULE "A" – LIST OF AUTHORITIES

1. *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1.

2. *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245.

3. *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87.

4. *Royal Bank v. Soundair Corp.*, [1991] O.J. No. 650.

5. *Beauty Counsellors of Canada Ltd., Re* (1986), 58 C.B.R. (N.S.) 237.

6. *1587930 Ontario Ltd., Re* (2006), 25 C.B.R. (5th) 260.

7. *Toronto Dominion Bank v. Eastern Gypsum Inc.* (1992), 129 N.B.R. (2d) 91.

SCHEDULE "B" – STATUTES AND REGULATIONS

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

36(3). …

Factors to be considered

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

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PROCEEDINGS COMMENCED AT TORONTO

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