

Court File No. CV15-10961-00CL

**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 NELSON EDUCATION LTD. AND
NELSON EDUCATION HOLDINGS LTD.**

Applicants

**RESPONDING FACTUM OF THE APPLICANTS
(Royal Bank of Canada "RBC" Motion for payment of
interest and fees returnable August 13, 2015)**

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PART I – OVERVIEW

1. The Applicants oppose RBC's request for an order that would require the Applicants to (i) pay to RBC (in its capacity as Second Lien Agent¹ under the Second Lien Credit Agreement) U.S. \$15.4 million in pre-filing interest (which RBC defines as the "**Second Lien Interest**") and CDN \$1.3 million in pre-filing unpaid advisors' fees (which RBC defines as the "**Second Lien Agent Fees**"), and (ii) to pay to RBC (in its capacity as a First Lien Lender) U.S. \$1.6 million for its "share" of the Initial First Lien Early Consent Fee and the Additional First Lien Early Consent Fee (which RBC collectively defines as the "**Consent Fee**") that the Applicants agreed to pay to Consenting First Lien Lenders under the First Lien Support Agreement – an agreement that RBC declined to sign.

¹ Capitalized words not otherwise defined herein have the meaning ascribed to them in the Affidavit of Greg Nordal Sworn May 11, 2015 in support of the CCAA application.

2. RBC seeks an order that these amounts (approximately CDN \$20 million in total) be paid out of the cash on hand of the Applicants before the assets of the Applicants (including its cash on hand) are transferred to the Purchaser (as hereinafter defined) under the asset sale Transaction for which the Applicants are seeking this Court's approval.² While RBC says it is neither consenting to nor opposing the sale approval aspect of the Applicants' motion³, it wants the amounts it is claiming on this motion to be paid before the Applicants' assets are transferred to the Purchaser, with the intended effect of reducing overall recoveries of the first lien lenders if the Transaction proceeds.⁴ Paying this amount of cash to RBC would divert cash⁵ that would otherwise be available to be used by the Purchaser to pay trade creditors in the ordinary course of the Nelson Business and to service the approximately \$200 million in new debt to which the Purchaser will be subject.

3. RBC is not entitled to the payment of Second Lien Interest or Second Lien Asset Fees, which simply form part of the Second Lien Debt (as defined in the Monitor's Second Report dated July 8, 2015) existing at the date of filing. The Second Lien Debt ranks behind the First Lien Debt (also as defined in the Second Report of the Monitor dated July 8, 2015) and no amounts can be paid on account of the Second Lien Debt under the Second Lien Credit Agreement until the First Lien Debt under the First Lien Credit

² See Applicants' Notice of Motion dated May 15, 2015 returnable August 13, 2015 seeking the Court's approval of the Transaction for the sale of Nelson Education's assets and business (the "**Nelson Business**") that is more fully described in the Applicants' companion factum filed in support of the Sale Approval Motion.

³ Cross-Examination of Les Vowell held August 5, 2015 (the "**Vowell Cross-Examination**"), pp. 11-12, Q. 32-33.

⁴ Vowell Cross-Examination, pp. 25-27, Q. 82-86.

⁵ Which ranges from a low of \$15 million in July to a high of \$45 million in December in the Nelson Business cash flow cycle – Transcript of Cross-Examination of Greg Nordal held August 4, 2015 ("**Nordal Cross-Examination**"), p. 10, Q. 27-31

Agreement has been repaid in full.⁶ It is the Applicants' position that the entitlements of the Second Lien Lenders to amounts due pre-filing can be no greater than what they could obtain through the exercise of their contractual rights and remedies, all of which give priority to re-payment in full to the First Lien Lenders. The value of the Company's assets is not sufficient to effect re-payment in full to the First Lien Lenders.

4. There is nothing about the circumstances in which the Second Lien Credit Agreement fell into default that now supports the claims that RBC makes. The Applicants were not in a position to pay the outstanding principal balance of approximately US \$270 million due on maturity of the First Lien Credit Agreement in July, 2014.⁷ The Company's decision in June of 2014 to stop paying the Second Lien Interest and to later stop paying the Second Lien Agent Fees, which led to the amounts RBC claims being unpaid at the date of the CCAA filing was a reasonable exercise of business judgement, having regard to the financial resources of the Applicants, the Company's need to continue to pay trade creditors in the ordinary course of business, the priority secured claim of the First Lien Lenders to the assets of the Nelson Business and the First Lien Lenders' ability (in contrast with that of the Second Lien Lenders) to take remedial action upon the maturity of the First Lien Credit Agreement in early July 2014.
5. The Company had been working for over a year with its lenders prior to the maturity of the First Lien Credit Agreement (the "**First Lien Maturity**") to find a consensual resolution of all of its debt obligations, and continued to do so after the First Lien

⁶ Vowell Cross-Examination, pp. 130, Q. 444.

⁷ Vowell Cross-Examination, p. 34, Q. 108-109; pp. 131-132, Q. 454-455; pp. 134-135, Q. 463; p. 154, Q. 537; Credit Report dated January 15, 2014, Tab B of Exhibit 1 to the Vowell Cross-Examination.

Maturity, but once default under the First Lien Credit Agreement was inevitable, the Applicants could not ignore the priorities that existed as between the First and Second Lien Lenders and their respective rights.

6. RBC made the conscious and considered choice in August of 2014 not to take any enforcement or realization steps for any sums in default for the Second Lien Interest or the Second Lien Agent Fees, but rather to adopt a defensive path to “...hopefully be in a position to encourage consensual agreement that see some recovery to the Second Lien after the First Lien has a full recovery”⁸ (emphasis added). RBC says its objective in a consensual restructuring was, with the passage of time, to allow for improvement in the Canadian market in an attempt to get a recovery for the second liens after the first lien was repaid⁹ (emphasis added).¹⁰
7. As elaborated in the companion factum in support of the Sale Approval Motion, the SISP that the Company undertook after the First Lien Maturity was designed and implemented to determine whether there was a purchaser for the Nelson Business as a going concern at a value in excess of that necessary to repay in full the First Lien Debt, with any such excess value to be applied to the Second Lien Debt (be it outstanding principal, interest or expenses). Instead, what the SISP established was that there was no transaction available that would permit the Applicants to repay the full amount of the approximately US \$270

⁸ Vowell Cross-Examination, pp. 69-70, Q. 234-235; Credit Report dated August 20, 2014, Tab H of Exhibit 1 to the Vowell Cross-Examination.

⁹ Vowell Cross-Examination, p. 71, Q. 239.

¹⁰ RBC’s internal credit reports suggest only qualified support for the Company’s restructuring efforts, “to the extent we can aide in restructuring to improve our position we will be cooperative”. RBC Credit Reports, Exhibit 1 to the Vowell Cross-Examination, at Tabs A to G.

million owing to the First Lien Lenders.¹¹ This has been confirmed by the Monitor.¹² Further, “[i]n the Monitor’s judgment there is no reasonable possibility that the liquidation value of the Nelson assets is greater than the First Lien Debt”.¹³

8. In April 2015 (the month prior to the CCAA filing) RBC considered that it had maintained a constructive working relationship with the Company but had resigned itself (according to its internal credit reports) to the expectation that “...the company will go through CCAA procedure that will result in the lenders converting some of their debt to equity and realize on the security.”¹⁴ RBC was not surprised when the Applicants filed for CCAA the next month.¹⁵ That filing cannot somehow elevate the Second Lien Lenders rights to payments of pre-filing amounts that, pre-filing they had no ability to recover and their appeal to this Court’s equitable jurisdiction to achieve that result should be rejected.
9. The simple fact is that, as of the date the Company ceased paying the Second Lien Interest and Second Lien Agent Fees and continuing until now, there has not been sufficient funds to allow the First Lien Lenders a full recovery, and no recovery for the Second Lien Lenders is available. There was, and continues to be, no justification for paying them because there is no value in the Company beyond the debt owed to the First Lien Lenders.

¹¹ Affidavit of Dean Mullett sworn May 11, 2015 (the “Mullett Affidavit”) at para. 67; Motion Record of the Applicants returnable August 13, 2015 (the “Sale Approval Motion Record”), Tab 2.

¹² Monitor’s Second Report at para. 78(g).

¹³ Monitor’s Second Report at para. 92.

¹⁴ Credit Report dated April 15, 2015, Tab K of Exhibit 1 to the Vowell Cross-Examination; Vowell Cross-Examination, pp. 82-83, Q. 274-277.

¹⁵ Vowell Cross-Examination, pp. 83-84, Q. 278-280.

10. As for RBC's claim that in its capacity as a First Lien Lender under the First Lien Credit Agreement it is entitled to a proportionate share of the Consent Fee which the Applicants agreed to pay under the First Lien Support Agreement to certain Consenting First Lien Lenders, this claim must also fail. RBC declined to become a party to the First Lien Support Agreement and is not entitled to the Consent Fee payable under it only to those who did sign it.
11. RBC does not challenge or seek to set aside the payments of interest and advisory and consent fees to the First Lien Lenders. What it wants are, in effect, tag along rights that it did not contract for under its First Lien Credit Agreement or the Intercreditor Agreement. In addition, RBC essentially asks the Court to re-write the First Lien Support Agreement to give them the benefit of that agreement which they did not sign, and a Consent Fee that they did not earn under that agreement.

PART II – THE FACTS

A. BACKGROUND

12. The Applicants obtained an Initial Order dated May 12, 2015 protecting them from claims by their creditors (including RBC in all of its capacities) under the CCAA. By Amended and Restated Initial Order dated June 8, 2015 (the "**Amended and Restated Order**"), FTI Consulting Canada ("**FTI**") was appointed as the Monitor effective May 29, 2015. Proceedings against the Applicants have been stayed until August 31, 2015.
13. In the companion Sale Approval Motion, the Applicants seek approval of the Transaction, whereby the First Lien Lenders would convert all of the debt owing to them

under the First Lien Credit Agreement into a new first lien term facility with, and common shares of, a newly incorporated company (the “**Purchaser**”) which would purchase the assets of the Applicants’ business.

14. As more fully set out in the companion factum, the Company and its financial advisor A&M conducted a thorough SISP to identify one or more potential purchasers of, or investors in, the Nelson Business with the goal of finding a transaction that would realize value beyond the amounts owing to the First Lien Lenders. No such transaction could be found, meaning that there was no value in the security held by the Second Lien Lenders. Accordingly, the Company decided it should proceed with the Transaction pursuant to the First Lien Support Agreement as the best option available, although no proceeds for the Second Lien Lenders would be realized under it.

Mullett Affidavit at paras. 30 and 53-54; Sale Approval Motion Record, Tab 2.

15. The Monitor has confirmed that the SISP was a thorough market test which can be relied on to establish that there is no value in the Company beyond the amounts owing to the First Lien Lenders. The Monitor accordingly supports the Company’s request for approval of the Transaction.

Monitor’s Second Report at paras. 14(h) and 16.

16. The Transaction is fully described, and the facts supporting its approval, are set out in the Applicants’ companion factum in support of the Sale Approval Motion.

B. SECOND LIEN INTEREST AND SECOND LIEN AGENT FEES

(1) Discussions with Creditors

17. Beginning in April 2013, with the assistance of its professional advisors, Nelson Education engaged in discussions and explored a variety of transaction alternatives with the Second Lien Agent and the First Lien Steering Committee in an effort to achieve a consensual transaction that would address the Company's obligations under its Credit Agreements, protect value, improve the financial position of the Company, and create stability for the business, including the Company's employees, customers, lenders and other key stakeholders.

Affidavit of Greg Nordal sworn May 11, 2015 (the "**May Nordal Affidavit**") at para. 7; Application Record of the Applicants returnable May 12, 2015 (the "**Application Record**"), Tab 2.

18. Between August 2013 and September 2014, the Company and its advisors provided information and updates about the Company and its business to the First Lien Steering Committee, the Second Lien Agent, and their respective advisors, and exchanged a number of without prejudice and confidential proposed transaction term sheets. Members of the Company's management and its advisors attended several in-person meetings with the First Lien Steering Committee and its advisors, and with the Second Lien Agent and its advisors, and diligently pursued a consensual solution. The Company tried to achieve a consensual restructuring transaction in advance of the July 3, 2014 maturity under the First Lien Credit Agreement (the "**First Lien Maturity**"), and did not give up on that prospect even afterwards.

May Nordal Affidavit at paras. 7 and 87; Application Record, Tab 2.
Nordal Cross-Examination, p 31 line 18 to p. 32 line 7 "*We never stopped trying to get that consensual agreement*"; p 57-58, Q 179-181, p. 64 Q 194-195

(2) Second Lien Interest Default

19. In March 2014, the Company's board of directors (the "**Board**") considered potential alternatives with respect to the quarterly interest payment that was coming due under the Second Lien Credit Agreement on March 31, 2014 (the "**March Interest Payment**"). These potential alternatives included paying the interest, not paying the interest, or seeking an extension of the cure period under the Second Lien Credit Agreement in respect of the payment.

Affidavit of Greg Nordal sworn July 22, 2015 (the "**July Nordal Affidavit**") at para. 3; Responding Motion Record of the Applicants returnable August 13, 2015 (the "**Responding Motion Record**"), Tab 1.

20. The Company's advisors engaged in discussions with the Second Lien Agent's advisors in connection with the March Interest Payment. At no point was the Company in a financial position to repay its principal indebtedness under the First Lien Credit Agreement, let alone the indebtedness (be it for principal, interest or expenses) under the Second Lien Credit Agreement, absent a restructuring or refinancing transaction.

July Nordal Affidavit at para. 4; Responding Motion Record, Tab 1.

May Nordal Affidavit at paras. 7 and 87; Application Record, Tab 2.

21. In order to avoid a default under the Second Lien Credit Agreement and a potential cross-default under the First Lien Credit Agreement, Nelson Education, Holdings, the Second Lien Agent and the Second Lien Lenders entered into a Grace Period Extension Agreement and subsequently a Second Grace Period Extension Agreement

(the “**Extension Agreements**”) as the Company continued to work with its lenders to try to achieve a consensual transaction.

Responses to Written Questions on May Nordal Affidavit, dated May 25, 2015 (the “**Responses to Nordal Questions**”) at paras. 9-16; Transcript Brief, Tab IV.

July Nordal Affidavit at paras. 5-6; Responding Motion Record, Tab 1.

22. Pursuant to the Extension Agreements, the Second Lien Agent and the Second Lien Lenders agreed to extend the cure period under the Second Lien Credit Agreement to May 30, 2014 and the Company paid a portion of the March Interest Payment in the amount of US\$350,000. The Company also continued to pay amounts in respect of the Second Lien Agent’s professional advisors and provided certain information (including financial information).

July Nordal Affidavit at paras. 5-6; Responding Motion Record, Tab 1.

Responses to Nordal Questions at para. 24; Transcript Brief, Tab IV.

23. On May 30, 2014 the second lien cure period expired. The Company requested a further extension, but the Second Lien Lenders did not agree to any further forbearance or standstill. The Company had not at that time reached a consensual restructuring transaction and therefore remained unable to repay principal indebtedness under the First Lien Credit Agreement.

July Nordal Affidavit at para. 7; Responding Motion Record, Tab 1.

Responses to Nordal Questions at para. 18; Transcript Brief, Tab IV.

24. Following the expiry of the Extension Agreements, in the face of imminent default under the First Lien Credit Agreement, the Company decided, consistent with the priorities

between the First Lien Lenders and the Second Lien Lenders, that it could not and should not continue making payments for interest under the Second Lien Credit Agreement. The Company did not pay the remaining March Interest Payment, resulting in a default under the Second Lien Credit Agreement on June 1, 2014. The Second Lien Credit Agreement remained in default thereafter until the CCAA filing, although it did not mature until July 2015, after the CCAA filing.

July Nordal Affidavit at para. 24; Responding Motion Record, Tab 1.

25. On June 27, 2014, the Board resolved to authorize the Company not to make the next quarterly interest payment due on June 30, 2014 under the Second Lien Credit Agreement (the “**June 2014 Interest Payment**”)¹⁶. By this time, the Company’s default under the First Lien Credit Agreement was imminent.

July Nordal Affidavit at para. 9; Responding Motion Record, Tab 1.

Responses to Nordal Questions at para. 20; Transcript Brief, Tab IV.

26. The rights, remedies and entitlements of the Second Lien Lenders upon default are clearly delineated under the Second Lien Credit Agreement, and are subject to the Intercreditor Agreement. These are more fully discussed in the factum filed by the First Lien Steering Committee on behalf of the First Lien Lenders in connection with the RBC Motion and the Sale Approval Motion and will not be repeated in this factum.¹⁷ What is

¹⁶ The First Lien Lenders were not involved in the negotiation of the Extension Agreements or the Company’s decision not to make the March 2014 Interest Payment or the June 2014 Interest Payment. (See July Nordal Affidavit at para. 10; Responding Motion Record, Tab 1).

¹⁷ The ability of the Second Lien Lenders to act being subject to, among other things, the 180 day standstill in their Intercreditor Agreement, which RBC’s internal credit reports acknowledge as early as March, 2014. Vowell Cross-Examination, Exhibit 1, Tab E and p. 64, Q.215.

important from the Company's perspective is that after the expiry of the second lien cure period (under the Extension Agreements) the Second Lien Credit Agreement went into default (first for non-payment of the Second Lien Interest and then, according to RBC, for non-payment of the Second Lien Agent Fees), yet the Second Lien Lenders did not provide a notice of an event of default to the First Lien Lenders' collateral agent which they were required to do in order to commence the Standstill Period under the Intercreditor Agreement. To the extent they had any recourse, the Second Lien Lenders took no steps in respect of the enforcement of any rights and remedies they had following the non-payments of amounts now claimed to be owing under the Second Lien Credit Agreement. The only thing RBC did was issue a reservation of rights letter in April of 2014 which was never acted upon.

July Nordal Affidavit at para. 8; Responding Motion Record, Tab 1.

Vowell Cross-Examination, pp. 59-60, Q. 194-197.

Exhibit "I" to the Affidavit of Les Vowell sworn July 21, 2015 (the "**Vowell July 21 Affidavit**"); Responding Motion Record of RBC returnable August 13, 2015 (the "**RBC Responding Motion Record**"), Tab 11.

Vowell July 21 Affidavit at para. 4; RBC Responding Motion Record, Tab 1.

Vowell Cross-Examination, pp. 53-56, Q. 181-188.

(3) First Lien Maturity and July Support Agreement Endorsed by RBC

27. When the First Lien Credit Agreement matured on July 3, 2014, the Company was unable to repay the obligations outstanding under the First Lien Credit Agreement.

May Nordal Affidavit at para. 20; Application Record, Tab 2.

July Nordal Affidavit at para. 11; Responding Motion Record, Tab 1.

28. On July 7, 2014, the Company proposed an amendment and extension of the First Lien Credit Agreement (the “**July Proposed Extension**”) and solicited consent from its First Lien Lenders (the “**July Consent Solicitation Process**”). The First Lien Credit Agreement requires consent of 100% of the lenders to extend the maturity date, and the July Proposed Extension did not ultimately receive the support of the First Lien Lenders. However, RBC was prepared to support this proposed extension and executed the Company’s proposed Consent and Support Agreement dated as of July 7, 2014 (the “**July Support Agreement**”), agreeing to a Term Sheet which was attached thereto as Schedule “A”.

July Nordal Affidavit at paras. 12-14; Responding Motion Record, Tab 1.

May Nordal Affidavit at para. 89; Application Record, Tab 2.

Responses to Nordal Questions at para. 21; Transcript Brief, Tab IV.

29. Although the July Support Agreement Term Sheet that RBC was prepared to agree to never became binding because all First Lien Lenders did not agree to it, it is instructive to look at what RBC was prepared to agree to, given the position that RBC now takes:

- (a) it included a condition that there be no cash payment of interest to lenders under the Second Lien Credit Agreement;
- (b) it made express provision for the payment of professional fees of the advisors of the First Lien Lenders, while making no provision for the payment of the professional fees of the advisors of the Second Lien Lenders;
- (c) it contemplated the continued payment of trade creditors (whether secured or unsecured) in the ordinary course of the Nelson Business;

- (d) it contained releases between the Company and the lenders (and their respective officers, directors, employees etc.) and provided that those releases could be implemented by way or Court order, if not signed individually;
- (e) it provided for a consent fee that would have been approximately U.S. \$13.4 million if all First Lien Lenders executed the July Support Agreement prior to a set early consent date, but also provided that those First Lien Lenders who did not sign would not receive the consent fee but would nevertheless be bound to the terms if it proceeded by one of the contemplated alternative transactions that did not require 100% consent of all First Lien Lenders;

Consent and Support Agreement sections 4(e), 5 (b), 5(d) and 7 and Sch. A, Term Sheet, s. II, p. 2, Schedule "D" to Responses to Nordal Questions; Transcript Brief, Tab IV(D).

Vowell Cross-Examination, p. 42-43, Q. 143-144.

Vowell Cross-Examination, pp. 35-36, Q. 114-118.

Vowell Cross-Examination, p.43-44, Q. 146-49.

Vowell Cross-Examination, p. 51, Q. 172.

(4) Second Lien Agent Fees Default

- 30. The Company paid approximately \$3 million in respect of the professional fees of the Second Lien Agent beginning in March 2013. The company agreed to reimburse the Second Lien Agent Fees, as is reflected in the CDG engagement letters (CDG being the financial advisor to RBC), when the Second Lien Agent was seeking professional advisory advice about, among other things, potential restructuring transactions in the context of the Company's attempts to reach a consensual resolution of all of its outstanding First and Second Lien Debt.

CDG Group Engagement Letters dated as of March 1, 2013 and March 10, 2014, respectively, Exhibit "B" to the Affidavit of Les Vowell sworn July 13, 2015 (the "**Vowell July 13 Affidavit**"); Motion Record of RBC returnable August 13, 2015 (the "**RBC Motion Record**"), Tab 2B.

31. The Company continued to honour that commitment up until the First Lien Maturity. The Board of Directors considered certain of the Second Lien Agent Fees at their August 5, 2014 meeting and delegated authority to management (who were at the time negotiating with the Second Lien Agent) to manage those fees. The Company determined not to pay any of the invoices for Second Lien Agent Fees dated (and received) after July 30, 2014 in the face of its default and inability to repay the amounts owing under the First Lien Credit Agreement and without any consensual resolution.

July Nordal Affidavit at paras. 18-20; Responding Motion Record, Tab 1.

Minutes of the Meeting of the Board of Directors of Nelson Education Ltd., August 5, 2014, Exhibit 15 to the Nordal Cross-Examination.

32. RBC claims to be contractually entitled to these amounts under section 10.4 of the Second Lien Credit Agreement, which provides that the Company will pay or reimburse the Second Lien Agent for "...all reasonable and documented out-of-pocket costs and expenses incurred in connection with the enforcement of any rights or remedies under [that] agreement." It does so despite admitting that it took no steps in respect of the enforcement of any rights or remedies under that agreement at any time pre-filing.

Second Lien Credit Agreement, Exhibit "E" to the Nordal May Affidavit; Application Record Tab 2E.

Vowell July 13 Affidavit at para. 3; RBC Motion Record, Tab 2.

Vowell Cross-Examination, p. 53-56, Q. 181-188.

(5) The First Lien Support Agreement

33. Following the presentation of the July Proposed Extension (which, despite RBC's endorsement did not receive support of all the First Lien Lenders), the Company and its advisors continued to have discussions and meetings with the First Lien Steering Committee and its advisors, and with the Second Lien Agent and its advisors, with the aim of achieving a consensual solution. These negotiations ultimately resulted in the First Lien Support Agreement and attached term sheet (the "**First Lien Term Sheet**") dated September 10, 2014, which was agreed to by all First Lien Lenders except RBC.¹⁸ Conditions precedent under the First Lien Term Sheet include payment of the Initial First Lien Early Consent Fee and the Additional First Lien Consent Fee to Consenting First Lien Lenders (defined by RBC as the "Consent Fee") as well as receipt by the First Lien Agent of all unpaid fees up to the Effective Date (as defined in the First Lien Term Sheet) owing to the First Lien Lenders and the First Lien Agent under the First Lien Credit Agreement, and payment in full in cash and payment of all accrued and unpaid expenses of the First Lien Agent and First Lien Lenders, including of their professional advisors.

Mullett Affidavit at paras. 25-26; Sale Approval Motion Record, Tab 2.

First Lien Support Agreement, Sch. A, First Lien Term Sheet, Exhibit "G" to the May Nordal Affidavit; Application Record, Tab 2G.

34. Under the First Lien Support Agreement (which had the support of the Required Majority of First Lien Lenders under the First Lien Credit Agreement, and RBC being the only one not to sign on to it) the First Lien Lenders agreed not to exercise default remedies while

¹⁸ This was the only structure that the Required Majority of First Lien Lenders under the First Lien Credit Agreement were prepared to agree to (they did not accept the "amend and extend" structure that RBC endorsed under the July Proposed Extension).

the SISP was carried out, and agreed that they would assume responsibility for all of the trade obligations to allow the Company to carry on in the ordinary course of business and preserve its value for all stakeholders.

First Lien Support Agreement, ss. 4(d) and 5(q)(viii) and Sch. A, First Lien Term Sheet, s. III, p. 3, and s. VIII, p. 11, Exhibit "G" to the May Nordal Affidavit; Application Record, Tab 2G.

Vowell Cross-Examination, p. 19, Q. 58.

35. Under the First Lien Support Agreement, the Consenting First Lien Lenders required the Company to agree to continue not to pay interest or other amounts coming due under the Second Lien Credit Agreement. These were not obligations for which the First Lien Lenders were prepared to assume responsibility. The Company had already stopped paying these amounts to the Second Lien Lenders prior to the First Lien Support Agreement (and this was consistent with what RBC had been prepared to agree to under the July Support Agreement and Term Sheet). The Company made no further interest or fee payments to the Second Lien Lenders following its entry into the First Lien Support Agreement.

July Nordal Affidavit at para. 16; Responding Motion Record, Tab 1.

Responses to Nordal Questions at para. 28; Transcript Brief, Tab IV.

36. By letter dated September 19, 2014, the Company's counsel provided the Second Lien Agent's counsel with a copy of the First Lien Support Agreement attaching the First Lien Term Sheet and a copy of the Company's presentation to the First Lien Lenders dated September 10, 2014 relating to the Transaction. The letter explained that "[t]he Company has until mid-November 2014 to determine a process for implementing the Transaction," that "the Company intends to continue to work cooperatively with the

Second Lien Agent and seek its views with respect to any such process,” and that “[i]f the Company does not obtain the support of the Second Lien Agent for such a process, the Company may require a court process to implement the Transaction.”

Letter from Goodmans to Paul Hastings dated September 19, 2014, Exhibit 3 to the Vowell Cross-Examination.

37. RBC’s counsel had initially advised on October 1, 2014 that RBC would agree to execute a reasonable non-disclosure agreement in connection with obtaining information relating to the SISP. Given RBC did not sign the First Lien Support Agreement, it had not agreed to be bound by the confidentiality provisions contained therein whereas all of the other First Lien Lenders had so agreed. Following the Company’s provision of a form of confidentiality agreement to RBC’s counsel for their consideration, RBC’s counsel subsequently advised that RBC would only consider the confidentiality agreement once payment of the Second Lien Agent’s fees had been resolved. RBC did not ultimately execute a confidentiality agreement in connection with the SISP or the Transaction. A&M did, however, provide RBC with verbal updates during the SISP.

Vowell Cross-Examination, p. 95, Q. 316, pp. 96-98, Q. 321-327 and pp. 100-101, Q. 336.
Monitor’s Second Report at paras. 127.

Letter from Paul Hastings to Goodmans dated October 1, 2014, Exhibit 5 to the Nordal Cross-Examination.

Correspondence between counsel for the Applicants and RBC dated October 31 to November 18, 2014, Exhibit “E” to the Affidavit of Les Vowell sworn July 13, 2015; Motion Record of RBC returnable August 13, 2015, Tab 2E.

Support Agreement, s. 12(b), Exhibit “G” to the May Nordal Affidavit; Application Record, Tab 2G.

38. A consensual transaction that had the potential of avoiding a court (insolvency) filing under the CCAA or the *Bankruptcy and Insolvency Act* (Canada) was the Company’s

preferred course of action to maximize value for all stakeholders and minimize costs. RBC recognized this as a preferred course of action as well. However, it was no secret that, failing an overall consensual resolution, the Company would proceed by way of an asset sale with court approval, if necessary, and RBC was aware of this by at least March of 2014.

Nordal Cross-Examination, pp. 31-32, Q. 104.
Vowell Cross-Examination, p. 37, Q. 123.

Credit Reports dated September 24, 2013 and April 15, 2015, Tabs A and K, respectively, of Exhibit 1 to the Vowell Cross-Examination.
Credit Report dated March 31, 2014, Tab E of Exhibit 1 to the Vowell Cross-Examination

C. RBC IS NOT ENTITLED TO A CONSENT FEE

39. RBC (in its capacity as a First Lien Lender) received a copy of the First Lien Support Agreement on September 10, 2014 and was given the opportunity to sign on to it until September 25, 2014. RBC chose not to, understanding that, to the extent the provisions of it were valid, it provided that the Applicants would only pay the Consent Fees under it to the First Lien Lenders who signed it, and that RBC by not signing was giving up the consent fee that the other Consenting First Lien Lenders would be paid.

First Lien Support Agreement, Sch. A, First Lien Term Sheet, s. 6, pp. 9-11
Exhibit "G" to the May Nordal Affidavit, Application Record, Tab 2G.

Vowell Cross-Examination, p. 90, Q. 302-303.

40. Consenting First Lien Lenders who executed the First Lien Support Agreement or a Joinder Agreement prior to September 25, 2014 (the "**Early Consenting First Lien Lenders**") were entitled to the Consent Fee pursuant to the terms of the First Lien Term Sheet.

First Lien Support Agreement, s. 5 and Sch. A, First Lien Term Sheet, s. VI, pp. 9-11, Exhibit "G" to the May Nordal Affidavit; Application Record, Tab 2G.

41. RBC is the only one of 22¹⁹ First Lien Lenders that is not a Consenting First Lien Lender; consequently, RBC is the only First Lien Lender that has not been paid the Consent Fee.

Exhibit "D" to the May Nordal Affidavit; Application Record, Tab 2D.

July Nordal Affidavit at para. 22; Responding Motion Record, Tab 1.

Mullett Affidavit at paras. 26-28; Sale Approval Motion Record, Tab 2.

42. The payment of the Consent Fee to the Early Consenting First Lien Lenders under the First Lien Support Agreement kept the prospect of the Transaction available to the Company following the default under the First Lien Credit Agreement. The Consent Fee was paid pursuant to the First Lien Support Agreement until May 2015, after which payments ceased in compliance with the Amended and Restated Initial Order.

July Nordal Affidavit at paras. 21-22; Responding Motion Record, Tab 1.

Nelson Education Limited (Re), Amended and Restated Initial Order, Court File No. CV15-10961-00CL at para. 8 (Ont. Sup. Ct.); Book of Authorities, Tab W.

43. The language of the First Lien Term Sheet pertaining to the Consent Fee is substantially similar to the language of Term Sheet attached as Schedule "A" to the July Support Agreement, which RBC was prepared to endorse and agree to. When it signed the July Support Agreement, RBC considered it was commercially reasonable for the Company to enter into an agreement that could result in a First Lien Lender that did not want to support the contemplated transactions not getting a consent fee if the transaction nonetheless went ahead.

¹⁹ At the time of signing there were 22 lenders in total, although the Company understands that there may now only be 21 First Lien Lenders due to an acquisition of one lender's position by another.

Consent and Support Agreement, Sch. A, Term Sheet, s. III, pp. 6-7, Schedule "D" to Responses to Nordal Questions; Transcript Brief, Tab IV(D).

Vowell Cross-Examination, pp. 48-50, Q. 163-169.

D. PAYMENTS TO TRADE CREDITORS BEFORE FILING CREATES NO BASIS FOR THE RELIEF THAT RBC CLAIMS

44. The Company continued to pay trade creditors after it ceased paying Second Lien Interest and Second Lien Agent Fees. It did this because Nelson Education relies on the supply of products and services from its suppliers and service providers, and of content from its content providers, for the ongoing creation, development and adaptations of its products and materials. The Company operates in a highly competitive environment where the ongoing creation and timely provision of products and materials are essential to ensure the continuance of the business. This required continued good relations with suppliers, service providers and content providers. The simple fact is that these payments were necessary to continue the Nelson Business as a going concern.

May Nordal Affidavit at paras. 151-154; Application Record, Tab 2.

45. The payments to trade creditors do not create a right to payment now to Second Lien Lenders. When RBC agreed to sign the July Support Agreement which provided for no payments to Second Lien Lenders, it expected that the Company would continue to pay trade creditors while it was attempting to complete a transaction. RBC acknowledges that it would expect recoveries to be increased if a "distressed" company continues as a going concern and concedes that to do so the company would need to retain the suppliers

needed to carry on business and its employees, and thus would expect the company to pay them in the ordinary course.²⁰

Vowell Cross-Examination, pp. 50-51, Q. 170-172.

46. The Amended and Restated Initial Order allows for payment of pre-filing and post-filing expenses and obligations to trade creditors in the ordinary course of business.

Amended and Restated Initial Order, *supra* at para. 6; Book of Authorities, Tab W.

PART III – ISSUES AND THE LAW

A. NO BASIS FOR INTERFERING WITH THE COMPANY'S DECISION TO STOP PAYING SECOND LIEN INTEREST AND PROFESSIONAL FEES

47. The unpaid Second Lien Interest is comprised of a portion of the March 2014 quarterly interest payment that was due on June 1, 2014 after the expiry of the Second Grace Period Extension Agreement, and all quarterly interest payments that came due under the Second Lien Credit Agreement after that to the CCAA filing.

A partial interest payment of \$350,000 USD was made at the time of the Second Lien Grace Period Extension Agreements.

Responses to Nordal Questions at paras. 16, 17 and 18, Sch. "B" and "C"; Transcript Brief, Tabs IV, IV(B) and IV(C).

Exhibit "F" to the Vowell July 13 Affidavit; RBC Motion Record, Tab 2.

Vowell Cross-Examination, p. 141, Q. 490.

48. The unpaid Second Lien Agent Fees are for amounts invoiced by the professional advisors to the Second Lien Lenders after the First Lien Credit Agreement had matured

²⁰ Vowell Cross-Examination, pp. 120-122, Q. 403-410.

and gone into default in July, 2014, which RBC claims nonetheless should have been paid by the Applicants up to the CCAA filing pursuant to the Second Lien Credit Agreement (specifically paragraph 10.04 of the Second Lien Credit Agreement which entitles the Second Lien Lenders to be reimbursed for reasonable and documented out of pocket costs and expenses incurred in connection with the enforcement of any rights or remedies under that agreement).

Vowell July 13 Affidavit at paras. 3-4 and Exhibit "A" thereto; RBC Motion Record, Tabs 2 and 2A.

Vowell Cross-Examination, p. 61, Q. 203 and pp. 62-63, Q. 209-211.

49. RBC appears to argue that it is somehow unfair for the First Lien Lenders and trade creditors to have been paid prior to the CCAA filing, while the Second Lien Lenders were not. There are two problems with this proposition. First, the comparison is inapt. Second, even if some creditors were paid proportionately more than others pre-filing, this results only in the under paid creditor having a larger claim. It gives rise to no right to an equalization whereby all creditors are placed on the footing they would have been if all had been paid equally up to the filing date.
50. Making payments pre-filing to the First Lien Lenders was consistent with the priorities to which RBC agreed by entering into the Intercreditor Agreement and the Company received consideration in the form of forbearance and time afforded by the First Lien Lenders. Making payments to trade creditors pre-filing was necessary to continue to business as a going concern.
51. On the other hand, the payment of Second Lien Interest and Second Lien Agent Fees could only have been justified: (1) as part of a consensual resolution with both the First

Lien and Second Lien Lenders, or (2) if a transaction had been identified that indicated the Company had a value in excess of the First Lien Debt. However, neither occurred, despite the Company's efforts.

52. The objective in CCAA proceedings is equitable rather than equal treatment in the CCAA, having regard to the size of pre-filing claims and their priority. This principle has been applied in the context of plan sanction, classification of creditors, and allocation of costs among creditors. Differential treatment amongst secured creditors has been specifically considered in this last context and found to be justified where the nature or priority of their security differs. And of course, the size of pre-filing claims depends on what payments were received by each creditor before filing, which for many reasons could be different.

Re T. Eaton Co., 1999 CarswellOnt 4661 at para. 5 (S.C.J. [Commercial List]);
Book of Authorities, Tab EE.

Re Hunters Trailer & Marine Ltd., 2001 ABQB 1094 at paras. 18 and 20; Book
of Authorities, Tab FF.

Re Keddy Motor Inns Ltd. (1992), 13 C.B.R. (3d) 245 at para. 37 (N.S. C.A.);
Book of Authorities, Tab GG.

53. The fact that pre-filing payments of interest and fees were made to the First Lien Lenders, and pre-filing payments were made to trade creditors while payments were not made to Second Lien Lenders, are not being, and could not be, challenged on the basis that the payments were preferences. It is nonetheless instructive to look at the approach taken by the courts to applications to set aside preferential payments to creditors which underscores the fact that payment to some creditors does not necessarily entail that others must be similarly paid.

54. The New Brunswick Court of Appeal has observed that a secured creditor is entitled to a preference as a matter of law.

St. Anne Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc., 2005 NBCA 55, [2005] N.B.J. No. 204 at paras. 12 and 18; Book of Authorities, Tab HH.

See also *Inex Pharmaceuticals Corp (Re)*, 2005 BCSC 1514 at para. 60, aff'd [2006] B.C.J. No. 472 at para. 12 (C.A.); Book of Authorities, Tab II.

See also *Re Imperial Lumber Limited v. Coast Mill Works Limited* (1956), 36 C.B.R. 36 (B.C.S.C.); Book of Authorities, Tab JJ.

55. Accordingly, a payment by a debtor to a secured creditor is protected where the payment does not exceed the value of the security. Conversely, a payment to a secured creditor whose security is without value (as is the security of the Second Lien Lenders here) is subject to attack.

Royal City Chrysler Plymouth Ltd. (Re) (1995), 30 C.B.R. (3d) 178 at para. 71 (Ont. Gen. Div.), aff'd (subnom *Royal Bank of Canada v. Mahon*), 3 C.B.R. (4th) 167 (Ont. C.A.); Book of Authorities, Tab KK.

56. Furthermore, payments made to purchase goods or services required for the on-going conduct of the bankrupt's business, or to honour contractual obligations allowing the insolvent to carry on business, when made in the ordinary course of business, are not preferential. A debtor may be selective about the creditors it chooses to pay in the context of attempting to keep its business alive.

Orion Industries Ltd. (Trustee of) v. Neil's General Contracting Ltd., 2013 ABCA 330 at para. 12 [*Orion Industries*]; Book of Authorities, Tab LL.

Fisher v. Moffatt & Powell (Perth) Ltd., [1984] O.J. No. 2337 (H.C.J.) at para. 12; Book of Authorities, Tab MM.

57. The 2008 decision of the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders* confirmed that courts should give deference to the business judgment of directors of a corporation where: (1) it was impossible for the directors to please all stakeholders, (2) the directors considered the interests of all stakeholders, (3) the directors made a decision that they perceived to be in the best interests of the corporation, and (4) the decision was within the range of reasonable choices that the directors could have made in weighing the conflicting interests. The courts will look to see that the directors made a reasonable decision, not a perfect one.

BCE Inc. v. 1976 Debentureholders, 2008 SCC 69 at paras. 40, 83, 104 and 112; Book of Authorities, Tab NN.

See also *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68 at para. 65; Book of Authorities, Tab OO, citing *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (C.A.), Weiler J.A. at p. 192; Book of Authorities, Tab PP.

58. In deciding to stop paying the Second Lien Interest and the Second Lien Agent Fees, while continuing to fulfil its obligations to the First Lien Lenders and trade creditors, the Company exercised reasonable business judgment having regard to the Company's circumstances. The Board considered the alternatives with regard to the payment of the Second Lien Interest. At no time during the strategic review and negotiation process was the Company in a position to repay the indebtedness owing under the First Lien Credit Agreement absent a restructuring transaction. Based on this, and having regard to the relative priorities of the First Lien Lenders and the Second Lien Lenders as established by the Intercreditor Agreement²¹, the Board reasonably resolved, immediately prior to the

²¹ The specifics of which are canvassed in detail in the factum of the First Lien Steering Committee on behalf of the First Lien Lenders filed in respect of the RBC Motion and the Sale Approval Motion.

First Lien Maturity, not to continue to pay the Second Lien Interest, and to stop paying Second Lien Agent Fees after the First Lien Maturity.²²

July Nordal Affidavit at paras. 3, 4, 9 and 24; Responding Motion Record, Tab 1.

59. If the Company had continued paying the Second Lien Interest and the Second Lien Agent Fees, it would have, in effect, been using the security of the First Lien Lenders to satisfy obligations under the Second Lien Credit Agreement—which arguably would have been a preference but, in any event, was not required pre-filing and is not something which equity now retroactively requires. To give effect to the contentions of the Second Lien Lenders would, in effect, deprive an insolvent company from the opportunity to negotiate for more time with its priority secured lenders to look for an alternative value maximizing transaction outside of a formal CCAA or other insolvency filing, because it would force the priority secured lenders to take immediate action to protect their position.

B. NO ENTITLEMENT TO CONSENT FEE

60. The Consent Fee was paid to the Early Consenting First Lien Lenders pursuant to the First Lien Support Agreement in connection with the proposed Transaction. It was not paid under the First Lien Credit Agreement. RBC, which did not execute the First Lien Support Agreement, is not an Early Consenting First Lien Lender, and therefore has not been paid the Consent Fee.

Exhibit “D” to the May Nordal Affidavit; Application Record, Tab 2D.

²² There is an argument that these fees are not payable, as claimed, under s. 10.04 of the Second Lien Credit Agreement given RBC’s admission that it has not taken any enforcement steps in respect of rights and remedies under the Second Lien Loan Agreement.

61. Payment of consent fees has been approved as fair and reasonable in the context of plan sanction orders where there is a rational purpose for the consideration, such as providing increased confidence in the plan and facilitating the negotiation and approval of the plan. In this case, the Consent Fee facilitated the negotiation of the Transaction, which provides a means of preserving the Nelson Business. Indeed, no party appears to be objecting to the Consent Fee as paid.

Sino-Forest Corp., Re, 2012 ONSC 7050 at paras. 17 and 65-67; Book of Authorities, Tab QQ.

62. However, the Consent Fee is available only to certain parties to the First Lien Support Agreement, under the terms of the First Lien Term Sheet: “To acquire rights and be subject to liabilities under a contract, one must be a party to it.” RBC chose not to become a party to the First Lien Support Agreement and is not entitled to the Consent Fee payable under it.

G.H.L.Fridman, *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011) at 176; Book of Authorities, Tab RR.
First Lien Support Agreement, s. 5 and Sch. A, Term Sheet, s. VI, pp. 9-11, Exhibit “G” to the May Nordal Affidavit; Application Record, Tab 2G.

63. The U.S. law expert retained by the First Lien Agent, Cortland Capital Market Services LLC, as the Supplemental Agent, and the First Lien Steering Committee has attested that he knows of no provision of the Loan Documents, including the First Lien Credit Agreement and Intercreditor Agreement (which are governed by New York law), or of New York law, that would give RBC any right to a consent fee that did not exist as a matter of separate contract.

Opinion of Allan L. Gropper dated July 22, 2015, Exhibit “B” to the Affidavit of Allan L. Gropper sworn July 22, 2015; Responding Motion Record of

Wilmington Trust, National Association, as the First Lien Agent, Cortland Capital Market Services LLC, as the Supplemental Agent, and the First Lien Steering Committee returnable August 13, 2015, Tab 3.

64. The Applicants submit that neither the First Lien Credit Agreement nor the Intercreditor Agreement prevent the payment of the Consent Fee to only those First Lien Lenders who signed on to the First Lien Support Agreement by the date specified. However, if (which the Applicants deny) there is some ambiguity in the First Lien Credit Agreement or Intercreditor Agreement as to whether their terms preclude the First Lien Support Agreement from containing the provision it did regarding the Consent Fee, then RBC's subsequent conduct may be taken into account in resolving it: "...there is no better way of determining what the parties intended than to look at what they did under [the agreement]." As RBC executed the July Support Agreement which contained consent fee language identical to the First Lien Support Agreement, it appears that RBC understood the terms of the First Lien Credit Agreement and Intercreditor Agreement to allow for a consent fee on those terms; the Applicants do not dispute that understanding.

Montreal Trust Co. of Canada v. Birmingham Lodge Ltd. (1995), 125 D.L.R. (4th) 193 at paras. 23-24 (Ont. C.A.), citing *Bank of Montreal v. University of Saskatchewan* (1953), 9 W.W.R. (N.S.) 193 at 199 (Sask. Q.B.); Book of Authorities, Tab SS.

65. Although the payment of the Consent Fee to the Consenting First Lien Lenders is not being, and could not be, challenged on the basis of a preference, it is similarly instructive to look at the approach taken by the courts in that context to underscore the appropriateness of the Company paying the Consenting First Lien Lenders. As the Alberta Court of Appeal has noted, "even a preferential payment made by an insolvent company at a time when its financial collapse is inevitable may be found to be legitimate

if the payment was made with a view to generating income or liquidating assets to satisfy the insolvent's creditors." The Consent Fee clearly meets that test of legitimacy.

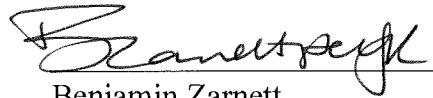
Orion Industries, supra at para. 12, citing *St Anne-Nackawic, supra*; Book of Authorities, Tab LL.

PART IV – RELIEF REQUESTED

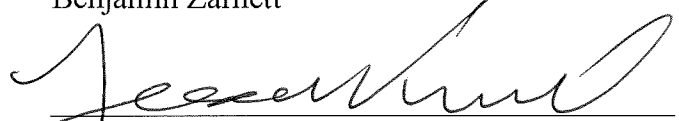
66. The Applicants request that the Court dismiss the RBC motion for payment of the Second Lien Interest, Second Lien Agent Fees and any "share" of the Consent Fee to RBC, with costs to the Applicants.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

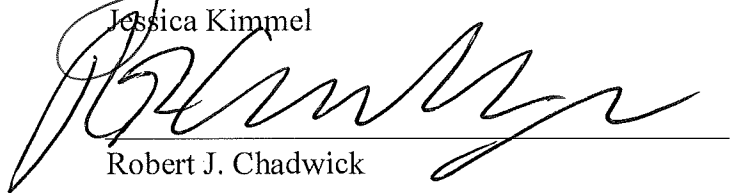
August 11, 2015



Benjamin Zarnett



Jessica Kimmel



Robert J. Chadwick



Caroline Descours

**SCHEDULE “A”
LIST OF AUTHORITIES**

1. *Re T. Eaton Co.*, 1999 CarswellOnt 4661(S.C.J. [Commercial List])
2. *Re Hunters Trailer & Marine Ltd.*, 2001 ABQB 1094
3. *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.)
4. *St. Anne Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.*, 2005 NBCA 55, [2005] N.B.J. No. 204
5. *Inex Pharmaceuticals Corp (Re)*, 2005 BCSC 1514, aff'd [2006] B.C.J. No. 472 (C.A.)
6. *Re Imperial Lumber Limited v. Coast Mill Works Limited* (1956), 36 C.B.R. 36 (B.C. S.C.)
7. *Royal City Chrysler Plymouth Ltd. (Re)* (1995), 30 C.B.R. (3d) 178 (Ont. Gen. Div.), aff'd (subnom *Royal Bank of Canada v. Mahon*), 3 C.B.R. (4th) 167 (Ont. C.A.)
8. *Orion Industries Ltd. (Trustee of) v. Neil's General Contracting Ltd.*, 2013 ABCA 330
9. *Fisher v. Moffatt & Powell (Perth) Ltd.*, [1984] O.J. No. 2337 (H.C.J.)
10. *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69
11. *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68
12. *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (C.A.)
13. *Sino-Forest Corp., Re*, 2012 ONSC 7050
14. G.H.L.Fridman, *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011)
15. *Montreal Trust Co. of Canada v. Birmingham Lodge Ltd.* (1995), 125 D.L.R. (4th) 193 (Ont. C.A.)

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

Court File No: CV15-10961-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.

Applicants

**ONTARIO
SUPERIOR COURT OF JUSTICE-
COMMERCIAL LIST**

Proceeding commenced at Toronto

**FACTUM OF THE APPLICANTS
(RBC Motion
returnable August 13, 2015)**

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