SUPERIOR COURT

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

No: 500-11-036133-094

DATE: September 23, 2010

PRESENT: **THE HONOURABLE DANIÈLE MAYRAND, S.C.J.**

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 on Schedules "A", "B" and "C"

Petitioners

And

ERNST & YOUNG INC.

Monitor

And

AURELIUS CAPITAL MANAGEMENT, LP
and
CONTRARIAN CAPITAL MANAGEMENT, L.L.C.

Respondents

REASONS FOR JUDGMENT RENDERED SEPTEMBER 20, 2010
ON MOTION FOR ADVICE AND DIRECTIONS (#707)

JM 1796

[1] The *Motion to Seek Advice and Directions* (the "**Motion**") was brought by the CCAA Petitioners as defined in the Motion other than Bowater Canada Finance Corporation ("**BCFC**"). They ask the Court to review the record and make a determination as to whether BCFC has any claims against the Petitioners (the "**Interco claims**"). The background involves the issuance, in 2001, by BCFC of US$600 million in 7.95% notes due in 2011 (the "**BCFC Notes**") of which respondents held US$200 million.

[2] The restructuring of the Petitioners is a complex and above-all time-sensitive matter. The CCAA Plan represents a delicate balancing of interests between employees, pensioners, suppliers and lenders of two principal operating companies (and their numerous subsidiaries and affiliates) operating an integrated cross-border business.

[3] The success of the transaction hinges on co-coordinating the approval of all of the necessary stakeholders, but also in obtaining the requisite approvals from regulators (in particular as regards pension matters), unions (as regards costs restructuring) and suppliers of new credit (exit financing of approximately US$1.3 billion being required to repay existing secured creditors and finance the emerging business on a stable basis).

[4] The hearing of the Motion has been held two days after the Petitioner's creditors approved their CCAA Plan by an overwhelming majority (but defeated by BCFC's creditors[1]). The Plan provides for the compromise and release of any and all claims against the Petitioners, including the Interco Claims.

[5] The Motion was brought due to a struggle between the Petitioners and Aurelius Capital Management, LP and Contrarian Capital Management, L.L.C. (collectively "**Aurelius**") who are sophisticated investors specializing, *inter alia*, in investing in distressed companies. They argue that they suffer prejudice from the failure of BCFC to pursue certain indistinct Interco Claims. However they have, as yet, taken no steps to pursue or file a claim on their own, although their status as BCFC's creditors enabled them to do so.

[6] Over the last year, several motions were filed by Aurelius but were either discontinued or withdrawn at the last minute. By its last proceedings, Aurelius attempted to have BCFC declared bankrupt and appoint another advisor in replacement of the Monitor. On July 8, 2010, the day it was to be presented, Aurelius desisted from its Motion. This Court authorized the withdrawal but barred Aurelius from filing any similar proceedings before the Sanction Hearing.

[7] Meanwhile, Petitioners took measures to inquire into the alleged Interco Claims. The Monitor conducted an extensive investigation and review of the Intercompany

[1] For BCFC: In value, the vote was 48% pro and 52% against.

transactions, which took place between BCFC and its affiliates between 2001 and 2007. A description of the transactions appears in the *Interim 49th Report of the Monitor* remitted to Aurelius on July 8, 2010. Although invited to consult and cooperate with the Monitor before the issuance of the final report, Aurelius did nothing of the sort.

[8] The Monitor filed its final report (mere changes) during this hearing as the *Amended Monitor's 49th Report.*

[9] In parallel, Petitioner obtained, from the U.S. Bankruptcy Court, the appointment of Independent advisors (the "**IA**") for BCFC, namely to investigate the Interco claims. The IA were given all the information by the Monitor related to the transactions under review and had access to the data room to prepare their report. On September 7, 2010, IA made a detailed presentation to BCFC Board of the transactions that occurred between BCFC and its affiliates between 2001 and 2009.

[10] On September 14, 2010, the IA counsel, Mr Togut, made verbal request to the U.S. Court for permission to file the IA report before the Canadian Court in view of the present hearing. He failed to do so because Aurelius objected to such release, although they had a draft version of the report since September 11, 2010 to the exclusion of Petitioners. Petitioners are precluded from having it under an Order of confidentiality issued by the U.S. Court. The U.S. Court was made aware that although a draft had been sent to Aurelius for comments, the conclusions reached in the report would not change. In view of Aurelius objection, the U.S. Court postponed the request of Mr Togut until September 24, 2010 after this hearing and the Sanction hearing on September 20, 2010.

[11] Until this day, BCFC has neither filed nor sought to file Interco claims[2].

REQUEST FOR ADJOURNMENT

[12] Aurelius filed a contestation to the Motion, and at the outset, objected to the hearing arguing that it should be adjourned. Except for Wilmington Trust, the trustee acting under the Notes issued by BCFC, all the major stakeholders supported Petitioner's Motion and opposed the adjournment.

[13] At this stage of the CCAA Proceedings, the Petitioners are on the eve of the Sanction Hearing scheduled on September 20, 2010, thus any unjustified delay could threaten the restructuring process and the emergence of Petitioners from Court protection. On September 16, 2010, the Court denied the request to adjourn and proceeded with the hearing of the Motion[3].

[2] On September 1, 2010, IA filed a Contribution claim of $US600 million against BI to protect BCFC rights.

[3] The transcript of the reasons given orally has been released today..

ANALYSIS

- **<u>The Bowater entities connected to BCFC transactions</u>**

[14] Bowater Inc ("**BI**") is a Delaware corporation and sole shareholder of BCFC. BI directly or indirectly holds a substantial portion of the U.S. operating assets of the ABH Group. BI guarantees unconditionally the BCFC Notes.

[15] Bowater Canadian Holdings Incorporated ("**BCHI**") is a Nova Scotia company, which is the holding company for BI's Canadian activities, except for the Nova Scotia operations.

[16] BCFC is a Nova Scotia unlimited liability company which is wholly owned by BI and is the issuer of the BCFC Notes. BCFC is not an operating company and carries on no trade. It is a special purpose financing entity, whose sole material liability consists of the outstanding BCFC Notes. BCFC's sole material assets consist of preferred shares of BCHI.

[17] Bowater Canadian Forest Products Inc. ("**BCFPI**") is a Nova Scotia company, which, directly or indirectly, holds substantially all of the Canadian operating assets of the BI Group. Since 2007, it is the limited partner of Bowater Canada Finance Limited Partnership ("**BCFLP**"). BCHI holds an indirect equity interest in BCFPI.

[18] Bowater Canadian Forest Products Inc. ("**BCFPI**") is a Nova Scotia company, which, directly or indirectly, holds substantially all of the Canadian operating assets of the BI Group. Since 2007, it is the limited partner of Bowater Canada Finance Limited Partnership ("**BCFLP**"). BCHI holds an indirect equity interest in BCFPI.

[19] Bowater Canada Treasury Corporation ("**BCTC**") is a Nova Scotia company, which, since 2007, is wholly owned by BCHI, and is the general partner of BCFLP.

[20] BCFLP is a New Brunswick limited partnership, which was used for financing activities; its general partner is BCTC and its only limited partner is BCFPI.

[21] Bowater Shelburne Corporation is a Nova Scotia company, which is wholly owned by BCFLP and has no activities.

[22] Bowater LaHave Corporation ("**Bowater LaHave**") is a Nova Scotia company, which is wholly owned by BCFPI, and is the holding company of Bowater-Korea Ltd., the owner of the Mokpo mill located in South Korea.

- **<u>Use of the proceeds of the BCFC notes</u>**

[23] BCFC borrowed US$600 million in a Note offering, which indicated that BCFC intended to invest in BI's Canadian business. Indeed the proceeds of the BCFC Notes were used to repay bridge financing entered into by BI to complete its acquisition of

Alliance Forest Products Inc. (now BCFPI) in consideration for US$251 million in cash and US$235 million in shares, and to repay US$274.5 million in BCFPI third party debt.

[24] Original investors in BCFC Notes were advised that BCFC would be using the note issuance proceeds to invest in equity of Bowater Inc. in Canada:

> "We are an unlimited liability company organized under the laws of the Province of Nova Scotia, Canada and a wholly-owned subsidiary of Bowater. Bowater formed us for the purpose of providing financing to Bowater in Canada. We have no independent operations and prior to this offering, we had no material assets or liabilities. We will use the proceeds from the sale of the original notes to acquire 99% of Bowater Canada Finance Limited Partnership from Bowater and to capitalize our wholly-owned subsidiary, Bowater Canada Treasury Corporation, which will then acquire the remaining 1% of Bowater Canada Finance Limited Partnership from Bowater Ventures Inc., a wholly-owned subsidiary of Bowater[4].

➢ **The investigation of the Monitor**

[25] The Monitor, an independent officer of the Court, often referred to as being the *eyes and ears of the Court* in CCAA matters, undertook an extensive and meticulous investigation of possible Interco claims of BCFC. Mr. Morrisson testified on behalf of the Monitor. He said that they reviewed books and records to see all transactions undertaken; they interviewed management; they reviewed thousands of pages of documents and generally had the full and complete co-operation of management and its advisors. They reviewed and understood the business and tax rationales for these transactions.

[26] He confirmed that from 2001 until the filing for CCAA protection in 2009 BCFC had no active business apart from receiving semi-annual contributions of equity from its parent corporation BI in sufficient amounts to pay interest on the BCFC Notes. M. Morrisson explained that throughout that period BCFC assets consisted in equity in its affiliates and no debt was owed by any of them to BCFC.

[27] The Monitor's report includes a table, which summarizes the balance sheets of BCFC as at December 31, 2008 and March 31, 2009:

4 Offering Circular (Exhibit R-3), p. 3; Prospectus (Exhibit R-4) at par. 18.

($000's)	As at March 31, 2009		As at December 31, 2008
ASSETS			
Current assets:			
Cash	1		2
Deferred Financing Expense	1,246		1,364
Investment in Subsidiary - BCHI	818,916		818,916
Total Assets	**820,163**		**820,282**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Accrued Interest	17,874		5,949
Accounts Payable Affiliate	121,626		121,638
Long Term Debt, Net of Current Installments	599,536		599,490
Long Term Tax Liability	8,315		8,477
Total Liabilities	**747,351**		**735,554**
Shareholders' equity:			
Capital Stock	214,650		214,650
Retained Earnings:			
Prior Year Retained Earnings	(129,922)		(99,483)
Prior Year Retained Earnings - Affiliates	-		
Current Year Retained Earnings	(11,916)		(30,439)
Total Retained Earnings	**(141,838)**		**(129,922)**
Total Equity	**72,812**		**84,728**
Total Liabilities and Shareholders' Equity	**820,163**		**820,282**

[28] These balance sheets confirms that BCFC's only assets consist of equity through its investment in BCHI and does not have any material Intercompany debt or was owned anything beyond equity in its affiliates.

➢ **The transactions under review**

[29] The alleged Intercompany Claims relate to transactions, which occurred between 2001 and 2007. While their implementation involved multiple steps extensively described in the Monitor's Reports, it suffices to summarize four of the steps together with relevant comments from the Monitor with respect to disclosure and their impact on BCFC as follows:

a. In 2001, BCFC acquired 99% of BCFLP from BI (the other 1% was acquired by BCTC, a wholly-owned subsidiary of BCFC). BCFC's only interest in BCHI and/or BCFPI at that point was through receivables owing by them to BCFLP.

   This transaction and the existence of Intercompany loans owed to BCFLP were disclosed in the Offering Circular and Prospectus;

b. In 2005, following the announcement of changes in US tax rules applicable to the 2001 financing structure, preferred shares in BCFPI were issued to BCFLP through the capitalization of debt owing by BCFPI to BCFLP. BCFC was not directly a party to this transaction.

This was disclosed in the BCFPI Management Discussion and Analysis (MD&A) for 2005;

c. In 2006, BI transferred US$400 million in BCFPI receivables to BCHI against common shares of BCHI. This and other BCFPI debt to BCHI (totaling US$643 million) was converted in BCFPI Class A preferred shares.

   This conversion of debt owed by BCFPI to BI into equity in BCHI strengthens the balance sheet of BCFPI. Although BCFC was not directly involved in this transaction it had the effect of strengthening the value of the equity in BCFPI held by BCFLP, which in turn is directly or indirectly owned by BCFC.

   This was disclosed in the BCFPI MD&A for 2006;

d. The one transaction that BCFC was a party to, after its initial investments in 2001, took place in 2007 when it exchanged its direct and indirect equity interest in a partnership subsidiary for preferred equity in another Bowater Inc. subsidiary. In 2007, BCFC's interest in BCFLP was exchanged for a preferred interest in BCHI through a series of steps, which saw BCHI acquire BCFLP and the interests in BCFPI owned by it. BCHI indirectly owned (i) all of the common shares of BCFPI, (ii) all of the Class A and Class B preferred shares of BCFPI (through BCFLP and Shelburne) and (iii) all of the Class C preferred shares of BCFPI[5]. The value of BCFPI was further increased by the value of the BI Korean operations, which were transferred to BCFPI from BI as part of this transaction.

   The net effect of this was to strengthen BCFPI, the core operating company in the Canadian chain of Bowater entities namely because it now had an indirect ownership interest in the Korean mill. In conclusion, the Monitor notes that the last transaction was undertaken for legitimate business purposes and was either neutral or beneficial to BCFC in light of the strengthened balance sheet of BCFPI.

   This was disclosed in the BCFPI MD&A for 2007.

[30] Petitioners and the Monitor have gone the extra mile to reassure Aurelius, BCFC's creditors and the Court with respect of the legitimacy of the transactions reviewed although there was no claim filed in connection therewith.

[31] The transactions occurred many years ago and were in accordance with the disclosure made to the investors including Aurelius, (without disclosure from Aurelius as to when they became holders of the BCFC Notes).

[5] BI owned all of the Class D preferred shares of BCFPI.

➢ **No claim was filed by Aurelius nor by BCFC's IA**

[32] Aurelius never filed a claim on its own behalf, nor has it either made substantive allegation that would suggest a reviewable transaction or fraudulent preference occurred. Moreover, had Aurelius chosen to file a claim, it could only have been in the nature of an equitable remedy under a corporate statute (*i.e.* oppression) rather than bankruptcy-related claims since the only asset of BCFC was equity. BCFC creditors have had access to oppression claims both before the CCAA process was commenced and during the CCAA process via the Claims Process.

[33] Aurelius and the Trustee of the Notes played a key role in preventing the report prepared by the Independent Advisors appointed in BCFC's United States bankruptcy proceedings being made available to this Court. They can hardly protest that the process was unfair to them as they suggested, the unavailability of the IA's report being the result of their objection.

[34] The written and oral evidence, in particular the transcript of the September 14, 2010 hearing before the United States Bankruptcy Court and the affidavit of Jacques Vachon (he was present at the hearing but Aurelius declined to examine him), demonstrates a number of facts which include:

a. Aurelius and the Trustee had in their possession a draft of the IA's Report including its conclusions;

b. Mr. Togut the counsel for the IA advised the U.S. Court that the conclusions would not be changing and the draft was for comment purposes only;

c. A detailed presentation of the report and of the transactions was made by the IA at a meeting of the Board of Directors of BCFC on Tuesday, September 7, 2010;

d. The Motion was filed late in the day on Tuesday September 7, 2010;

e. The IA, who has filed a Contribution claim[6] on behalf of BCFC against BI on September 1, 2010, has not filed any Intercompany claims against any other entity whether before or since such presentation to the BCFC Board;

f. Mr. Togut, sought permission from the U.S. Court on September 14, 2010 to file the confidential IA's report with this Court in light of the upcoming motion on Intercompany claims and was unable to do so due to an objection raised, inter *alia*, by Aurelius;

[6] This claim of US$600 million is filed under section 135 of *The Nova Scotia Companies Act*, and will be contested by Petitioners.

g. Mr. Togut did not complain at such hearing that the IA had other claims which he wished to file but was being interfered with in some way; and,

h. Although aware of this hearing and Motion, IA 's Canadian counsel, did not see any requirement to be present to oppose the relief being sought.

[35] The only possible inference to draw from the above facts is that the IA have completed their report and made no recommendation to pursue claims against other entities; and, Aurelius and the Trustee, knowing these conclusions, prevented the report from being communicated to this Court in a timely way.

[36] The *Amended Monitor's 49th Report* confirms that, in fact, BCFC did what the Prospectus said it would do with the proceeds of the offering. The details of how the note proceeds were routed were complex and occupied several pages of the report, but the effect was precisely as advertised in the offering. The other transactions were disclosed publicly on each occasion and provided sufficient details of how these transactions were accomplished, the end result and their effect[7].

[37] Aurelius also submits that the process promised by the Petitioners in the occurrence of a no vote has not been respected. They refer to the Notice of meeting and information Circular of August 10, 2010 transmitted to the creditors[8]. This argument is facetious and has no merit.

[38] The Motion has been brought in anticipation of the no-vote by Aurelius whose position on the disapproval of the CCAA Plan was well known prior to the vote. Indeed the Motion, the extensive investigation of the Monitor, the IA's report remitted to Aurelius, the detailed presentation by the IA to BCFC board of Directors and the hearing of the Motion represents a proper, objective and complete process. It allows by this due consideration of all the issues at stake. It is quite sufficient under the circumstances.

[39] The CCAA is about the pragmatic, the art of the possible. In this case, there is no basis to start an additional process as sought by Aurelius.

[40] Given the nature of the Motion no costs will be awarded.

FOR THESE REASONS, THE COURT:

[41] **DECLARES** that BCFC has no claim against the Petitioners under reserve of the Contribution claim as defined in the Motion;

[7] BCFPI Management Discussion and Analysis April 27, 2006 (Exhibit R-5), p. 14; BCFPI Management Discussion and Analysis April 26, 2007 (Exhibit R-6), p. 20; BCFPI Management Discussion and Analysis April 26, 2007 (Exhibit R-6), p. 19; BCFPI Management Discussion and Analysis April 29, 2008 (Exhibit R-7), p. 4.

[8] N-10, p. 87-88.

[42] **WITHOUT COSTS.**

Danièle Mayrand, J.S.C.

Me Sean F. Dunphy
Me Guy P. Martel and
Me Guillaume Boudreau-Simard
STIKEMAN ELLIOTT
Attorneys for Petitioners

Me Robert I. Thornton (Toronto)
THORNTON GROUT FINNIGAN LLP
and
Me Gilles Paquin
FISHMAN FLANZ MELAN PAQUIN LLP
Attorneys for the Monitor Ernst & Young Inc.

Me Marc Duchesne
BORDEN LADNER GERVAIS (Montréal)
Attorney for the ad hoc Committee of the Senior Secure Noteholders and
US Bank National Association in Debentures Trustee for the Senior Secure Noteholders

Me Frederick L. Myers (Toronto) and
Me Jonathan Warin (Toronto)
GOODMANS LLP
Attorney for the ad hoc Committee of Bondholders

HEENAN BLAIKIE
Attorneys for Fairfax Financial Holding Limited

Me Neil Peden
WOODS
Attorney for the Official Committee of Unsecured Creditors of AbitibiBowater Inc. et al

Me Louis Dumont
FRASER MILNER CASGRAIN
And
Me Neil Rabinovitch
THORNTON GROUT FINNIGAN LLP
Attorneys for Aurelius Capital Management, LP and
Contrarian Capital Management, L.L.C.

Me Robert Tessier
MILLER THOMPSON POULIOT LLP
Attorney for the Trustee of the Noteholders

Date of hearing: September 16 and 17, 2010

SCHEDULE "A"

ABITIBI PETITIONERS

1. ABITIBI-CONSOLIDATED INC.
2. ABITIBI-CONSOLIDATED COMPANY OF CANADA
3. 3224112 NOVA SCOTIA LIMITED
4. MARKETING DONOHUE INC.
5. ABITIBI-CONSOLIDATED CANADIAN OFFICE PRODUCTS HOLDINGS INC.
6. 3834328 CANADA INC.
7. 6169678 CANADA INC.
8. 4042140 CANADA INC.
9. DONOHUE RECYCLING INC.
10. 1508756 ONTARIO INC.
11. 3217925 NOVA SCOTIA COMPANY
12. LA TUQUE FOREST PRODUCTS INC.
13. ABITIBI-CONSOLIDATED NOVA SCOTIA INCORPORATED
14. SAGUENAY FOREST PRODUCTS INC.
15. TERRA NOVA EXPLORATIONS LTD.
16. THE JONQUIERE PULP COMPANY
17. THE INTERNATIONAL BRIDGE AND TERMINAL COMPANY
18. SCRAMBLE MINING LTD.
19. 9150-3383 QUÉBEC INC.
20. ABITIBI-CONSOLIDATED (U.K.) INC.

SCHEDULE "B"
BOWATER PETITIONERS

1. BOWATER CANADIAN HOLDINGS INC.
2. BOWATER CANADA FINANCE CORPORATION
3. BOWATER CANADIAN LIMITED
4. 3231378 NOVA SCOTIA COMPANY
5. ABITIBIBOWATER CANADA INC.
6. BOWATER CANADA TREASURY CORPORATION
7. BOWATER CANADIAN FOREST PRODUCTS INC.
8. BOWATER SHELBURNE CORPORATION
9. BOWATER LAHAVE CORPORATION
10. ST-MAURICE RIVER DRIVE COMPANY LIMITED
11. BOWATER TREATED WOOD INC.
12. CANEXEL HARDBOARD INC.
13. 9068-9050 QUÉBEC INC.
14. ALLIANCE FOREST PRODUCTS (2001) INC.
15. BOWATER BELLEDUNE SAWMILL INC.
16. BOWATER MARITIMES INC.
17. BOWATER MITIS INC.
18. BOWATER GUÉRETTE INC.
19. BOWATER COUTURIER INC.

SCHEDULE "C"

18.6 CCAA PETITIONERS

1. ABITIBIBOWATER INC.
2. ABITIBIBOWATER US HOLDING 1 CORP.
3. BOWATER VENTURES INC.
4. BOWATER INCORPORATED
5. BOWATER NUWAY INC.
6. BOWATER NUWAY MID-STATES INC.
7. CATAWBA PROPERTY HOLDINGS LLC
8. BOWATER FINANCE COMPANY INC.
9. BOWATER SOUTH AMERICAN HOLDINGS INCORPORATED
10. BOWATER AMERICA INC.
11. LAKE SUPERIOR FOREST PRODUCTS INC.
12. BOWATER NEWSPRINT SOUTH LLC
13. BOWATER NEWSPRINT SOUTH OPERATIONS LLC
14. BOWATER FINANCE II, LLC
15. BOWATER ALABAMA LLC
16. COOSA PINES GOLF CLUB HOLDINGS LLC