

No. S-120712
Vancouver Registry

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

AND

IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT*,
R.S.C. 1985, c. C-44

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57

AND

IN THE MATTER OF CATALYST PAPER CORPORATION
AND THE PETITIONERS LISTED IN SCHEDULE "A"

PETITIONERS

WRITTEN ARGUMENT OF WELLS FARGO BANK, NATIONAL ASSOCIATION
RESPONDING TO THE PETITIONERS' APPLICATION FOR A SANCTION ORDER

June 27, 2012

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PART I - OVERVIEW

1. The Second Amended Plan (as defined below) unfairly prejudices Wells Fargo Bank, National Association, in its capacity as indenture trustee under the Petitioners' unsecured notes indenture (the "Indenture Trustee").
2. Under the terms of Catalyst's unsecured notes indenture, the Indenture Trustee has the right to recover the costs that it has incurred in its capacity as indenture trustee from any distributions in respect of the unsecured notes. However, by virtue of the Second Amended Plan, the Indenture Trustee will be impermissibly forced to forfeit these material and substantive contractual rights that were expressly granted to the Indenture Trustee by the Petitioners and the holders of the unsecured notes.
3. The *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA") clearly allows the Petitioners to effect a compromise of claims that creditors have against the Petitioners. It, however, is equally clear that the CCAA does not permit the Petitioners to affect rights that exist as between creditors themselves. Despite this accepted principle, the Second Amended Plan purports to modify a key term of the existing legal relationship between the holders of unsecured notes and the Indenture Trustee.

PART II - THE FACTS

BACKGROUND

4. On January 31, 2012, the Petitioners were granted relief under the CCAA pursuant to the Initial Order of this Court (the "Initial Order").
5. On March 22, 2012, this Court granted, *inter alia*, an order accepting the filing of the Petitioners' plan of compromise and arrangement (the "Original Plan").
6. On May 23, 2012, an amended and restated version of the Original Plan, dated May 15, 2012, (the "Amended Plan") was filed with this Court. Also on May 23, 2012, the Amended Plan was put to two votes of the Petitioners' creditors. The Amended Plan did not receive the required support from the Petitioners' creditors.

7. On June 18, 2012, a second amended and restated Plan (the "Second Amended Plan") was filed with this Court. The Second Amended Plan has now been approved by the required majorities of the Petitioners' creditors.

Indenture Trustee Is Entitled To Recover Costs Under The Unsecured Notes Indenture

8. The Indenture Trustee under a trust indenture (the "Unsecured Notes Indenture") for the 7 ^{3/8}% senior notes issued by Norske Skog Canada Limited (n/k/a Catalyst Paper Corporation) due March 1, 2014 (the "Unsecured Notes") has incurred costs in the performance of its role as indenture trustee in connection with these proceedings.¹
9. Section 6.07 of the Unsecured Notes Indenture establishes, among other things: (i) an obligation for the Petitioners to reimburse the Indenture Trustee for costs that it incurs in its capacity as indenture trustee; and (ii) a lien on any property that the Indenture Trustee holds to ensure that its costs are recovered from amounts that would otherwise be payable to holders of Unsecured Notes.
10. Section 6.07 states, in part, that:

The Company and any Guarantors shall reimburse the Trustee and each Agent upon request for all reasonable disbursements, expenses and advances incurred or made by it in connection with its duties under this Indenture, including the reasonable compensation, disbursements and expenses of the Trustee's agents and counsel. ...

To secure the payment obligations of the Company and any Guarantors in this Section 6.07, the Trustee shall have a lien prior to the Notes on all money or property held or collected by the Trustee except such money or property held in trust to pay principal of and interest on particular notes...

When the Trustee incurs expenses (including reasonable fees and expenses of its Agents and counsel) or renders services after an Event of Default specified in clause (6) or (7) of Section 5.01(a) hereof occurs [which includes a default arising from commencement of CCAA proceedings], the expenses and

¹ Affidavit #3 of Brian Baarda, sworn January 31, 2012 (3rd Baarda Affidavit)

compensation for the services are intended to constitute expenses of administration under any Bankruptcy Law.²

11. Section 6.07 of the Unsecured Notes Indenture contemplates that distributions to holders of Unsecured Notes will be paid through the Indenture Trustee in order to permit the Indenture Trustee to exercise its lien rights.
12. This is also consistent with the remedies established in Article 5 of the Unsecured Notes Indenture, which contemplates the Indenture Trustee's enforcement of remedies on behalf of the holders of Unsecured Notes.
13. Section 5.03 provides the Indenture Trustee with the power to pursue remedies on an event of default on behalf of the holders of Unsecured Notes:

If an Event of Default occurs and is continuing, the Trustee may pursue any available remedy by proceeding at law or in equity to collect the payment of principal of, or premium, if any, and interest on the Notes or to enforce the performance of any provision of the Notes or this Indenture.³

14. Section 5.05 provides that, in insolvency proceedings, unless the Indenture Trustee otherwise consents, payments from those proceedings to the benefit of Unsecured Notes shall be made to the Indenture Trustee. The holders of Unsecured Notes have expressly authorized and agreed to this:

In case of any judicial proceeding relative to the Company or any Guarantor, its property or its creditors....the Trustee shall be authorized to collect and receive any moneys or other property payable or deliverable on any such claims and to distribute the same; and any custodian, receiver, assignee, trustee, liquidator, sequestrator or other similar official in any judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly to the Holders, to pay to the Trustee any amount due it for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents

² 3rd Baarda Affidavit at Exhibit D.

³ 3rd Baarda Affidavit at Exhibit D.

and counsel, and any other amounts due the Trustee under Section 6.07.⁴ [emphasis added]

15. Once funds have been recovered by the Indenture Trustee, as contemplated by Sections 5.03 and 5.05, Section 5.07 of the Unsecured Notes Indenture provides greater detail on the mechanisms that govern the right of the Indenture Trustee to receive proceeds ahead of the holders of Unsecured Notes. In particular, the Unsecured Notes Indenture provides a clear waterfall of priorities with amounts payable to the Indenture Trustee having the first right of payment:

Subject to Article Twelve, any money collected by the Trustee pursuant to this Article Five, shall be applied in the following order, at the date or dates (including record dates) fixed by the Trustee and, in case of the distribution of such money on account of the principal amount of, premium, if any, and interest, upon presentation of the Securities and the notation thereon of the payment if only partially paid and upon surrender thereof if fully paid:

FIRST: To the payment of all amounts due the Trustee under Section 6.07; and

SECOND: to Holders for amounts due and unpaid on the Notes for principal, premium, if any, and interest (including Additional Interest, if any) as to each, ratably, without preference or priority of any kind, according to the amounts due and payable on the Notes; and

THIRD: to the Company or, to the extent the Trustee collects any amount from any Guarantor, to such Guarantor.⁵

16. The Unsecured Notes Indenture is clear: (i) the Indenture Trustee is the party to which funds are to be paid following an event of default or the commencement of insolvency proceedings; and (ii) once those funds are paid to the Indenture Trustee, the Indenture Trustee is entitled to recover its costs prior to any distribution to holders of Unsecured Notes.

⁴ 3rd Baarda Affidavit at Exhibit D.

⁵ 3rd Baarda Affidavit at Exhibit D.

Second Amended Plan Prejudices Indenture Trustee's Rights vis-à-vis Holders Of Unsecured Notes

17. Under the Second Amended Plan, distributions are made directly from the Petitioners to holders of Unsecured Notes. As a result, the Indenture Trustee will have no means by which to recover the costs that it has incurred by performing its role as an indenture trustee in connection with these CCAA proceedings.
18. Section 6.6 of the Second Amended Plan provides that distributions flow to beneficial holders of Unsecured Notes through The Depository Trust Company ("DTC") and not through the Indenture Trustee:

Delivery To Unsecured Noteholders

The Unsecured Notes are held by DTC. To the extent the New Common Shares are eligible to be distributed through DTC, the delivery of interests in New Common Shares to Unsecured Noteholders who have made a valid Equity Election will be made through the facilities of DTC to DTC participants, who, in turn will make delivery of interests in such New Common Shares to the beneficial holders of such Unsecured Notes entitled thereto pursuant to standing instructions and customary practices. To the extent the New Common Shares are not eligible to be distributed through DTC, delivery shall be made by distributing physical certificates to Unsecured Noteholders through the facilities of DTC or the Unsecured Notes Indenture Trustee as applicable. The Debtors and the Indenture Trustees will have no liability or obligation in respect of any deliveries from DTC, or its nominee, to DTC participants or to beneficial holders.

Delivery of PREI Proceeds Pool to Unsecured Creditors Who Are Not Equity Election Creditors

On or as soon as reasonably practicable after the later of (a) the Effective Date, (b) the Business Day following the date all Disputed Claims have been (i) Allowed or (ii) determined by Final Order in accordance with the Claims Procedure Order and (c) the Business Day following the closing of the sale of PREI, the Monitor shall distribute to each Affected Unsecured Creditor with an Allowed Unsecured Claim who has not made a valid Equity Election, such Creditor's pro rata share (calculated by reference to Section 3.2) of the PREI Proceeds Pool.

Delivery of cash to each Affected Unsecured Creditor with an Allowed Unsecured Claim who has not made a valid Equity Election will be made by way of cheque sent by pre-paid ordinary mail to the address specified in such Creditor's Claim Amount

Notice (as such term is defined in the Claims Procedure Order) or Proof of Claim or, if such Unsecured Creditor is an Unsecured Noteholder, to the DTC participant holding such Creditor's Unsecured Notes as at the Effective Time.⁶

19. Moreover, Section 6.1 of the Second Amended Plan purports to eliminate the protections provided to the Indenture Trustee in Articles 5 and 6 of the Unsecured Notes Indenture:

On the Effective Date, except as otherwise provided in the Plan, all notes, shares, instruments, certificates, indentures, guarantees, and other documents or agreements evidencing the First Lien Notes Claims, the Unsecured Notes Claims, and Equity Interests, including, without limitation, the First Lien Notes, the Unsecured Notes, the First Lien Notes Indentures, and the Unsecured Notes Indenture, shall be deemed automatically cancelled and shall be of no further force or effect, whether surrendered or cancelled or otherwise, and the obligations of the Debtors thereunder or in any way related thereto shall be satisfied and discharged, except to the extent expressly set forth in Section 6.02 of the Unsecured Notes Indenture and Section 6.06 of the First Lien Notes Indenture.⁷

PART III - ISSUES TO BE DETERMINED

20. The sole issue to be determined is whether the Second Amended Plan can and should compromise rights and obligations between the Indenture Trustee and the holders of the Unsecured Notes that exist pursuant to Unsecured Notes Indenture.

PART IV - THE LAW

21. When Unsecured Notes are purchased by a particular holder, that holder elects to be bound by the terms of the indenture governing those Unsecured Notes. A legal relationship is established between the holder of the Unsecured Notes and the

⁶ Petitioners' Notice of Application dated June 26, 2012, Schedule B.

⁷ Petitioners' Notice of Application dated June 26, 2012, Schedule B; While Section 6.1 of the Second Amended Plan treats the First Lien Notes Indenture (as defined in the Second Amended Plan) in the same manner as the Unsecured Notes Indenture, the trustee under the First Lien Notes Indenture is entitled to receive payment of all reasonable and documented fees and expenses incurred pursuant to Section 6.13 of the Second Amended Plan. The Indenture Trustee is not similarly treated.

Indenture Trustee that governs their relative claims to any distributions from the issuer. The Second Amended Plan cannot modify that legal relationship.

22. In *Pacific Coastal Airlines Ltd. v. Air Canada* (2001), 19 B.L.R. (3d) 286 at paras. 24 and 25 (B.C.S.C.), Justice Tysoe found that the CCAA does not allow a debtor company to use a plan of compromise and arrangement to alter the legal rights and remedies that its creditors may have against each other:

The purpose of a CCAA proceeding, as reflected in the preamble to the legislation, is to 'facilitate compromises and arrangements between companies and their creditors'. Its purpose is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-debtors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company. [emphasis added]

23. The Ontario Superior Court of Justice has resolved this issue in a similar manner in *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 297 at para. 7:

The CCAA is styled as 'An act to facilitate compromises and arrangements between companies and their creditors' and its short title is: Companies' Creditors Arrangement Act. Ss. 4, 5 and 6 talk of compromises and arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves and not directly involving the company. [emphasis added]

24. In *Re Stelco Inc.*, the Ontario court was required to consider whether or not certain subordination rights between holders of senior debentures and holders of certain convertible debt were to be compromised. Based upon the above analysis, the subordination rights were not compromised.
25. Despite consistent guidance from the courts, the Second Amended Plan eliminates the express contractual rights of the Indenture Trustee to recover its costs from distributions in respect of the Unsecured Notes.
26. The conclusion that the Indenture Trustee must be entitled to recover its costs from distributions in respect of the Unsecured Notes is both consistent with the express

terms of the Unsecured Notes Indenture and the CCAA, and the only commercially reasonable and equitable result.

27. Indenture trustees provide services for the benefit of both the issuers and the holders of notes pursuant to explicit terms and conditions set forth in the applicable indenture. In accepting the role of indenture trustee under and in accordance with the terms of the Unsecured Notes Indenture, the Indenture Trustee did not assume any financial risk that its costs would not be paid in the event distributions are made in respect of the Unsecured Notes. In fact, the Unsecured Notes Indenture expressly provides that all such costs would be paid.

PART V - CONCLUSION

28. As currently drafted, the Second Amended Plan prejudices the Indenture Trustee in a manner that amounts to a compromise of rights that is not permissible under the CCAA. The Indenture Trustee does not seek to stand in the way of the Plan, but believes that alternative relief should be available to protect its rights under the Unsecured Notes Indenture.


NORTON ROSE CANADA LLP

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