

2009 CarswellQue 12167, [2009] R.J.Q. 1738, J.E. 2009-1107, 2009 QCCS 2188, 58 C.B.R. (5th) 1, EYB 2009-159133, 183 A.C.W.S. (3d) 26

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Abitibowater inc., Re

Dans l'affaire du plan d'arrangement de: Abitibowater inc., Abitibi-Consolidated inc. et Bowater Canadian Holdings Inc., Intimées, c. Ernst & Young inc., Contrôleur, et SFK Pâte, s.e.n.c., Requérante

Cour supérieure du Québec

Mayrand J.C.S.

Heard: 11 mai 2009 - 14 mai 2009

Judgment: 21 mai 2009

Docket: C.S. Qué. Montréal 500-11-036133-094

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Counsel: *Me Guillaume-Pierre Michaud*, pour ACI Term Lenders

*Me Karim Renno, Me Martin Desrosiers, Me Karine Chênevert*, pour la requérante

*Me Guy P. Martel, Me Mélanie Béland*, pour les intimées

*Me Gilles Paquin*, pour le contrôleur

*Me Frederick L. Myers*, pour ad hoc Committee of Bondholders

*Me Vanessa Jodoin*, pour ad hoc Committee of the Senior Secured Noteholders

Subject: Insolvency; Corporate and Commercial

*Mayrand J.C.S.:*

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1 The applicant, SFK Pulp General Partnership ("*SFK*"), seeks cancellation of the notice of repudiation (the "*Notice*") sent to it by Abitibi-Consolidated Company of Canada ("*ACI*"), relating to two wood chip and bark supply agreements (the "*Contracts*").

2 Under the protection of the *Companies' Creditors Arrangement Act*<sup>[FN1]</sup> ("*CCAA*"), AbitibiBowater Inc. and its subsidiaries (the "*ABI group*") have availed themselves of s. 46(f) of the Initial Order granted by this Court on April 17, 2009, authorizing them to terminate their Contracts.

3 Since the preliminary discussions between ACI and SFK were unsuccessful, ACI sent the Notice on April 24, 2009, taking effect immediately. The party that considers itself injured may, under the [TRANSLATION] "snap-back provision" in the Initial Order, request a review of the decision to terminate the Contracts. Hence the present application.

4 Initially, SFK's application included applications for provisional orders and protection orders. In order to avoid additional costs and delay, the parties have agreed to have the issue decided forthwith on its merits.

#### 4 *THE PARTIES*

##### • **SFK**

5 SFK is a general partnership that owns and operates a northern bleached softwood kraft ("*NBSK*") pulp mill (the "*Mill*") located in Saint-Félicien, in the Lac-Saint-Jean region. It acquired the Mill from ACI in 2002 and paid \$628 million for it, notably through public issues. Shares, which sold for \$10 at that time, are now trading at 35¢.

6 The Mill is the only one in Quebec that produces commercial NBSK pulp, recognized for its superior quality. SFK sells it to the paper industry and exports it elsewhere in Canada, to the United States and Europe. The Mill has 306 employees and generates a large number of indirect jobs. It goes without saying that it is one of the engines of the local and regional economy.

##### • **ABI Group and ACI**

7 The background, corporate status, and indebtedness of the ABI group are amply described in the Initial Order granted by this Court on April 17, 2009. The ABI group's indebtedness is close to \$10 billion and its losses during the past nine months amount to approximately \$1.9 billion. The indebtedness of ACI and its subsidiaries was \$6 billion and its operating losses \$1.06 billion in 2008.

8 The ABI group operates 23 pulp and paper mills and 30 lumber mills in the United States, Canada, the United Kingdom, and South Korea. Mill operations are down, running at 32% of capacity, in rotation and by work shift in order to limit job losses. Some mills have completely shut down.

9 The ABI group owns six sawmills and has a substantial interest in at least three others within a 100-km radius of the Mill in Saint-Félicien. It is central to the regional economy, and in much greater proportions than SFK.

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9 *THE ISSUE*

9 *THE QUESTIONS TO BE DECIDED CAN BE SUMMARIZED AS:*

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

2. **In light of these criteria, does the Court need to intervene to restore the Contracts?**

#### **THE POSITION OF THE PARTIES**

##### **• SFK**

10 According to SFK, the Court should refuse to endorse the repudiation of the Contracts because the balance of inconvenience and the prejudice involved weigh in favour of SFK, already seriously affected by the economic crisis. It invokes s. 32 of *Bill C-47*,<sup>[FN2]</sup> assented to in December 2007 but not enacted.

11 It claims, *inter alia*, that the contract for wood chips is to ACI's advantage, and that repudiation constitutes a disguised unilateral amendment.

##### **• ABI Group and ACI**

12 The ABI group is required to compromise its debt and reorganize its operations. ACI, with the Monitor's approval, decided to repudiate the Contracts on the grounds that they were too onerous in several respects and would be harmful to its reorganization.

13 Contrary to what underlies SFK's claims, the ABI group and ACI argue that the prejudice needs to be evaluated on a collective, not an individual, basis.

14 Apart from the Monitor, which supports what they are doing, the ABI group and ACI have received support from their long-term lenders and the holders of secured and unsecured debt, which insist that SFK be treated the same way they are.

#### **PURPOSE OF THE CCAA AND THE JUDGE'S ROLE**

15 The main purpose of the CCAA is to enable an insolvent company to continue in business and return to solvency, to the benefit of all those who are affected and who will be involved in the reorganization.

16 Other Canadian courts designate these parties as the "broader constituency of investors, creditors and employees and reflects diverse societal interests".<sup>[FN3]</sup>

17 For the ABI group and ACI, these are their creditors (secured and unsecured), their investors (the holders of secured and

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unsecured debt), and their shareholders, employees, suppliers, and bridge lenders. For the purposes of this judgment, the Court shall refer to them as stakeholders.

18 Vested with broad judicial discretion, [TRANSLATION] " . . . the role of the judge, assisted by the Monitor, is like that of a captain in the midst of a storm who has to decide whether to throw the problem cargo overboard in order to save the ship. There is no room for prevarication".[FN4]

19 These considerable powers are exercised in a fair and reasonable manner, in light of the facts in the present case, while keeping as a guideline the main purpose of the CCAA: to facilitate the reorganization of a company for the benefit of the company and its stakeholders.[FN5]

20 From the perspective of the CCAA, there are no winners, but a single hope, that the debtor company will emerge successfully from its restructuring, for its benefit and that of the stakeholders.

## ANALYSIS

### *1. The criteria applicable to the termination of a contract under the CCAA*

21 It is not disputed that the CCAA permits the debtor company to terminate its contracts. Furthermore, the Initial Order explicitly provides for this. Where the parties disagree is concerning the standard and its application.

22 First, one comment must be made. SFK claims that the amendments projected by *Bill C-47* must be considered. These amendments are not in force and cannot be taken into consideration to decide the present question.[FN6]

23 This being so, the standard retained by the courts permits the debtor company to terminate a contract insofar as such termination is advantageous and beneficial for its reorganization, although it does not have to establish that it is essential thereto.

24 Since the judgment in *PCI*,[FN7] which endorsed this standard and the decision of the Court of Appeal in *Mine Jeffrey*[FN8] confirming its principles, the state of law has remained the same, subject, however, to the comments below.

25 The power to repudiate contracts derives from the statutory discretion conferred by the CCAA and not the inherent jurisdiction[FN9] to which courts had recourse when called to decide questions whose innovativeness was limited only by the lawyers' imagination.

26 The exercise of this statutory discretion, including the discretion which allowed repudiation of contracts, is subject to an analysis of the criteria of fairness and reasonableness essential to each decision made by a judge pursuant to the CCAA.

27 This analysis is done in a collective manner, by taking all the stakeholders into account, not each one individually. In *Skeena Cellulose Inc.*,[FN10] the British Columbia Court of Appeal wrote the following in this regard:

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[60] The appellants are obviously part of the "broad constituency" served by the CCAA. But the key to the fairness analysis, in my view, lies in the very breadth of that constituency and wide range of interests that may be properly asserted by individuals, corporations, government entities and communities. Here, it seems to me, is where the flaw in the appellants' case lies: essentially, they wish to limit the scope of the inquiry to fairness as between five evergreen contractors or as between themselves and Skeena, whereas the case-law decided under the CCAA, and its general purposes discussed above, require that the views and interests of the "broad constituency" be considered. . . . As the Chief Justice noted, many individuals and corporations, as well as the Province, incurred major losses under the Plan. **Each of them might also ask "Why me?"** However, as he also noted, that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.

27 (Emphasis added.)

28 More recently, the Quebec Court of Appeal considered the standard applicable to the termination of a lease:[FN11]

[TRANSLATION]

[27] . . . But, in any case, does there need to be a peril? Is it enough that termination is essential for a turnaround? Is it enough for it to be expedient or desirable?

29 In response, the Court of Appeal cited the comments of Mtre Sylvain Vauclair,[FN12] which it sets forth as the general rule in this area, namely:[FN13]

[TRANSLATION]

[28] **Concerning the standard that is to guide a judge, the appellant cites Mtre Sylvain Vauclair who, after an overview of the situation in the United States, the common-law provinces of Canada, and Quebec, finds that:**

First, no decision contradicts the proposition that a debtor company may terminate the contracts to which it is a party and which are harmful to its restructuring under the terms of the CCAA.

Second, the courts exercise their inherent jurisdiction with prudence, certainly, but not only in cases necessary to the survival of the debtor company or otherwise of importance.

[29] **In an apt analysis of Dylex, the author writes:**

The owner of certain shopping centres is opposed to the debtor company terminating the leases for these centres on the ground that these terminations "would materially affect each shopping centre".

These terminations are part of a program of 200 store closures.

These three terminations, taken singly, do not seem crucial to the plan or to the survival of the debtor company and the

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judge describes the situation in the following manner at page 109, para. 5:

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

Once again, a court points out:

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

It should be noted that the court specifically rejects the argument to the effect that the desired terminations must be essential to the success of the plan of arrangement.

(Emphasis added.)

30 In short, the CCAA aims to allow the debtor company to overcome its financial difficulties while at the same time limiting the prejudice suffered by those whose interests are affected, taking into consideration the interests of all the stakeholders. That is why the decisions leading to it must be fair and reasonable.[FN14]

31 The law having been stated, it may now be applied. As Farley J. pointed out: "Equitable treatment does not mean equal treatment. Equal treatment may be contrary to equitable treatment." [FN15]

## *2. Does the Court need to intervene and restore the Contracts?*

32 First of all, two matters raised by SFK must be dealt with. SFK is wrong to accuse ACI of bad faith for initiating discussions before sending the Notice. Even if the termination of the Contracts could have the effect of [TRANSLATION] "forcing" negotiations, this in itself is not illegal.

33 The Court also cannot retain SFK's story that ACI is making money with the wood chips or that it is a [TRANSLATION] "good business". This cannot be supported. The wood chips are by-products of the activities of the sawmills operated by the ABI group, the cost of production for which is very high when done outside lumber manufacturing operations.

### **• The forest industry against the backdrop of the world economic crisis**

34 That said, the analysis of this question must take into account the global decline in the forest industry and paper mills.

35 In 2007 and 2008, the unprecedented slump in the U.S. housing market was evidenced by the decline in housing starts (less than 500,000 units under construction), unheard of since World War II. As a result, the profitability of forestry operations and of the paper mills dependent on these operations has been wavering.

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36 Since November 2008, the ABI group's operations have been reduced to 32% of their capacity. All sawmills are running a deficit on an annual basis, and there is no sign that points to a rebound in the lumber industry in the short- or medium term.[FN16]

37 The termination of the Contracts is part of the restructuring of the ABI group's wood products segment, namely logging, transportation of wood to sawmills and manufacture of lumber.

38 In addition, there are by-products from wood processing, including wood chips and bark.

39 SFK, which does not have wood or stumpage rights, needs wood chips to fuel the Mill and bark to meet its energy consumption. During the acquisition of the Mill in 2002, ACI and SFK therefore agreed on Contracts.

40 The wood chip supply contract, with a term of twenty (20) years, guarantees a wood chip supply of 612,000 dry metric tons ("*DMT*") per year; 70% must come from black spruce, and the remainder from gray pine or other softwood.

41 The price per DMT is calculated by correlating the price of NBSK pulp and the market value (the "*market price*") of wood chips. The price per DMT cannot however be \$20 more than or less than the market price of a DMT of wood chips in a given year. SFK assumes freight at a cost of \$16.23 per tonne. At least 70% of the base quantity comes from the ABI group sawmills, which are located less than 100 km from the Mill.

42 As a result of market fluctuations, the price of NBSK pulp plummeted, while for wood chips, it rose to a historic high (\$145 DMT). The price of wood chips is also higher in Quebec than anywhere else in North America.

43 According to the price ratio stipulated in the contract, ACI sells its wood chips to SFK at \$125 DMT. Since 2002, SFK has accordingly benefited from a discount of \$20 per DMT, compared to the market price. ACI established that since 2002, this discount has translated into a cost of \$90 million, or \$12.24 million per year (\$20 multiplied by the number of tonnes sold to SFK).

44 There is, however, more.

45 Economic conditions considerably reduced lumber processing activities, and ACI could no longer produce a sufficient quantity of wood chips to meet the needs for maintaining the paper mills in the ABI group and also to discharge its obligation to deliver 612,000 DMT of wood chips to SFK annually.

46 ACI is therefore required to buy wood chips from third parties and produce a limited quantity of wood chips by processing entire logs. According to the Monitor's report, ACI must add an annual loss of \$1.5 million for the past four years because of this inefficient production.[FN17]

47 In 2007 and 2008, ACI had to buy respectively 1,050,000 DMT and 786,000 DMT of wood chips from third parties at the market price, and in some cases, even at a higher price, given the major repercussions of falling demand for wood products. These losses are in addition to those resulting from the low level of sawmill operations.

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48 The EBITDA[FN18] of the ABI group sawmills, including that of the sawmills located in the Lac Saint-Jean region, is as follows:

	Fiscal 2007	Fiscal 2008	1st Quarter 2009	April 2009
ABI group	-\$91 million	-\$45 million	-\$16 million	-\$4.4 million
Lac-Saint-Jean region	-\$23 million	-\$9 million	-\$5.4 million	-\$2.3 million

49 The ABI group must therefore compromise its debt repayment and reorganize its operations. Under the circumstances, ACI decided to repudiate the Contracts, which were too costly and harmful to its reorganization.[FN19] The resulting savings from the repudiation of the wood chip contract worked out to 25% of the results for April 2009.

• The position of SFK

50 When a major industry player like the ABI group wavers, it will inevitably affect its suppliers, employees and service providers.

51 The position of SFK is not exactly robust, but it is nonetheless stronger than that of ACI. Hard hit by the crisis in the forest industry and the decline in the price of NSBK pulp, SFK had suspended operations in the Mill twice since December 2008, for a total period of 62 days, even before receiving the Notice.

52 While the financial position of the ABI group and ACI has been worsening for a number of years, the financial deterioration of SFK's operations is more recent. The financial statements of SFK and its affiliates have reported a negative EBITDA since the first quarter of 2009. Beforehand, EBITDA was as follows: 1) 2006 = \$39.8 million; 2) 2007 = \$39.2 million; and 2008 = \$39.5 million.

53 SFK's consolidated forecasts for fiscal 2009 show a negative EBITDA of \$17.5 million if it pays for wood chips at the market price, *i.e.*, \$1 million more a month.

54 SFK argues that its survival is at stake because with the higher costs of chips at market price, it will be unable to respect the solvency ratios under its financial covenants,[FN20] which makes it vulnerable vis-à-vis its lenders.

55 This is likely. However, according to its consolidated financial statements, the assets of the holders of partnership shares are quite significant: \$522 million in 2008, \$509 million in 2009, and \$449 million according to forecasts for fiscal 2009.

56 SFK will need to discuss with its lenders and ACI, which offers to continue to supply it, but to a lesser degree (500,000 DMT) and at market price.

57 In passing, the Court points out that the restructuring concerned is not that of SFK, but rather of the ABI group and ACI.



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58 Furthermore, SFK has not shown that without the wood chip contract, it could not have obtained supplies elsewhere.

59 SFK currently has approximately 56,000 DMT of wood chips and is already obtaining supplies from a third party. In March 2009, it entered into a supply contract with Chantiers Chibougamau for the delivery of 100,000 DMT at a price of \$138, excluding freight. It obtained supplies there in March instead of from ACI, invoking the CFI standard.

60 During this time, ACI, bound by the wood chip contract, was unable to sell wood chips in addition to being unable to sell them to third parties at market price. Lastly, wood chip inventories will become available for SFK because ACI will no longer need to get supplies from third parties, which will free a corresponding number of tonnes of wood chips.

61 One cannot quite simply consider, as SFK proposes, that the \$12 million profitability gap is "a drop in the bucket" for ACI.

62 The ABI group sawmills are running at a monthly deficit of \$4.4 million, with those at Lac-Saint-Jean at \$2.3 million. The wood chip contract contributes up to 25%, which is not insignificant over a seven-year period, as it amounts to \$90 million.

63 Short-term lenders, of which ACI is in dire need, will only materialize if ACI has a chance of honouring its obligations.

64 In reality, SFK's position is tantamount to requesting to balance the inconvenience resulting from the termination of the Contracts in light of the criteria for obtaining a protection order under the *Code of Civil Procedure*. The criteria guiding the judge under the CCAA are different.[FN21]

65 It bears repeating that what is at stake here is not limited to SFK, the ABI group, and ACI, but extends to the stakeholders dependent on its survival, including 10,000 employees in Canada, 1,700 forestry workers, 2,300 self-employed workers, 950 local and regional suppliers, 500 forestry operations specialists, and the list goes on.[FN22]

66 According to ACI and the Monitor, the repudiation of the contract is advantageous, beneficial and necessary for the reorganization of the company. The evidence supports this observation. In this context, bearing in mind the interests of all the stakeholders, the Court considers that there is no need to become involved.

67 It is small consolation, but SFK can file a proof of claim as an unsecured creditor for the damages suffered as a result of the termination of the Contracts.

68 As case law shows,[FN23] the one whose contract has been repudiated must be treated in the same way as all the other creditors of the debtor:

43 The applicants state that « SCI is a large, multi-million dollar business enterprise. » While that is true, SCI has also been struggling for many years to become profitable. There are many people in addition to the applicants who depend on SCI's viability. While the applicants will no doubt be adversely affected by the terminations, they are in no different position in this regard than many other unsecured creditors of SCI who must prove their claims under the Plan and who

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stand to recoup only a small fraction of their claims. It is to be noted that while the sale price of SCI was \$8 million, the applicants have filed proofs of claim in excess of \$5 million.

44 It is the unfortunate and generally unavoidable result of an insolvency restructuring that some individuals or entities will suffer hardship. In this case as part of its restructuring, SCI had to terminate numerous employees. They no doubt suffered hardship.

[Emphasis added.]

69 Although the challenge facing ABI and its stakeholders is enormous, it dates back to April 17, 2009. ACI has established that the wood chip contract is a drag on the restructuring of its operations and that it is bad for the reorganization of ABI group as a whole. That is enough in the circumstances.

• **Bark contract**

70 Bark is also a by-product of sawmill operations. The bark contract provides for delivery of 102,551 DMT of fresh bark to SFK every year at market price. Since 2007, ACI has not complied with the tonnages that should be delivered, for the same reasons as those stated previously regarding the production of wood chips.

	2007	2008
Fresh bark	83,000 DMT	57,000 DMT
On-site bark	16,000 DMT	21,000 DMT
Total	99,000 DMT	78,000 DMT

71 Even though SFK did not flag this default, the termination of the contract here is also justified because ACI will not be able to comply with the terms and conditions without slipping into the hole even further.

72 The impact of this termination on SFK is not so prejudicial because it can obtain supplies from the on-site bark, in the Lac-Saint-Jean region, which offers sufficient quantities for the next twenty to thirty years.

73 Although on-site bark costs a bit more than fresh bark, given its humidity level, and even though additional costs must be taken into consideration to access it, the cost will be substantially lower than that of fuel oil.

74 Under the circumstances, there is no question of the Court intervening here.

**THE MONITOR'S RECOMMENDATION**

75 In closing, even if the Monitor gave its approval only after the repudiation of the Contracts, it had been consulted beforehand and had identified the difficulties encountered in maintaining the Contracts. It recommended their termination. The Monitor's fourth report has a complete analysis of the impact of the Contracts and convinced the Court that this recommenda-

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tion should prevail.

**FOR THESE REASONS, THE COURT:**

*DISMISSES the Motion to institute proceedings for provisional, protection, and final orders, declaring the repudiation of certain Contracts null and void;*

***WITH COSTS.***

FN1 R.S.C. 1985 c. C-36.

FN2 *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47 (amended S.C. 2007, c. 36, ss. 61 to 82) (*Bill C-47*).

FN3 *Skeena Cellulose Inc.* (B.C.C.A.) 2003 Carswell BC 1399 at para. 35.

FN4 *9145-7978 Québec inc.* (Arrangement relatif à) 2007 QCCA 768 at para. 11.

FN5 *Supra* note 3 at para. 39.

FN6 *Supra* note 4 at para. 5.

FN7 *PCI Chemicals Canada Inc.* (Re) J.E. 2002-718 (Sup. Ct.), leave to appeal refused, 2002 (J.Q.) No. 9988 (Que. C.A.).

FN8 *Syndicat national de l'amiante Asbestos inc. v. Mine Jeffrey Inc.*, J.E. 2003-346 (C.A.) at para. 32.

FN9 *Supra* note 3, para. 35; *Metcalfe & Mansfield Alternative Investments Corp.* (Re) 2008 ONCA 587 at paras. 50-52.

FN10 *Supra* note 3 at para. 60.

FN11 *Supra* note 4 at para. 27.

FN12 S. Vaclair, S. "Termination of a contract under the terms of an order, pursuant to the CCAA," second advanced lecture on bankruptcy and insolvency, *Derniers développements législatifs et pratiques* (2002).

FN13 *Supra* note 4 at para. 28.

FN14 *9145-7978 Québec inc.* (Arrangement relatif à), 2007 QCCA 618 (Gendreau J.A.) judgment granting leave to appeal at para. 17.

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FN15 *Samni Atlas Inc., Re*, 1998 3 C.B.R. (4th) 171 at para. 4.

FN16 Testimony of ABI's Yves Laflamme, Senior Vice President, Wood Products, whom the Court qualifies as being very credible.

FN17 Monitor's fourth report, para. 30.

FN18 Earnings before interest, income taxes, depreciation and amortization.

FN19 Supra note 3, para. 57: ". . . In the terminology used by Mr. Forstrom, there was a « causal link » between the terminations and the chances of success of the Reorganization Plan. For this reason, I do not agree with his submission that Dylex is different in principle from the case at bar: the appellant's contracts in particular were said to be too costly for Skeena to continue operating under them, in the same way the terminated leases were said to be too costly for Dylex to continue leasing under them. And, weighing Dylex's precarious financial position against that of the landlord (which was described as « less than robust »), the Court 'gave the nod' to the insolvent corporation, rejecting the proposition that Dylex should have to prove that without the three proposed closures (of leases), its proposal would not be viable. . . . (Emphasis added)

FN20 (R-9) Credit agreement dated October 30, 2006.

FN21 It is appropriate to distinguish *Doman*, on which SFK relies, where the debtor wanted to take advantage of the repudiation of a contract without having established that it benefited therefrom for its reorganization: *Doman Industries Ltd., Re*, 2004 BCCA 382.

FN22 See para. 318 of the *Application for the issue of an initial order* that was made in this record.

FN23 *Skeena Cellulose Inc. (Re)*, 2002 Carswell BC 2032 at paras. 43-44, *per* Brenner J. (B.C. Sup. Ct.).

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