SUPERIOR COURT

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

No : 500-11-036133-094

DATE : MAY 21, 2009

PRESENT : THE HONOURABLE MADAM JUSTICE DANIÈLE MAYRAND, J.S.C.

IN THE MATTER OF THE PLAN OF ARRANGEMENT OF:

ABITIBIBOWATER INC.
And
ABITIBI-CONSOLIDATED INC.
And
BOWATER CANADIAN HOLDINGS INC. AND OTHERS
Respondents

And
ERNST & YOUNG INC.
Monitor

And
SFK PULP GENERAL PARTNERSHIP
Petitioner

JUDGEMENT

---

[1] The petitioner, SFK Pulp General Partnership ("**SFK**"), is requesting the cancellation of the notice of repudiation (the "**Notice**") that has been sent to it by Abitibi-Consolidated Company of Canada ("**ACI**") and that relates to two supply contracts, one for wood chips and the other for bark (the "**Contracts**").

[2] Under the protection afforded by the *Companies Creditors Arrangement Act*[1] (the "**CCAA**"), AbitibiBowater Inc. and its subsidiaries ("**ABI Group**") have availed themselves of section 46 (f) of the Initial Order delivered by this Court on April 17, 2009, which allows them to repudiate their contracts.

[1] R.S.C. 1985, c. C-36

[3] Since nothing came of the discussions held previously between ACI and SFK, ACI sent the Notice on April 24, 2009 with immediate effect. The party who feels aggrieved can, under the "return clause" provided in the Initial Order, ask that the decision to repudiate the Contracts be reviewed. Hence this motion.

[4] At first, SFK's motion included requests for interim and safeguard orders. In order to avoid delays and additional costs, the parties agreed that the issue be dealt with immediately on the merits.

THE PARTIES

- **SFK**

[5] SFK is a general partnership that owns and operates the northern bleached softwood Kraft pulp ("**NBSK Pulp**") mill (the "**Mill**") located in Saint-Félicien, in the Lac-Saint-Jean region. It acquired the Mill from ACI in 2002 and paid $628 M for it, including by way of public offerings. The units, then sold at $10, trade today at 35 cents.

[6] The Mill is the only one in Quebec to produce commercial NBSK Pulp that is recognized for its superior quality. SFK sells it to the paper industry and exports it throughout Canada, the United States and Europe. The Mill has 306 employees and indirectly generates an important number of jobs. It goes without saying that the Mill represents one of the important generators of the regional and local economy.

- **ABI Group and ACI**

[7] ABI Group's history, corporate status and indebtedness are fully described in the Initial Order delivered by this Court on April 17, 2009. ABI Group's indebtedness is close to $10 G and its losses, during the last nine months, are approximately $1.9 G. The indebtedness of ACI and its subsidiaries amounts to $6 G and its operating losses, to $ 1.06 G in 2008.

[8] ABI Group operates twenty-three pulp and paper facilities and thirty wood products facilities located in the United States, Canada, the United Kingdom and South Korea. The facilities' operations have been reduced such that they are producing at 32% of their capacity, on a rotational basis and by work shifts, to limit the loss of employment. Some of them have been completely shut down.

[9] ABI Group owns six sawmills and holds a substantial interest in at least three others in a radius of 100 km of the Mill. It is at the heart of the regional economy, to a much greater degree than SFK.

THE DISPUTE

The outstanding issues can be summarized as follows:

1. **What criteria apply to the repudiation of contracts under the CCAA?**

2. **In light of these criteria, must the Court intervene to reinstate the contracts?**

THE PARTIES' POSITION

- **SFK**

[10] According to SFK, the Court should refuse to endorse the repudiation of the Contracts, because the balance of inconveniences and the prejudices advocate in favor of SFK, already very much affected by the economic crisis. It raises section 32 of Bill C-47[2], assented to in December 2007 but not yet in force.

[11] In addition, it claims that the contract for wood chips is beneficial to ACI and that its repudiation constitutes a disguised unilateral change.

- **ABI Group and ACI**

[12] ABI Group must compromise its debt and reorganize its operations. ACI, with the approval of the Monitor, decided to repudiate the Contracts on the grounds that they are too onerous in many regards and detrimental to its reorganization.

[13] Contrary to what SFK's allegations underlie, ABI Group and ACI argue that the prejudice must be evaluated collectively and not on an individual basis.

[14] Besides the Monitor, who supports their approach, ABI Group and ACI have received the support of their long-term lenders and the secured and unsecured bondholders who insist that SFK be treated like them.

THE OBJECTIVE OF THE CCAA AND THE ROLE OF THE JUDGE

[15] The CCAA's first objective is to allow an insolvent company to stay in business and to reach its solvency threshold again for the benefit of all those affected and who will be involved in its reorganization.

[16] The courts of the other provinces call these persons "the broader constituency of investors creditors and employees and reflects diverse socially interests"[3].

[17] For ABI Group and ACI, it is their secured and unsecured creditors, their investors (the secured and unsecured bondholders), as well as their shareholders, employees, suppliers and interim lenders. For the purpose of this judgment, they are qualified as stakeholders by the Court.

[18] Given a broad judicial discretion […] the role of the judge, helped by the Monitor, closely resembles the role of a captain in a storm who has to decide if he throws out to sea the problematic cargo to save the ship. There is no room for prevarication[4].

[19] These considerable powers must be exercised fairly and reasonably in light of the facts of this case while retaining, as a guideline, the first objective of the CCAA: to facilitate the reorganization of the company for its own benefit and the benefit of its stakeholders[5].

---

[2] *Act enacting the Wage Earner Protection Program Act and amending the Bankruptcy and Insolvency Act, the Companies Creditors Arrangement Act and other acts in consequence thereof*, S.C. 2005, C-47 (amended S.C. 2007, c. 36 sections 61 to 82) ("Bill C-47").
[3] *Skeena Cellulose Inc.* (B-C C.A.) 2003 Carswell BC 1399, par. 35.
[4] *9145-7978 Québec Inc.* (Arrangement relating to) 2007 QCCA 768, par. 11.

[20] From the CCAA's perspective, there are no winners, but only one hope: that the debtor successfully emerges from its restructuring for its own benefit and that of its stakeholders.

THE ANALYSIS

1. The Criteria that Apply to the Repudiation of a Contract under the CCAA

[21] It is not disputed that the CCAA allows the debtor to repudiate its contracts. The Initial Order explicitly provides for it. The parties' opinions differ, however, on the standard and its application.

[22] A first comment is necessary. SFK claims that the amendments proposed by Bill C-47 must be taken into consideration. These amendments are not in force and cannot be taken into account to decide this issue[6].

[23] That being said, the standard accepted by the courts allows the debtor to repudiate contracts as long as such repudiation is advantageous and beneficial for its reorganization without having to establish that it is an essential part of it.

[24] Since the judgment in the PCI[7] case which endorsed this standard and the Court of Appeal judgment in the *Mine Jeffrey*[8] case, which confirmed the principles, the state of the law has remained the same, subject however to the following comments.

[25] The power to repudiate contracts arises from the statutory discretion given by the CCAA and not from the inherent jurisdiction[9] used by the courts that are called upon to deal with issues, the novelty of which is limited only by lawyers' imagination.

[26] The exercise of this statutory discretion, including the one allowing the repudiation of contracts, is subject to the analysis of the criteria of fairness and reasonableness that is essential to every decision taken by the judge under the CCAA.

[27] This analysis is conducted in a collective fashion, by taking into consideration all the stakeholders, and not on an individual basis. In the *Skeena Cellulose Inc.*[10] decision, the Court of Appeal of British Columbia wrote the following on this subject:

> [60] The appellants are obviously part of the "broad constituency" served by the CCAA. But the key to the fairness analysis, in my view, lies in the very breadth of that constituency and wide range of interests that may be properly asserted by individuals, corporations, government entities and communities. Here, it seems to me, is where the flaw in the appellants' case lies: essentially, they wish to limit the scope of the inquiry to fairness as between five evergreen contractors or as between themselves and Skeena, whereas the case-law decided under the CCAA, and its general purposes discussed above, require that the views and interests of the "broad constituency" be considered. […] As the Chief Justice noted, many individuals and corporations, as well as the

---

[5] Previously cited, note 3, par. 39.
[6] Previously cited, note 4, par. 5.
[7] *PCI Chemicals Canada Inc. (Re)* J.E. 2002-718 (S.C.), leave to appeal denied; 2002 (J.Q.) No. 9988 (Quebec, C.A.).
[8] *Syndicat national de l'amiante Asbestos inc. vs Mine Jeffrey Inc.,* J.E. 2003-346 (C.A.) par. 32.
[9] Previously cited, note 3, par. 35, *Metcalfe & Mansfield Alternative Investments Corp. (Re)* 2008 ONCA 587, par. 50-52.
[10] Previously cited, note 3, par. 60.

Province, incurred major losses under the Plan. **<u>Each of them might also ask "Why me?"</u>** However, as he also noted, that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.

(Emphasis added)

[28] More recently, the Quebec Court of Appeal asked the following question about the standard applicable to the repudiation of a lease[11].

[27] **[TRANSLATION]** […] However, be that as it may, is it necessary that there be peril? Is it enough that the repudiation be essential to the recovery? Is it enough that it be appropriate or desirable?

[29] In response, the Court of Appeal cites the comments of Sylvain Vauclair[12] as being the general rule on the subject, that is[13]:

[28] <u>On the standard that is supposed to guide the judge</u>, the appellant cites Sylvain Vauclair who, after an overview of the situation in the United States, in the Canadian common law provinces and in Quebec concludes:

[TRANSLATION] <u>First of all, no decision contradicts the proposition that a debtor can repudiate the contracts to which it is a party and that are harmful to its restructuring under the CCAA.</u>

<u>Secondly, the courts exercise their inherent jurisdiction with caution, certainly, but not only in cases where it is necessary for the survival of the debtor or otherwise important.</u>

[29] Aptly analyzing the *Dylex* case, the author writes:

[TRANSLATION] The owner of certain shopping centres is opposed to the repudiation by the debtor of leases related to those centres on the grounds that this repudiation "would materially affect each shopping centre".

The repudiation of these leases is part of a plan to close 200 stores.

The repudiation of these three leases, each considered on its own, does not appear to be fundamental to the plan or the survival of the debtor, and the judge describes the situation as follows at page 109, paragraph 5:

"The subject stores have been a financial drain on Dylex, at a time when it is in a tight financial squeeze. Their closure is projected to bring about variable cost saving [sic] and a [sic] amelioration of some fixed costs […]".

Once again, a court states:

[11] Previously cited, note 4, par. 27.
[12] Vauclair, S.; (The repudiation of a contract under a CCAA order), second advanced conference on bankruptcy and insolvency, last legislative and practical developments (2002).
[13] Previously cited, note 4, par. 28.

"It is clear that s.11 of the C.C.A.A. gives the power to the Court to sanction a plan which includes termination of leases as part of the debtor's plan of arrangement […]".

It is important to note that the Court specifically rejects the argument to the effect that the sought-after repudiation must be essential to the success of the plan of arrangement.

(Emphasis added)

[30] In short, the CCAA aims to allow the debtor to overcome its financial difficulties, while limiting the damages suffered by those whose interests are affected and taking into account the interests of all stakeholders, that is why the decisions leading to it must be fair and reasonable[14].

[31] The legal statement having been established, it must now be applied. As judge Farley mentioned: "Equitable treatment does not mean equal treatment. Equal treatment may be contrary to equitable treatment"[15].

2. Must the Court Intervene and Reinstate the Contracts?

[32] We must first address two elements raised by SFK. SFK is wrong to accuse ACI of acting in bad faith for having started discussions before sending the Notice. Even though the Contracts' repudiation can have a compelling effect on the negotiations, this in itself is not illegal.

[33] Also, the Court cannot uphold SFK's version according to which ACI wants to make money with the wood chips nor that it is a "good business". This is untenable. The wood chips are by-products of the sawmills operated by ABI Group, the production cost of which is very high when production is carried out outside lumber processing operations.

- **The Wood Industry in the Context of the Worldwide Economic Crisis**

[34] That being said, the analysis of this question must take into account the worldwide decline in the forest and paper industry.

[35] The unprecedented weakness of the housing market in the United States in 2007 and 2008 is evidenced by the decline in the number of housing starts (fewer than 500,000 units of construction), a situation that had not been seen since World War II. This causes the profitability of the forest and paper operations that feed off this market, amongst other variables, to fluctuate.

[36] Since November 2008, ABI Group's operations have been reduced to 32% of their capacity. On an annual basis, all the sawmills are unprofitable and there is no indication that an upturn in the timber industry's operations is foreseeable in the short or medium term[16].

[14] *9145-7978 Québec inc. (Arrangement relating to)* 2007 QCCA 618, Gendreau J.C.A., judgment authorizing leave to appeal, par. 17.
[15] *Samni Atlas Inc., (Re)* 1998 3 C.B.R. (4th) 171, par. 4.
[16] Testimony of Yves Laflamme, Senior Vice-President, Wood Products Business of ABI, which the Court qualifies as very credible.

[37] The repudiation of the contracts is part of the restructuring of ABI Group's wood products operations, namely the harvesting of wood, its transportation to the sawmills and its processing into timber.

[38] Wood processing creates by-products, including wood chips and bark.

[39] SFK, which has no wood or timber rights, needs wood chips to supply the Mill and bark to satisfy its energy consumption. In connection with the Mill's acquisition in 2002, ACI and SFK therefore agreed on the Contracts.

[40] The wood chip contract, entered into for a term of twenty years, guarantees a supply of wood chips of 612,000 bone-dry metric tons ("**BDMT**") per year; 70% must come from black spruce and the balance must come from jack pine or other softwood.

[41] The price per BDMT is calculated in correlation with the price of NBSK Pulp and the market value (the "**market price**") of the wood chips. The price per BDMT cannot however be more than $20 over or under the market price of a BDMT of wood chips during a given year. SFK assumes the transportation cost of $16.23 per ton. At least 70% of the base quantity comes from ABI Group's sawmills, which are located less than 100 km from the Mill.

[42] Following market fluctuations, the price of NBSK Pulp fell and the price of wood chips reached its highest historical level ($145 BDMT). The price of wood chips is also higher in Quebec than anywhere else in North America.

[43] As per the pricing mechanism agreed to in the contract, ACI sells its wood chips to SFK at $125 BDMT. Since 2002, SFK benefits from a $20 BDMT discount, compared to the market price. ACI has established that, since 2002, this discount represents a cost of $90 M, or $12.24 M per year ($20 multiplied by the number of tons sold to SFK).

[44] But, there is more.

[45] The economic conditions have considerably reduced timber processing operations and ACI is no longer able to produce enough wood chips to maintain ABI Group's Paper Mills. In addition, ACI cannot honor its obligation to annually deliver 612,000 BDMT of wood chips to SFK.

[46] Therefore, ACI must buy wood chips from third parties and produce a limited quantity of wood chips by processing entire logs. According to the Monitor's report, ACI must add an annual loss of $1.5 M for the last four years because of this inefficient production[17].

[47] In 2007 and 2008, ACI had to buy 1,050,000 BDMT and 786,000 BDMT respectively of wood chips from third parties, at the market price, and in some cases, at an even higher price, taking into account the important repercussions of the decline in the demand for wood products. These losses are over and above those resulting from the weak level of sawmill operations.

[48] The EBITDA[18] of ABI Group's sawmills, including those located in the Lac-Saint-Jean region, are as follows:

[17] Monitor's fourth report, par. 30.
[18] Earnings before interest, tax, depreciation and amortization.

	Year 2007	Year 2008	1st quarter 2009	April 2009
ABI Group	- $91 M	- $45 M	- $16 M	- $4.4 M
Lac-Saint-Jean Region	- $23 M	- $9 M	- $5.4 M	- $2.3 M

[49] ABI Group must compromise its debt and reorganize its activities. In this context, ACI has decided to repudiate the Contracts that are too onerous and detrimental to its reorganization[19]. The savings resulting from the repudiation of the wood chip contract corresponds to 25% of the results for April 2009.

- **SFK's Situation**

[50] It is inevitable that when a dominant player, such as ABI Group is in its environment, becomes unsteady, it has a rough impact on its suppliers, workers and service providers.

[51] SFK's situation is not ideal, nonetheless, it is much better than ACI's. Hit very hard by the wood industry crisis and the fall of NSBK Pulp prices, SFK has suspended its Mill operations twice since December 2008, for a period totaling 62 days, and this was done even before receiving the Notice.

[52] As ABI Group's and ACI's financial situation has been deteriorating for many years, the financial decline of SFK's operations is more recent. Since the first quarter of 2009, SFK's financial statements and those of its affiliated companies show a negative EBITDA. Previously, the EBITDA was as follows: 1) 2006 = $39.8 M; 2) 2007 = $39.2 M; 2008 = $39.5 M.

[53] SFK's consolidated projections for the 2009 financial year show a negative EBITDA of $17.5 M if it pays the wood chips at the market price, being $1 M more per month.

[54] SFK maintains that its survival is at stake, that with the rise in the cost of wood chips to the market price, it will not be able to comply with the solvency ratios set out in its financial obligations[20], which makes SFK vulnerable towards its lenders.

[55] This is likely. However, as per its consolidated financial statements, the unitholders' equity is significant: $522 M in 2008, $509 M in 2009 and $449 M according to projections for 2009.

[56] SFK will have to discuss with its lenders and ACI, which offers to continue supplying SFK with a lesser quantity (500,000 BDMT) at the market price.

---

[19] Previously cited, note 3, par. 57: […] *In the terminology used by Mr. Forstrom, there was a "casual link" between the terminations and the chances of success of the Reorganization Plan. For this reason, I do not agree with his submission that Dylex is different in principle from the case at bar: <u>the appellant's contracts in particular were said to be too costly for Skeena to continue operating under them, in the same way the terminated leases were said to be too costly for Dylex to continue leasing under them.</u> And, weighing Dylex's precarious financial position against that of the landlord (which was described as "less than robust"), the Court "gave the nod" to the insolvent corporation, rejecting the proposition that Dylex should have to prove that without the three proposed closures (of leases), its proposal would not be viable […]* (Emphasis added)

[20] (R-9) Credit Agreement dated October 30, 2006.

UNOFFICIAL TRANSLATION

[57] The Court wishes to emphasize that the restructuring at stake is not SFK's, but rather that of ABI Group and ACI.

[58] In addition, SFK did not establish that without the wood chip contract, it could not find another supplier.

[59] SFK currently has about 56,000 BDMT of wood chips and already has third-party suppliers. In March 2009, SFK entered into a supply contract with Chantiers Chibougamau, for the delivery of 100,000 BDMT of wood chips at the price of $138, excluding transportation costs. Last March, SFK got its supply of wood chips from Chantiers Chibougamau rather than from ACI, by invoking the FCI standard.

[60] During this time, ACI, who is bound by the wood chip contract, was unable to sell SFK wood chips and was unable to sell them to third parties at the market price. Finally, wood chip inventories will become available for SFK, since ACI will no longer have to get its supply from third parties, which will make available tons of wood chips.

[61] One simply cannot consider, as SFK proposes, that $12 M of profitability gap represents "a drop in the bucket" for ACI.

[62] ABI Group's sawmills show a loss of $4.4 M per month, while those for the Lac-Saint-Jean region show $2.3 M. The wood chip contract contributes to this loss up to 25%. This is no small amount over a 7-year period; it represents $90 M.

[63] Short-term lenders, which ACI has a blatant need for, will not come forward unless there is a chance that ACI can honor its obligations.

[64] In reality, SFK's position amounts to asking that the inconvenience resulting from the repudiation of the Contracts be weighted against the criteria that must be met in order to obtain a safeguard order under the *Code of Civil Procedure*. The criteria set out in the CCAA that guide the judge are different[21].

[65] It must be reiterated that what is at stake is not only limited to SFK on the one hand and ABI Group and ACI on the other hand, but also extends to the stakeholders that are dependant on their survival, including 10,000 employees in Canada, 1,700 forest workers, 2,300 independent workers, 950 local and regional suppliers, 500 forest operations specialists, etc.[22].

[66] According to ACI and the Monitor, the repudiation of the contract is beneficial, advantageous and necessary to the company's reorganization. The evidence presented supports this statement. In this context, taking into account the interests of all the stakeholders, the Court considers that it should not intervene.

[67] It is of little consolation, but SFK will be able to file, as an ordinary creditor, a proof of claim for the damages suffered as a result of the repudiation of the Contracts.

[21] It is appropriate to distinguish the *Doman* case, on which SFK relies, where the debtor wanted to benefit from the repudiation of a contract without having established that it would benefit its reorganization. *Doman Industries Ltd. (Re)* 2004 B.- C.C.A. 382.

[22] See paragraph 318 of the Motion for an Initial Order filed in this case.

[68] As case law teaches us[23], the party whose contract has been repudiated must be treated the same way as all of the other debtor's creditors.

> 43 The applicants state that "SCI is a large, multi-million dollar business enterprise." While that is true, SCI has also been struggling for many years to become profitable. There are many people in addition to the applicants who depend on SCI's viability. While the applicants will no doubt be adversely affected by the terminations, they are in no different position in this regard than many other unsecured creditors of SCI who must prove their claims under the Plan and who stand to recoup only a small fraction of their claims. It is to be noted that while the sale price of SCI was $8 million, the applicants have filed proofs of claim in excess of $5 million.
>
> 44 It is the unfortunate and generally unavoidable result of an insolvency restructuring that some individuals or entities will suffer hardship. In this case as part of its restructuring, SCI had to terminate numerous employees. They no doubt suffered hardship.

[Emphasis added]

[69] Although ABI and its stakeholders face a huge challenge, it is well underway since April 17, 2009. ACI has demonstrated that the wood chip contract represents an obstacle for its operations' restructuring and that it is detrimental to the reorganization of ABI Group as a whole. In these circumstances, this is sufficient.

- **The Bark Contract**

[70] Bark is also a by-product derived from the sawmills' operations. The bark contract provides for the delivery to SFK of 102,551 BDMT of fresh bark per year at the market price. Since 2007, ACI does not respect the number of tons that must be delivered, for the same reasons as those previously mentioned for the production of wood chips.

	Year 2007	**Year 2008**
Fresh Bark	83,000 BDMT	57,000 BDMT
On-site Bark	16,000 BDMT	21,000 BDMT
Total	99,000 BDMT	78,000 BDMT

[71] Even though SFK has not raised this default, the contract's repudiation is also justified here, since ACI will not be able to comply with its terms without getting bogged down even more.

[72] The impact of this repudiation on SFK is not that harmful since SFK will be able to get its supply from the on-site bark in the Lac-Saint-Jean region, which holds sufficient quantities for the next twenty to thirty years.

[23] *Skeena Cellulose Inc. (Re)*, Judge Brenner's judgment, 2002 Carswell BC 2032 (B. – C. S.C.), par. 43 and 44.

[73] Even though on-site bark is a little more expensive than fresh bark given its humidity level, and that additional costs must be taken into account to have access to it, overall costs will be considerably less expensive than fuel oil.

[74] In the circumstances, there is no reason why the Court should intervene.

THE MONITOR'S RECOMMENDATION

[75] Lastly, although the Monitor gave its approval only after the repudiation of the Contracts, it had been consulted beforehand and had identified problems resulting from the survival of the Contracts. It recommends their repudiation. Its fourth report includes a complete analysis of the Contracts' impact and convinces the Court that this recommendation must prevail.

FOR THESE REASONS, THE COURT :

DISMISSES the motion to institute proceedings for interim, safeguard and final orders and for declaring null and void the repudiation of certain Contracts;

WITH COSTS.

CERTIFIED COPY

Danièle Mayrand, j.s.c. (signed)

Assistant Registrar (signed)

Karim Renno, Martin Desrosiers and Karine Chênevert
OSLER HOSKIN & HARCOURT LLP
Attorneys for the Petitioner

Guy P. Martel and Mélanie Béland
STIKEMAN ELLIOTT (Montreal)
Attorneys for the Respondents

Gilles Paquin
FLANZ FISHMAN MELAND PAQUIN LLP
Attorney for the Monitor

Frederick L. Myers
GOODMANS LLP (Toronto)
Attorney for the Ad Hoc Committee of Bondholders

Guillaume-Pierre Michaud
FASKEN MARTINEAU
Attorney for the ACI Term Lenders

Vanessa Jodoin
BORDEN LADNER GERVAIS
Attorney for the Ad Hoc Committee of the Senior Secured Noteholders

Hearing dates: May 11, 12, 13 and 14, 2009