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

FACTUM OF THE ROYAL BANK OF CANADA

August 11, 2015

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PART I - NATURE OF THE MOTIONS

1. Nelson Education Ltd. ("**Nelson Education**" or the "**Company**") and Nelson Education Holdings Ltd ("**Holdings**" and collectively with Nelson Education, the "**Applicants**") commenced these proceedings (the "**CCAA Proceedings**") under the *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36 (the "**CCAA**") on May 12, 2015 (the "**Filing Date**") for the sole purpose of establishing a mechanism by which to effect a credit bid by the First Lien Lenders (as defined herein) for the Applicants' entire business (the "**Credit Bid Transaction**").

2. Royal Bank of Canada's ("**RBC**") motion ("**RBC's Motion**") seeks an Order:

   (a) Directing Nelson Education to pay to RBC, in its capacity as Administrative Agent and Collateral Agent (the "**Second Lien Agent**") pursuant to the Second Lien Credit Agreement dated as of July 5, 2007 (the "**Second Lien Credit Agreement**"),

(i) the costs, expenses and professional fees incurred by the Second Lien Agent prior to the Filing Date in the amount of CDN$1,316,181.73 (the "**Second Lien Fees**"); and

(ii) the accrued and unpaid interest under the Second Lien Credit Agreement outstanding as at the Filing Date in the amount of US$15,365,998.83 (the "**Second Lien Interest**");

(b) Declaring that RBC, in its capacity as a lender under the First Lien Credit Agreement (a "**First Lien Lender**") dated as of July 5, 2007 (the "**First Lien Credit Agreement**"), is entitled to its proportionate share of the Initial First Lien Early Consent Fee and the Additional First Lien Early Consent Fee (each as defined in the Support Agreement dated as of September 10, 2014 (the "**Support Agreement**") among Nelson Education, Nelson Education Holding Ltd. ("**Holdings**"), Wilmington Trust, National Association, as Administrative Agent and Collateral Agent (the "**First Lien Agent**") and certain lenders under the First Lien Credit Agreement (together with the Joining Consenting First Lien Lenders, collectively the "**Consenting First Lien Lenders**")) paid to the Consenting First Lien Lenders, being all First Lien Lenders except RBC, (collectively, the "**Consent Fee**") and directing Nelson Education and/or the Consenting First Lien Lenders to pay RBC its proportionate share of the Consent Fee in the amount of US$1,559,492 (the "**RBC Consent Fee**"); and

(c) Declaring that the Second Lien Fees, the Second Lien Interest and the RBC Consent Fee shall be paid to RBC forthwith from cash on hand, and in any event prior to the conclusion of the Credit Bid Transaction, if approved by the Court.

3. The Applicants' motion (the "**Sale Approval Motion**") seeks, among other relief, the approval of the Credit Bid Transaction. In addition, the Applicants seek non-customary relief as part of the Sale Approval Motion which includes a Court ordered release and an order binding all First Lien Lenders, including RBC, to a Stockholders and Registration Rights Agreement in respect of 682533 N.B. Inc. ("**Parent Holdco**"), the parent company of 682534 N.B. Inc. (the "**Purchaser**") as part of the Approval and Vesting Order being sought to effect the Credit Bid Transaction (the "**Non-Customary Relief**").

PART II - OVERVIEW

(a) Sale Approval Motion

4. RBC takes no position on the Sale Approval Motion sought by the Applicants and the First Lien Lenders other than as it relates to the Non-Customary Relief. RBC has the right, contractually and otherwise, to bring all matters in these motions before the Court.

5. RBC has raised concerns with respect to a process that was undertaken outside of a Court proceeding, the lack of transparency prior to the commencement of the CCAA Proceedings and the means by which the Consenting First Lien Lenders and the Company orchestrated a targeted and specific harm to the Second Lien Lenders, including through the execution and implementation of the Support Agreement.

6. The facts and circumstances in this case are highly unusual and the legal issues before the Court are important. The relief sought by the Applicants and Consenting First Lien Lenders stretches the bounds of relief sought in a Canadian insolvency proceeding. A

credit bid transaction has been brought before the Court, the sole result of which will be an extinguishment of $153 million of secured debt owed to one party (the Second Lien Lenders), in the absence of: (i) consent; (ii) a Plan of Arrangement; or (iii) a court-supervised process.

7. In circumstances where the CCAA does not contain provisions addressing credit bidding procedures and protections, such as those contained in Section 363 of the U.S. Bankruptcy Code, careful consideration of all relevant factors by the Court is even more important.

(b) RBC's Motion

8. Through a series of steps beginning in March 2014 and culminating in the execution and implementation of the Support Agreement, the Consenting First Lien Lenders have directly and in conjunction with, as a result of the First Lien Lenders' economic control over the Applicants, inflicted a targeted harm against RBC in its various capacities, and against the other Second Lien Lenders. This targeted harm goes far beyond merely protecting the First Lien Lenders' lien position on the Collateral (as defined in the Intercreditor Agreement), and represents an intentional interference with the contractual rights of RBC and the Second Lien Lenders.

9. The Consenting First Lien Lenders also have breached their contractual obligations and the duty of good faith pursuant to the Intercreditor Agreement, in entering into and implementing the Support Agreement.

10. In its various capacities, including as cash management provider to the Applicants, RBC has continued to comply with all contractual obligations and act in good faith in its dealings with the First Lien Lenders and the Applicants. It respects the First Lien Lenders' right to enforce rights and remedies over the Collateral, including by way of the Credit Bid Transaction, and has respected all directions received by the Company with respect to the non-payment of interest from bank accounts maintained at RBC.

11. RBC has done so, despite the actions of the Consenting First Lien Lenders which appeared to dare it to do otherwise.

12. The value of the assets or business of the Applicants at this time, or any shortfall that the First Lien Lenders may suffer upon completion of the Credit Bid Transaction, is irrelevant to the relief sought by RBC. RBC's Motion is to enforce contractual terms that the First Lien Lenders long ago agreed would apply in these circumstances and these terms are not limited in any way by the value of the Collateral as may now be determined by the Court on the Sale Approval Motion.

13. The rights of the Second Lien Lenders and the obligations of the First Lien Lenders as they relates to the relief sought by RBC in this Insolvency or Liquidation Proceeding are specifically preserved by section 7.4(d) of the Intercreditor Agreement.

14. RBC has continuously reserved its rights in respect of the various contractual breaches by the Applicants and the Consenting First Lien Lenders. There are no jurisdictional issues

in respect of any aspect of the Sale Approval Motion or the relief sought on the RBC Motion.

15. If the RBC Motion is not granted, the First Lien Lenders and the Applicants will be rewarded for their actions and RBC and the Second Lien Lenders will be deprived of any remedy.

16. Just as the value of the Collateral is irrelevant to the enforcement of contractual rights and the relief sought on the RBC Motion, so too is the manner in which RBC internally reported or recorded its positions as a First Lien Lender or Second Lien Lender for regulatory or accounting purposes.

17. RBC is the only Canadian financial institution within the First Lien Lenders and the Second Lien Lenders. It is subject to a highly regulated environment for accounting and compliance purposes that is entirely unrelated to, and has no bearing on, its ability to enforce contractual obligations in agreements to which it is a party. Any attempt by the First Lien Lenders to rely on internal provisioning or reporting within RBC is an attempt to distract from the matters in issue. Doing so also ignores the fact that RBC acts as Agent for Second Lien Lenders who are not affected by (and would have no knowledge of) any internal provisioning or reporting that RBC may undertake with respect to its own loan position.

PART III - THE FACTS

18. The Applicants are indebted to the First Lien Lenders pursuant to a First Lien Credit Agreement dated July 5, 2007 in the amount of approximately US$268.7 million. The Applicants are indebted to the Second Lien Lenders pursuant to a Second Lien Credit Agreement dated July 5, 2007 in the amount of approximately US$153.2 million plus accrued and unpaid interest and fees. [1]

19. The Applicants, the First Lien Lenders, the Second Lien Lenders (and the Agents for the lenders) are parties to an Intercreditor Agreement dated July 5, 2007 (the "**Intercreditor Agreement**"). All capitalized terms used herein and not otherwise defined are as defined in the Intercreditor Agreement.

20. Section 8.1 of the Intercreditor Agreement provides that in the event of any conflict between the provisions of the First Lien Credit Agreement or the Second Lien Credit Agreement and the provisions of the Intercreditor Agreement, the Intercreditor Agreement shall govern and control.[2]

21. Section 8.2 of the Intercreditor Agreement provides that it is a continuing agreement of "lien subordination".[3]

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[1] Affidavit of Greg Nordal sworn on May 11, 2015 (the "**First Nordal Affidavit**") at paras. 18, 59 and 63, Applicants' Application Record at Tab 2. All amounts in this paragraph are as at the Filing Date.
[2] Section 8.1 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[3] Section 8.2 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1. See paragraphs 76 to 86 of this Factum.

22. Section 7.4(d) of the Intercreditor Agreement provides that the rights and obligations of the First Lien Lenders and the Second Lien Lenders, respectively, remain in full force and effect irrespective of the commencement of any Insolvency or Liquidation Proceeding in respect of the Company.[4]

23. The First Lien Credit Agreement matured on July 3, 2014. Prior to the issuance of a Direction to Credit Bid on May 6, 2015, the First Lien Lenders have taken no steps to enforce their rights over any Collateral.[5]

24. The Second Lien Credit Agreement matured on July 3, 2015. The Second Lien Lenders have taken no steps to enforce their rights over any Collateral. The Second Lien Lenders have issued numerous letters reserving their rights.[6]

25. In March, 2014 the Company advised RBC, in its capacity as Second Lien Agent, that it intended to not make its regularly scheduled quarterly interest payment in the amount of approximately US$2.5 million that was due on March 31, 2014. This was stated to be for the purpose of "*maintain[ing] Nelson's flexibility regarding the Second Lien interest payment and the Company's request for an extension of the cure period under the Second Lien Credit Agreement*".[7]

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[4] Section 7.4(d) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[5] First Nordal Affidavit at para. 59; Nordal Trans., p. 12 at questions 40-41; Affidavit of Annie Kwok sworn on July 21, 2015 (the "**Kwok Affidavit**") at para. 2 and Exhibit "A", Responding Motion Record of First Lien Agent et al at Tab 5 and 6.
[6] Affidavit of Les Vowell sworn on July 21, 2015 ("**Second Vowell Affidavit**") at Exhibit "I", RBC Responding Motion Record at Tab I; Transcript of Greg Nordal Examination on August 4, 2015 (the "**Nordal Trans.**") at Exhibit 4 to 8.
[7] Transcript of Les Vowell Examination on August 5, 2015 (the "**Vowell Trans.**") at Exhibit 7.

26. At that time, the Company had approximately $33 million of cash on hand. This represented the mid-point of the Company's usual liquidity cycle, which fluctuated from a low of $15 million in July, to a high of $45 million at the end of each year.[8]

27. Since March 2014, all unsecured creditors of the Company have continued to be paid in the ordinary course. At any given point in time, there is approximately $18.2 million owing to trade creditors.[9]

28. The Company's financial advisor, Dean Mullett of Alvarez & Marsal ("**A&M**"), advised Les Vowell of RBC that the First Lien Lenders were putting "extreme pressure" on the Company to not make the March quarterly interest payment to the Second Lien Lenders.[10]

29. The Company did not make the interest payment due under the Second Lien Credit Agreement in the amount of approximately $2.5 million on March 31, 2014.[11]

30. On April 9, 2015, the Applicants, the Second Lien Agent and the Second Lien Lenders entered into a Grace Period Extension Agreement pursuant to which, among other things, Nelson Education made a partial interest payment to the Second Lien Lenders in the

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[8] Nordal Trans., pp. 9-10 at questions 23-31.
[9] Nordal Trans., pp. 23-24 at questions 79-84.
[10] Vowell Trans., pp. 141-142 at questions 495-497.
[11] Nordal Trans., pp. 7-8 at questions 16-17.

amount of US$350,000. Since that date, no further interest payments have been made to the Second Lien Lenders.[12]

31. A Second Grace Period Extension Agreement was entered into by the Applicants, the Second Lien Agent and the Second Lien Lenders on April 30, 2014 pursuant to which the cure period for the March interest payment was extended to the earlier of May 30, 2014 or a termination event (defined in the letter). The cure period was not extended by the Second Lien Lenders beyond May 30, 2014 and the March, 2014 quarterly interest payment was not made.[13]

32. Interest owing and unpaid to the Second Lien Lenders under the Second Lien Credit Agreement as at the Filing Date is US$15,365,998.83.[14]

33. RBC anticipated that the maturity of the First Lien Credit Agreement on July 5, 2014 would trigger a CCAA filing if a consensual resolution had not been reached among the Company, the First Lien Lenders and the Second Lien Lenders.[15] It advised internally, as part of its credit reporting, that upon that occurring, there would be no expectation of further interest payments being received by the Second Lien Lenders.[16]

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[12] Responses to Written Questions of Greg Nordal dated May 25, 2015 ("**Nordal Responses**") at para. 16 and Schedule "A"; Affidavit of Les Vowell sworn on July 13, 2015 (the "**First Vowell Affidavit**") at Exhibit "F", RBC Motion Record at Tab F.
[13] Nordal Responses at paras. 17-18.
[14] First Vowell Affidavit at para. 12 and Exhibit "F".
[15] Vowell Trans., pp. 133 and 170 at questions 455-458 and 597.
[16] Vowell Trans., p. 131-133, questions 453-458 and Exhibit 1 in the Credit Reports at Tabs B, C, D, E and F under heading *TVM Rationale for TVM Assumption* "1st lien will not be repaid at maturity and will be extended as part of a longer term restructuring." See Section 6.7(b) of the Intercreditor Agreement as it relates to post-filing interest.

34. Contrary to RBC's assumption that a CCAA filing would occur upon the maturity of the First Lien Credit Agreement if a consensual resolution had not been reached, that did not occur. As no Insolvency or Liquidation Proceeding was commenced and no consensual resolution had been reached, RBC's expectation was that the Second Lien Lenders would continue to receive payment of interest and fees, in accordance with the terms of the Intercreditor Agreement.[17]

35. The Company engaged in negotiations with its First Lien Lenders in an effort to "amend and extend" the First Lien Obligations beyond their Maturity Date of July 3, 2014.[18] The extension sought by the Company was for a three year period.[19]

36. In July, 2014 RBC executed a Consent and Support Agreement with the Company which contemplated an extension of the maturity date of the First Lien Credit Agreement by three years, to 2017 (the "**July Extension Agreement**").[20]

37. As the July Extension Agreement contemplated an extension of the Maturity Date of the First Lien Obligations, it required 100% support of the First Lien Lenders.[21] Pursuant to the Intercreditor Agreement, any extension of the Maturity Date of the First Lien

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[17] Vowell Trans., pp. 132-133 at questions 453-458.
[18] First Nordal Affidavit at para. 89; Nordal Trans. pp. 31-32 at question 104.
[19] Nordal Responses at Schedule "C".
[20] Nordal Responses at Schedule "C".
[21] Section 10.01(b) of the First Lien Credit Agreement states that each directly affected Lender must consent to any amendment to postpone any date scheduled for payment of principal or interest under Section 2.08 or 2.09. Section 2.08(a)(ii) requires the aggregate principal amount outstanding to be repaid on the Maturity Date. RBC Compendium of Agreements at Tab 2.

Obligations that was beyond the maturity date of the Second Lien Obligations (July 5, 2015) also required the consent of the Second Lien Agent.[22]

38. RBC's evidence is that the July Extension Agreement would have required either: (i) a consensual restructuring; (ii) a CBCA filing; or (iii) a CCAA filing. A consensual restructuring would require 100% consent.[23]

39. The July Extension Agreement did not provide for an extinguishment of the secured obligations owing under the Second Lien Credit Agreement. Rather, the July Extension Agreement provided for negotiations with the Second Lien Lenders with a view to reaching a consensual resolution of the Second Lien Obligations. The discussions at the time were that 100% of the Second Lien Obligations would remain in place, the term would be extended by three years and the interest thereunder would be paid via payments in kind (PIK). The July Extension Agreement did not receive the necessary support of the other First Lien Lenders and accordingly never became operative. [24]

40. During the July solicitation process and until execution of the Support Agreement in September 2014, the framework to address the Company's levered capital structure had included value being available to the Second Lien Lenders.[25] It had also included

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[22] Section 5.3(2) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[23] Vowell Trans., pp. 37-38 at questions 121-125 and pp.48-49 at questions 163-168.
[24] Second Vowell Affidavit at para. 4; Nordal Responses at Schedule "C"; Nordal Trans., p. 27 at question 93 and p. 29 at questions 96-98. First Nordal Affidavit at para. 89; Vowell Trans., p. 38 at question 124-125 and pp. 46-47 at questions 159-160.
[25] Second Vowell Affidavit at para. 5.

potential value for the existing equity holders of the Company, who were subordinate to the Second Lien Lenders.[26]

41. RBC's strategy, as outlined in its internal credit reporting, was to engage in discussions with a view to the parties reaching a negotiated resolution. Two options were outlined in its August 20, 2014 internal reporting:

> The 1st lien stated objective is no recovery to the 2nd lien. They further said they would rather pay $10-$15 MM to their advisors than have the 2nd lien have any recovery after the 1st lien is repaid.
>
> 1. Do not defend our position – Not recommended as 2nd lien agent and largest lender, there is significant upside to protect.
>
> 2. Vigorously defend to hopefully be in a position to encourage consensual agreement that would see some recovery to the 2nd lien after the 1st lien has a full recovery.
>
> We recommend.[27]

42. On September 10, 2014 the Company executed a Support Agreement (the "**Support Agreement**") with certain of the First Lien Lenders (the "**Consenting First Lien Lenders**") which RBC did not execute. RBC's decision to not execute the Support Agreement included the fact that it "violated every concept of the Intercreditor Agreement as well as the first and second lien agreement."[28]

43. Nelson Education stopped paying the Second Lien Agent Fees in or around the time it entered into the Support Agreement. The Second Lien Agent's legal fees that have not

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[26] Vowel Trans., Exhibit 1 in the Credit Reports at Tabs E and F.
[27] Vowell Trans., Exhibit 1 in the Credit Reports at Tab H at p.2.
[28] Vowell Trans., p. 90 at questions 300-301. The basis for his views are set out in this Factum.

been paid by Nelson Education are CDN$376,601.68 and the financial advisor fees are CDN$939,580.05 for a total of CDN$1,316,181.73.[29]

44. As Mr. Nordal stated in his Affidavit:

> Under the First Lien Support Agreement, the consenting First Lien Lenders **required** the company to agree to continue its non-payment of interest or other amounts coming due under the Second Lien Credit Agreement, which at that point had not reached its maturity and had not yet been declared by the Second Lien Lenders to be in default.[30] [emphasis added]

and again on his cross-examination in response to a question regarding the term of the Support Agreement requiring non-payment to the Second Lien Lenders:

> I knew we had to have that provision or the First Lien Lenders would take other remedies to resolve the indebtedness.[31]

45. In particular, pursuant to Section 5 of the Support Agreement, the Applicants agreed with the First Lien Agent and the Consenting First Lien Lenders to the following:

> (o) The Companies shall comply with all terms and provisions of the First Lien Credit Agreement, other than (i) the requirement to repay all principal amounts upon maturity; (ii) the requirements under section 7.10 the First Lien Credit Agreement; and (iii) **any requirements to comply with the Second Lien Credit Agreement**;
> ...
> (q) Neither of the Companies shall, directly or indirectly, do any of the following, other than as consented to by the Majority Initial Consenting First Lien Lenders:
> ...
>> (viii) **make any payment in connection with the Second Lien Credit Agreement**, including (x) any

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[29] Nordal Responses at para. 26; First Vowell Affidavit at paras. 4, 5 and 9 and Exhibit "A".
[30] Affidavit of Greg Nordal sworn on July 22, 2015 at para. 16 (the "**Second Nordal Affidavit**"); Nordal Trans., pp. 36-37 at questions 121-122.
[31] Nordal Trans., pp. 37-38 at questions 118-127.

> interest or other payment that is due or that may become due pursuant to the Second Lien Credit Agreement, and (y) any payment for fees, costs or expenses to any legal, financial or other advisor to the Second Lien Agent.[32]

46. Prior to September, 2014, certain of the First Lien Lenders had wanted a Chief Restructuring Officer appointed over the Company Upon execution of the Support Agreement, this requirement was dropped.[33]

47. On September 10, 2014, the Company's CEO Greg Nordal participated in a Lender call to announce the execution of the Support Agreement. A published market report on the call indicated that the Support Agreement "[laid] out the terms by which the lenders would take control of the Company, subject to a parallel sale process."[34]

48. Prior to this Court Ordering, on May 29, 2015, that the First Lien Lenders were not entitled to receive payment of any further interest or fees unless the Second Lien Lenders also were paid such amounts,[35] the Company had paid the Consenting First Lien Lenders US$12.639 million in Consent Fees.[36] If this Court determines that pursuant to the First Lien Credit Agreement, RBC as a First Lien Lender is entitled to its proportionate share of the Consent Fees the amount it would be entitled to is US$1,559,492.[37]

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[32] Section 5(i)(o) and (q)(viii) of the Support Agreement, RBC Compendium of Agreements at Tab 4.
[33] Nordal Trans., pp. 30-31, questions 100-103.
[34] Nordal Trans., Exhibit 2; Mr. Nordal was asked on his cross-examination to advise of any inaccuracies in this published report on the call, and made no reference to this statement. Nordal Trans., pp. 41-42, questions 141-144. In providing "Supplement Answers following Mr. Nordal's cross examination, the Applicants' counsel corrected certain facts stated by Mr. Nordal, but made no reference to this statement.
[35] *Nelson Education Ltd. (Re)*, 2015 ONSC 3580 at para. 47 ["***Nelson Education***"], RBC Book of Authorities at Tab 1.
[36] Comprised of an Initial First Lien Early Consent Fee in the amount of US$7,504,862.00 and Additional First Lien Early Consent Fees in the amount of US$5,134,138. First Vowell Affidavit at para. 13 and Exhibit "G"; Nordal Trans., pp. 14-15 at questions 50-53.
[37] First Vowell Affidavit at para. 13 Exhibit "G"; Nordal Trans., p. 15 at questions 54-55.

49. The First Lien Lenders have never issued a demand for payment or a Notice of Intention to Enforce Security pursuant to section 244 of the *Bankruptcy and Insolvency Act* ("*BIA*").[38]

50. During the period from July 2014 (maturity of the First Lien Credit Agreement) to July 2015, the First Lien Lenders have received payment of the following amounts from the Company:

(a) US$13.6 million on account of interest under the First Lien Credit Agreement;

(b) US$12.639 million in Consent Fees under the Support Agreement; and

(c) CDN$5 million for professional fees.[39]

51. The Consenting First Lien Lenders issued a Direction to Credit Bid dated May 6, 2015 (the "**Credit Bid Direction**"), which directs the First Lien Agent and Cortland Capital Market Services LLC (the "**Supplemental First Lien Agent**") and which states:

> Multiple Events of Default have occurred and are continuing under the [First Lien] Credit Agreement. Accordingly, the Required Lenders **have determined to exercise their rights and remedies under the Loan Documents** by making a credit bid with the Indebtedness outstanding under the [First Lien] Credit Agreement for certain assets and certain liabilities of the Borrower.
> ...
> The Directing Lenders hereby authorize, expressly consent and direct (the "Direction") the [First Lien] Agent and the Supplemental [First Lien] Agent, on behalf of the Agent... to take the following actions on behalf of the [First Lien] Lenders as set forth in this letter:
> 1. To have the Supplemental [First Lien] Agent credit bid any and all of the outstanding and unpaid principal and interest of all Loans under the [First Lien] Credit Agreement for substantially all of the assets and certain liabilities of the Borrower (collectively, the "Credit Bid Assets") in

[38] Nordal Trans., p. 12 at questions 40-41.
[39] Nordal Transcript, pp. 12-15 at questions 42-53.

> accordance with the provisions of the Asset Purchase Agreement substantially in the form attached hereto as Exhibit A...[40]

52. Discussions with Heritage Canada following execution of the Support Agreement have been undertaken by the Consenting First Lien Lenders. Mr. Nordal testified that the basis upon which Heritage Canada approval was not required is the First Lien Lenders' view that the Credit Bid Transaction contemplated by the Support Agreement was a "realization of a security, secured loan".[41]

53. On May 12, 2015, the Applicants commenced these CCAA Proceedings and obtained an Order granting certain relief including the appointment of A&M as Monitor.

54. At the Comeback Motion on May 29, 2015, an Amended and Restated Initial Order was granted (the "**Amended & Restated Initial Order**"). Among other things, the Amended & Restated Initial Order replaced A&M with FTI Consulting Inc. as Monitor of the Applicants (the "**Monitor**").

55. Both prior to and following the commencement of the CCAA Proceedings, RBC was of the view that there was value for the Second Lien Lenders in a reorganization or restructuring of the Applicants.[42] At the request of the Monitor following its appointment

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[40] Kwok Affidavit at paras. 2-3 and Exhibit "A".
[41] Nordal Transcript, pp. 44-61 at questions 148-164. *Investment Canada Act*, R.S.C., 1985, c. 28 (1st Supp.), s. 10(1.1).
[42] Vowell Trans. p. 39 at question 131, pp. 46-47 at questions 158-159, p. 71 at questions 239-240, p. 75 at questions 253 and pp. 128-129 at questions 435-438 and Exhibit 1 in the Credit Reports at Tabs at H at p.2, I at p. 2, J at p. 2 and K at p. 3.

on May 29, 2015, RBC and its counsel provided the Monitor with certain documents outlining the basis for its view that there was value for the Second Lien Lenders.[43]

56. In compliance with its regulatory and other requirements, RBC provided regular internal reporting on various matters including provisioning of the loans for accounting and audit purposes. It was entirely within RBC's discretion (*vis-à-vis* the parties to this proceeding), had it chosen to do so, to have written off the entire principal amount of its own loan position under the First and Second Lien Obligation the day after they were incurred. Any such decision would have had no impact on the enforcement of its contractual rights pursuant to the relevant loan documents or the Intercreditor Agreement.

57. To meet regulatory requirements and satisfy external auditors, all provisions taken on RBC's position on its loans were to be as conservative as possible. Internal valuing exercises were not an attempt to estimate the economic value of the Company going forward. In addition, any valuation work done by external financial advisors was "wholly irrelevant to the provisioning exercise". It is also wholly irrelevant to the relief sought in RBC's Motion.[44]

58. On June 29, 2015 Justice Newbould scheduled the sale approval motion and the motion to be brought by RBC to be heard on August 13, 2015. On July 8, 2015 the Monitor issued its Second Report to the Court (the "**Monitor's Report**"). The Monitor's Report

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[43] Second Vowell Affidavit at paras. 5, 14-16 and Exhibits "E", "F" and "G".
[44] Vowell Trans, pp. 78-80, questions 260-266; pp.65-66, question 222; and pp.75-77, question 253-254.

is limited to the Applicants' Sale Approval Motion, other than the Non-Customary Relief, and does not address the relief sought by RBC in its motion.[45]

59. Upon RBC receiving and considering the Monitor's Report, its counsel advised the Applicants, the Monitor and the First Lien Lenders on July 17, 2015 that it would be taking no position on the Sale Approval Motion – neither supporting nor opposing it – but would be addressing the Non-Customary Relief contained in the draft Order.

PART IV - THE ISSUES

60. The Motions before the Court raise the following issues:

(a) Is RBC in its capacity as Second Lien Agent contractually entitled to the Second Lien Interest and Second Lien Fees?

(b) Should the Court order and direct payment of the Second Lien Fees and the Second Lien Interest forthwith, and in any event prior to the conclusion of the Credit Bid Transaction, if approved by the Court?

(c) Should RBC, in its capacity as a First Lien Lender, receive payment of the RBC Consent Fee?

(d) Is RBC entitled to raise the issues it has in this CCAA Proceeding and on these Motions?

(e) How, if at all, does the Gropper Opinion impact the Motions before the Court?

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[45] Monitor's Second Report to the Court dated July 8, 2015.

(f) If the Court approves the Credit Bid Transaction, is it Appropriate for the Court to grant the Non-Customary Relief sought by the Applicants in this Case?

PART V - THE LAW

ISSUE 1: Is RBC in its capacity as Second Lien Agent contractually entitled to the Second Lien Interest and Second Lien Fees?

61. Pursuant to the Second Lien Credit Agreement and the Intercreditor Agreement, RBC as Second Lien Agent is contractually entitled to payment of the Second Lien Interest and the Second Lien Fees.[46]

62. Pursuant to section 2.09 of the Second Lien Credit Agreement, the Second Lien Lenders are entitled to interest as calculated therein. It is uncontroverted that the outstanding interest owing from the date Nelson Education ceased fulfilling its contractual obligations to the Second Lien Lenders is in the amount of US$15,365,998.83.[47]

63. In addition to the payment of interest, pursuant to Section 10.04(b) of the Second Lien Credit Agreement, Nelson Education is required to pay or reimburse the Second Lien Agent and each Second Lien Lender:

> ...for all reasonable and documented out-of-pocket costs and expenses incurred in connection with the enforcement of any rights or remedies under this Agreement or the other Loan Documents (including all such costs and expenses incurred during any legal proceeding, including any proceeding under any Debtor Relief

[46] *Nelson Education, supra* note 35 at para. 44.
[47] Section 2.09 of the Second Lien Credit Agreement, RBC Compendium of Agreements at Tab 3; First Vowell Affidavit at para. 12 and Exhibit "F".

> Law, and including all Attorney Costs of counsel to the Administrative Agent).[48]

64. The Second Lien Fees outstanding as at the Filing Date are CDN$1,316,181.73.[49]

65. The payment of amounts being claimed by the Second Lien Lenders is also specifically permitted under the First Lien Credit Agreement. Article 7 contains customary negative covenants restricting a borrower from making certain payments, including <u>prepaying</u> amounts to the Second Lien Lenders. However, Section 7.09(a) contains a "carve-out" which specifically permits the payment of interest to the Second Lien Lenders. Section 7.09(a) of the First Lien Credit Agreement provides, in relevant part, that so long as any Obligation is outstanding under the First Lien Credit Agreement, the Company shall not:

> (a) Prepay, redeem, purchase or otherwise satisfy prior to the scheduled maturity thereof in any manner (**it being understood that payments of regularly scheduled principal, interest and mandatory prepayments shall be permitted**) the Second Lien Term Loans . . .[50] [emphasis added]

66. The Second Lien Lenders' right to payment of interest and fees is specifically confirmed in the Intercreditor Agreement. Section 3.1(f) of the Intercreditor Agreement provides as follows:

> Except as set forth in Section 3.1(a) and Section 4, to the extent applicable, **nothing in this Agreement shall prohibit the receipt by the Second Lien Collateral Agent or any Second Lien Claimholders of the required payments of interest, principal and other amounts owed in respect of the Second Lien Obligations**[51] **or receipt of payments**

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[48] Section 10.04 of the Second Lien Credit Agreement, RBC Compendium of Agreements at Tab 3.
[49] First Vowell Affidavit at para.2(b) and 4 and Exhibit "A".
[50] Article VII preamble and Section 7.09(a) of the First Lien Credit Agreement, RBC Compendium of Agreements at Tab 2.
[51] See Section 1.1 of the Intercreditor Agreement, The definition of "Second Lien Obligations" includes "all Obligations under the Second Lien Credit Agreement and the other Second Lien Loan Documents." The definition

> **permitted under the First Lien Loan Documents, including without limitation, under Section 7.09(a) of the First Lien Credit Agreement** so long as such receipt is not the indirect result of the exercise by the Second Lien Collateral Agent or any Second Lien Claimholders of rights or remedies as a secured creditor (including set off) or enforcement in contravention of this Agreement"[52] [emphasis added]

67. The only exceptions to Section 3.1(f) of the Intercreditor Agreement are Sections 3.1(a) and Section 4 and neither Section is applicable in this case.

68. Section 3.1(a) prevents RBC from exercising rights or remedies with respect to Collateral during any Standstill Period,[53] contesting certain actions brought by the First Lien Collateral Agent or a First Lien Claimholder[54] and, subject to Section 3.1(a)(1) and 3.1(c), objecting to forbearance or certain foreclosure proceedings.[55] At no point prior to the commencement of these CCAA proceedings, during which time the Company had the obligation to pay interest, fees and expenses, did RBC take any such actions.

69. Section 4 is comprised of Section 4.1 and Section 4.2. Section 4.1 of the Intercreditor Agreement addresses the receipt and application of proceeds of Collateral in connection with the sale or other disposition of Collateral received by the First Lien Collateral Agent and is inapplicable to this case. Section 4.2 of the Intercreditor Agreement is also inapplicable, as it addresses any **Collateral or proceeds thereof** received by the Second

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of "Obligations" broadly includes all amounts owed under the Second Lien Loan Documents, including "interest", "expenses," "fees" and "Attorney Costs" (which would include amounts due under Section 2.09 and 10.04(b) of the Second Lien Credit Agreement), RBC Compendium of Agreements at Tab 1.

[52] Section 3.1(f) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

[53] See Section 3.1(a)(1) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

[54] See Section 3.1(a)(2) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

[55] See Section 3.1(a)(3) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

Lien Agent "in connection with the existence of any right or remedy in contravention of this Agreement."[56]

70. In addition, Section 8.17 of the Intercreditor Agreement provides that:

> ...Nothing in this Agreement is intended to or shall impair the obligations of the Company or any other Grantor, **which are absolute and unconditional**, **to pay** the First Lien Obligations and **the Second Lien Obligations as and when the same shall become due** and payable in accordance with their terms"[57] [emphasis added].

71. Over and above RBC's contractual entitlement to its costs, expenses and professional fees in its capacity as Second Lien Agent and Second Lien Lender, RBC is also contractually entitled to these amounts in its capacity as First Lien Lender and Cash Management Provider. Section 10.04(b) of the First Lien Credit Agreement contains an identical provision to the Section 10.04(b) of the Second Lien Credit Agreement in paragraph 63 above, and relates to "each Lender". As a result, RBC is contractually entitled to receive payment or reimbursement for its fees, costs and expenses as under the First Lien Credit Agreement.[58]

72. In not making the payments referred to herein, the Applicants have breached the Second Lien Credit Agreement and the Intercreditor Agreement to which they are a party.

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[56] Section 4.1 and 4.2 of the Intercreditor Agreement., RBC Compendium of Agreements at Tab 1.
[57] Section 8.17 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1. See also note 51 re: definition of "Second Lien Obligations".
[58] Section 10.04 of the First Lien Credit Agreement, RBC Compendium of Agreements at Tab 2.

ISSUE 2: Should the Court order and direct payment of the Second Lien Fees and the Second Lien Interest forthwith and in any event prior to the conclusion of the Credit Bid Transaction, if approved by the Court?

73. For the reasons set out herein, RBC submits that the Court should direct payment of the Second Lien Fees and the Second Lien Interest forthwith and in any event prior to the conclusion of the Credit Bid Transaction, if approved by the Court.

74. The First Lien Lenders have failed to comply with their contractual obligations to the Second Lien Lenders under the Intercreditor Agreement. The Applicants have failed to comply with their contractual obligations to the Second Lien Lenders under the Second Lien Credit Agreement and the Intercreditor Agreement. These breaches were targeted and directed at the Second Lien Lenders.

75. RBC submits that contracting parties' rights and remedies are defined by and ought to be enforced in accordance with the contracts which they execute. Moreover, the Court should not provide cover to contracting parties that resile from their obligations.

(b) The Support Agreement is an Attempt to Obtain Indirectly What the First Lien Lenders were not Entitled to Directly - Lien Subordination vs. Payment Subordination

76. The Support Agreement is a targeted attempt by the Consenting First Lien Lenders to obtain indirectly, what they were not contractually entitled to directly under the Intercreditor Agreement and were not able to obtain through negotiations with the Second Lien Lenders.

77. As confirmed in the Model Intercreditor Task Force Report ("**Task Force Report**") published by the American Bankruptcy Association[59] as cited in the opinion of Allan L. Gropper ("**Gropper**") dated July 22, 2015 (the "**Gropper Opinion**"),[60] there is a clear distinction between intercreditor agreements that provide for "lien subordination" and those that also provide for "payment subordination".[61]

78. **Lien** subordination is limited to **dealings with the collateral** over which both groups of lenders hold security. It gives the senior lender "a head start" with respect to any enforcement actions in respect of the collateral and ensures a priority "waterfall" from the proceeds of enforcement over collateral. [62] By contrast, **payment** subordination means that subordinate lenders have also subordinated in favour of the senior lender their right to payment and have agreed to turn over all monies received, whether or not derived from the proceeds of the common collateral.[63]

79. The Gropper Opinion confirms that the provisions of the Intercreditor Agreement in this case are similar to those in the Model Intercreditor Agreement that is the subject of the Task Force Report, "and, in any event, do not appear to be unique or unusual".[64]

80. As confirmed in the Task Force Report, "the typical second lien financing intercreditor agreement does not require payment subordination".[65] Rather, it entitles second lien

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[59] 65 A.B.A. Bus Law. 809-883 (May 2010), RBC Book of Authorities at Tab 2. Due to its length, only relevant portions of the Task Force Report are included.
[60] Affidavit of Allan L. Gropper sworn on July 22, 2015 ("**Gropper Affidavit**") at Exhibit "B" at p. 2 (bottom).
[61] Task Force Report, s*upra* note 59 at Section 1.2 and footnote 8.
[62] Task Force Report, *supra* note 59 at footnote 41 at Section 4.1.
[63] Task Force Report, *supra* note 59, footnote 27 at Section 2.1.
[64] *Ibid.*
[65] *Ibid.*

lenders to receive and retain payments of interest, principal and other amounts in respect of a second lien obligation unless the receipt results from an enforcement in respect of the collateral.[66] The Gropper Opinion confirms that the Intercreditor Agreement is a typical second lien financing Intercreditor Agreement.[67]

81. For the avoidance of any doubt, Section 8.2 of the Intercreditor Agreement makes clear that "This is a continuing Agreement of **lien** subordination...."[68]

82. As set out above, in this case, Section 3.1(f) of the Intercreditor Agreement provides as follows:

> Except as set forth is section 3.1(a) and section 4 to the extent applicable, **nothing in this Agreement** shall prohibit the receipt by the Second Lien Collateral Agent or any Second Lien Claimholders of the required payments of interest, principal and other amounts owed in respect of the Second Lien Obligations or receipt of payments permitted under the First Lien Loan Documents, including without limitation, under section 7.09(a) of the First Lien Credit Agreement, **so long as such receipt is not the direct or indirect result of the exercise by the Second Lien Collateral Agent or any Second Lien Claimholders of rights or remedies as a secured creditor (including set off) or enforcement in contravention of this Agreement.** Nothing in this Agreement impairs or otherwise adversely affects any rights or remedies the First Lien Collateral Agent or the First Lien Claim Holders may have with respect to the First Lien Collateral.[69] [emphasis added]

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[66] Task Force Report, *supra* note 59 at Section 2.1.
[67] Gropper Opinion, *supra* note 60 at p.2.
[68] Section 8.2 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[69] The operative language in this section is identical to that contained in section 1.2 of the Model Intercreditor Agreement in the Task Force Report which provides: "*Nothing in this Agreement will affect the entitlement of any Second Lien Claimholder to receive and retain required payments of interest, principal, and other amounts in respect of a Second Lien Obligation unless the receipt is expressly prohibited by, or results from the Second Lien Claimholder's breach of, this Agreement*."

83. There has been no exercise by the Second Lien Collateral Agent or any Second Lien Claimholders of any rights or remedies as a secured creditor (including set off) or enforcement in contravention of this Agreement. Subject only to the two limitations listed in the opening words to the above provision,[70] the right of payment in favour of the Second Lien Lenders is not only absolute, but is also stated to be paramount to any other provision in the Intercreditor Agreement that would have the effect of limiting it.

84. The distinction between lien subordination and payment subordination has been highlighted most recently in a leading U.S. case on intercreditor agreements involving the Chapter 11 proceedings of Momentive Performance Holdings.[71] In *Momentive*, the intercreditor agreement had similar provisions to the Model Intercreditor Agreement that is the subject matter of the Task Force Report, and to the Intercreditor Agreement in this case, each of which involved a lien subordination but not a payment subordination.

85. In *Momentive*, the Bankruptcy Court analyzed the restrictions that the intercreditor agreement imposed on the second lien lenders. Those restrictions required that the second lien holders turn over to senior lenders the proceeds of their contractual liens (and any judicial liens they might obtain). The intercreditor agreement, as is typical, also

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[70] Section 3.1(a) of the Intercreditor Agreement is clear and unambiguous in its application to the exercise of rights and remedies in respect of the Collateral.
Section 4 of the Intercreditor Agreement also applies solely to "Collateral or proceeds thereof" and is further qualified by the fact that the Second Lien Lender's receipt of any Collateral or proceeds be "in contravention of this Agreement". RBC Compendium of Agreements at Tab 1.

[71] *In re MPM Silicones, LLC*, 2014 WL 4436335, at *9 (Bankr. S.D.N.Y. Sept 9, 2014) *aff'd,* 531 B.R. 321 (S.D.N.Y. 2015) *appeal filed,* Docket No: 15-1682 (2d Cir. May 22, 2015), *U.S. Bank N.A. v. Wilmington Savings Fund Society, FSB (In re MPM Silicones, LLC)*, 531 B.R. 321, 331 (S.D.N.Y. 2015) *appeal filed,* Docket No: 15-1682 (2d Cir. May 22, 2015) [collectively, "***Momentive***"], RBC Book of Authorities at Tab 3.

thoroughly addressed the rights of the secured parties to enforce their respective security interests in the collateral. But, as the U.S. Bankruptcy Court noted, these provisions "pertain to lien subordination, governing rights in respect of shared collateral," and are not "debt subordination provisions."[72] The reasoning of the U.S. Bankruptcy Court in *Momentive*, and of the U.S. District Court that affirmed the U.S. Bankruptcy Court's opinion, are that (a) only proceeds that clearly result from the enforcement of rights over common collateral and a "transformation of that collateral" will be treated as proceeds of collateral requiring turnover to the first lien lenders; and (b) restrictions on a subordinate secured lender's rights in an intercreditor agreement will be narrowly construed and do not amount to a waiver of their rights as an unsecured creditor. [73]

86. In the present case, the First Lien Lenders only bargained for and obtained a **lien** subordination from the Second Lien Lenders under the Intercreditor Agreement. However, as a result of actions taken by the Consenting First Lien Lenders through the instrumentality of the Company, the Consenting First Lien Lenders seek to put themselves in the position as if they had contracted for the benefit of **payment** subordination as well. They took steps to contravene the clear terms of the Intercreditor Agreement which entitled the Second Lien Lenders to payment of interest and fees, while at the same time creating, and then paying themselves, a new Consent Fee, which also breached the Intercreditor Agreement.

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[72] *Momentive*, 2014 WL 4436335, at *7 (Bankr. S.D.N.Y. Sept 9, 2014).
[73] See Lawrence Safran et al, "The Weakest Link in Intercreditor Agreements Breaks Again in *Momentive*" (16 October 2014), online: Latham & Watkins <http://www.lw.com> RBC Book of Authorities at Tab 4.
Donald S. Bernstein et al, "*Momentive* Ruling Highlights Risks to Senior Creditors Under Intercreditor Agreements" (7 October 2014), online: Davis Polk <http://www.davispolk.com>, RBC Book of Authorities at Tab 5;
See also *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010), RBC Book of Authorities at Tab 6.

(c) The Actions of the Consenting First Lien Lenders and the Applicants Constitute a Breach of the Duty of Good Faith

87. The actions of the Consenting First Lien Lenders and the Company in executing the Support Agreement result in a breach of the duty of good faith in contract law.

88. The Intercreditor Agreement is a contract entered into among each of the Applicants, the First Lien Agent and the Second Lien Agent and its governing law is the law of the State of New York (subject to specific references to Ontario being the governing law in certain circumstances, which are addressed herein).

89. The Support Agreement is a contract entered into among each of the Applicants, the First Lien Agent and the Consenting First Lien Lenders and its governing law is the law of the Province of Ontario.

90. Under New York law, "Implicit in all contracts is a covenant of good faith and fair dealing in the course of contract performance."[74] Encompassed within the implied obligation of each promisor to exercise good faith are "any promises which a reasonable person in the position of the promisee would be justified in understanding were included." [75]

91. A complete catalogue of types of bad faith under New York law is not possible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain; lack of diligence and slacking off; willful rendering of

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[74] *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 389 (1995), RBC Book of Authorities at Tab 7.
[75] *Ibid.* (internal quotation omitted).

imperfect performance; abuse of a power to specify terms; and interference with or failure to cooperate in the other party's performance.[76] Under New York law, a defendant violates the implied covenant when it purposefully sabotages a plaintiff's ability to benefit under the contract.[77] Breach of the implied duty of good faith constitutes a breach of the contract.[78]

92. The duty of good faith is a recognized organizing principle of contract law in Canada. Parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.[79] When carrying out the performance of a contract, "a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner."[80] While this does not require contracting parties to serve the other party's interests, it "requires that a party not seek to undermine those interests in bad faith."[81]

93. This organizing principle is guided by the existing law on the duty of good faith, but also allows for the future development of manifestations of the duty of good faith in contractual performance.[82]

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[76] Restatement (Second) of Contracts § 205, comment d (1981), RBC Book of Authorities at Tab 8.
[77] *See Kader v. Paper Software, Inc.,* 111 F.3d 337, 341-42 (2d Cir. 1997, RBC Book of Authorities at Tab 9.
[78] *Fasolino Foods Co. v. Banca Nazionale del Lavoro*, 961 F.2d 1052, 1056 (2d Cir. 1992), RBC Book of Authorities at Tab 10. It should be noted that New York law does not recognize a separate cause of action for breach of the implied covenant of good faith and fair dealing when a breach of contract action, based on the same facts, is also pled. *Harris v. Provident Cos., Inc.*, 310 F.3d 73 (2d Cir. 2002), RBC Book of Authorities at Tab 11.
[79] *Bhasin v. Hrynew*, 2014 SCC 71, 2014 CSC 71 at para. 63 ["***Bhasin***"], RBC Book of Authorities at Tab 12.
[80] *Ibid.* at para. 64.
[81] *Ibid* at para. 65.
[82] *Ibid.* at paras. 66 and 69.

94. In this case, the Consenting First Lien Lenders and the Applicants had a complete disregard to the legitimate contractual interests of the Second Lien Lenders under the Intercreditor Agreement. The execution of the Support Agreement directly undermined the interests of the Second Lien Lenders.

(d) Did the conduct of the First Lien Lenders induce the breach of the Second Lien Credit Agreement by Nelson Education

95. RBC submits that the First Lien Lenders induced the Applicants to breach the Second Lien Credit Agreement and this inducement resulted in damages to the Second Lien Agent in the amount of US$15,365,998.83 on account of interest and CDN$1,316,181.73 on account of fees.

96. In order to establish inducing breach of contract, the following elements must be established:

(a) the defendant had knowledge of the contract between the plaintiff and the third party;

(b) the defendant's conduct was intended to cause the third party to breach the contract;[83]

(c) the defendant's conduct caused the third party to breach the contract; and

(d) the plaintiff suffered damage as a result of the breach.[84]

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[83] See *Drouillard v. Cogeco Cable Inc.*, 2007 CarswellOnt 2624 at para. 29 (Ont. C.A.) ["***Drouillard***"], RBC Book of Authorities at Tab 13. To satisfy this element of the tort, the procurement of the breach must be intended and direct. In Professor Lewis N. Klar's text Tort Law (Toronto: Carswell, 2003) at 612, he states:

> In order to succeed, a plaintiff must prove that the defendant intended to procure a breach of contract. In this respect, intention is proven by showing that the defendant acted with the desire to cause a breach of contract, or with the substantial certainty that a breach of contract would result from the defendant's conduct.

97. In this case, the Consenting First Lien Lenders had direct knowledge of the Second Lien Credit Agreement and its terms.

98. In March 2014, the First Lien Lenders put "extreme pressure" on the Applicants not to pay the contractually entitled interest owing to the Second Lien Lenders.[85] The intent of the pressure was to have the Company breach its obligation to pay the Second Lien Lenders their interest payment. At this time Nelson had approximately $33 million in cash on hand - this was not about whether Nelson Education could afford to make the payment.[86]

99. The result of this pressure was that the Company did not pay this interest payment in the amount of approximately $2.5 million when due and only paid $350,000 in respect thereof as part of the Grace Period Extension Agreement executed on April 7, 2014.[87]

100. The Support Agreement executed by the Consenting First Lien Lenders confirms beyond peradventure the intent of the Consenting First Lien Lenders to preclude the Applicants from paying interest and fees to the Second Lien Lenders under the Second Lien Credit Agreement (i.e. thereby breaching the Second Lien Credit Agreement) unless so agreed by the Consenting First Lien Lenders. The Support Agreement states this intent in paragraph (q)(viii) as follows:

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[84] *Correia v. Canac Kitchens*, 2008 ONCA 506 at para. 99, RBC Book of Authorities at Tab 14.
[85] Vowell Trans., pp. 141-142 at questions 495-497.
[86] Nordal Trans., pp. 8-9 at questions 20-22.
[87] Nordal Trans., pp. 7-8, at questions 16-17. 2015; Nordal Responses at para. 16 and Schedule "A"

> (q) Neither of the Companies shall, directly or indirectly, do any of the following, other than as consented to by the Majority Initial Consenting First Lien Lenders:
> ...
> (viii) make any payment in connection with the Second Lien Credit Agreement, including (x) any interest or other payment that is due or that may become due pursuant to the Second Lien Credit Agreement, and (y) any payment for fees, costs or expenses to any legal, financial or other advisor to the Second Lien Agent.[88]

101. In the Support Agreement the Consenting First Lien Lenders unequivocally required the Company to breach Section 8.17 (and other provisions) of the Intercreditor Agreement and prevented payments under the Second Lien Credit Agreement from being made when due.

102. The Support Agreement had the intended result of causing Nelson Education to breach the Second Lien Agreement by not paying the Second Lien Lenders its interest and fees from and after its execution.

103. RBC submits that each time a payment was due under the Second Lien Credit Agreement (example quarterly for interest) and the Consenting First Lien Lenders withheld their consent to make such payment, it constituted a new breach of the Second Loan Lien Agreement induced by the Consenting First Lien Lenders.

104. This Court has previously found that "since the First Lien Support Agreement with the consenting first lien lenders, the decision [to pay interest, costs, expenses and

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[88] Section 5(i),(o) and (q)(viii) of the Support Agreement, RBC Compendium of Agreements at Tab 4.

professional fees] has been taken out of the hands of Nelson and turned over to the consenting first lien lenders."[89]

105. In response to an email from RBC dated November 4, 2014 as to whether Nelson Education would be paying the Second Lien professional fees, Greg Nordal, CEO of Nelson Education, advised:

> The answer to your question is we are restricted on the matter you raise due to the terms of our support agreement with the Lien 1 group. I am not in a position to give you an affirmative response. Our legal counsel will elaborate in their reply to your representatives.[90]

106. The Applicants' counsel subsequently advised as follows regarding the Applicants' breach of the Second Lien Agreement obligations:

> ...pursuant to the Support Agreement dated as of September 10, 2014 among Nelson, Nelson Education Holdings Ltd., the First Lien Agent and the First Lien Lenders party thereto, Nelson is restricted from making any payments in connection with the Second Lien Credit Agreement, including any payment for fees, costs or expenses to any legal, financial or other advisor to the Second Lien Agent without the consent of the Majority Initial Consenting First Lien Lenders. **We have to date not received such consent**. [91]

107. As a result of the breaches of the Second Lien Credit Agreement that were induced by the Consenting First Lien Lenders, the Second Lien Agent is owed US$15,365,998.83 on account of interest and CDN$1,316,181.73 on account of fees.

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[89] *Nelson Education, supra* note 35 at para. 46.
[90] First Vowell Affidavit, at para. 11 and Exhibit "D".
[91] First Vowell Affidavit, at para. 11 and Exhibit "E" at letter from Robert Chadwick dated November 17, 2014.

108. RBC submits that the affirmative defence of justification is not open to the Consenting First Lien Lenders in this case. The Ontario Court of Appeal has stated the following regarding the application of the defence of justification:

> There are certain situations where a defendant can avoid liability by claiming that his actions which induced the breach of a contract were justified. Phillip H. Osborne, *Law of Torts*, 2d ed. (Toronto: Irwin Law, 2003) at 300-302, reviews the defence of justification but asserts there is little useful modern Canadian authority for this principle. Osborne notes, at 300-301, that what authority there is suggests "it has a narrow scope", "that the absence of malice or bad faith is insufficient to establish the defence", and "that a scrupulous consideration must be given to all the surrounding circumstances." Osborne paints with a broad brush certain circumstances — such as protecting the public interest — where inducing a party to breach a contract may be justified and where a defendant may be insulated from attracting liability in tort. See also Lewis N. Klar, *Tort Law*, 3d ed. (Toronto: Carswell, 2003) at 618-20.[92]

109. Any justification by the Consenting First Lien Lenders on the basis that they were protecting their position as Consenting First Lien Lenders must be viewed through the lens of their existing contractual obligations under the Intercreditor Agreement. They had bargained for and obtained lien subordination but not payment subordination.

110. There is an existing agreement that constrains and defines what the Consenting First Lien Lenders are permitted to do and it is within that framework that any defence of justification to inducing breach of contract must be viewed. The First Lien Lenders cannot rely on their **own** breach of contractual obligations, as justification for inducing

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[92] *Drouillard, supra* note 83 at para. 39.

another party to breach its contractual obligations. To permit such a result would be perverse and circular.

(e) As a condition of the Credit Bid Transaction being approved, the Harm directed by the Consenting First Lien Lenders should be Rectified

111. Section 3.1 (b) of the Intercreditor Agreement states that laws of Canada and the rules and decisions of this Court govern the credit bid by the Consenting First Lien Lenders, as all Collateral is located in Canada. Section 3.1(b) of the Intercreditor Agreement provides, in relevant part, as follows:

> Until the Discharge of First Lien Obligations has occurred, whether or not any Insolvency or Liquidation Proceeding has been commenced by or against the Company or any other Grantor, subject to Section 3.1(a)(1), the First Lien Collateral Agent and the First Lien Claimholders shall have the right to enforce rights, exercise remedies **(including set off and the right to credit bid their debt which, to the extent the Collateral is located in Canada, will be subject to applicable law in Canada or any order of a Court that has jurisdiction over such matters in Canada)**... [93] [emphasis added.

112. A Court shall enforce the parties' negotiated choice of law provisions unless fundamental policies would be violated.[94] No fundamental policy is violated when parties agree that

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[93] Section 3.1(b) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

[94] *Woodling v. Garret Corp.*, 813 F.2d 543, 551 (2d Cir. 1986) ("New York law requires the court to honor the parties' choice insofar as matters of substance are concerned, so long as fundamental policies of New York law are not thereby violated."), RBC Book of Authorities at Tab 15.

Vasquez v. Delcan Corp., 1998 CarswellOnt 2784 at para. 31 (Gen. Div.) ("In accordance with Canadian conflict of laws principles, courts respect the parties' express choice of the law to govern their contract, absent vitiating factors. In the leading case, *Vita Food Products Inc. v. Unus Shipping Co.*, [1939] A.C. 277 (Canada P.C.), the Privy Council held that the parties' expressed intention should determine the proper law of a contract, provided that the application of that law is not contrary to public policy, and the choice was *bona fide* and legal."), RBC Book of Authorities at Tab 16.

the law of a jurisdiction in which Collateral is located will govern a credit bid by a secured creditor with respect to such Collateral.

113. It is not disputed that (a) the First Lien Collateral Agent is seeking to credit bid, (b) all of the Collateral subject to the credit bid is located in Canada, and (c) this Court has jurisdiction over matters relating to the credit bid. Accordingly, it is Canadian law and the orders of this Court that govern the Consenting First Lien Lenders' credit bid, and this Court is free to consider any and all issues regarding the Sale Approval Motion, the relief sought by RBC and all other matters related thereto.

114. Unlike in the U.S. where credit bidding is codified in Chapter 11 of the U.S. Bankruptcy Code, credit bidding in Canada is not contained in the CCAA.[95] In the U.S. a secured lender has the right to credit bid "unless the court for cause orders otherwise."[96]

115. Canadian Courts have recognized the right of creditors to credit bid in insolvency proceedings. However, there is relatively little case law in Canada regarding credit bidding[97] and no cases that have addressed whether a party's conduct should be considered by the Court at the time that approval of a Credit Bid Transaction is sought.

116. RBC submits that the Bankruptcy Court is a Court of equity and parties seeking relief from the Court should come to the Court with clean hands. This would include any party seeking the approval of a credit bid transaction from the Court and that, as a result, the

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[95] See 11 U.S.C. § 363(k).
[96] 11 U.S.C. § 363(k).
[97] See Joseph Latham & Brenden O'Neil, "Credit Bidding in Canada Recent Developments" *Lexpert* (July 2011) 71 online: <http://www.lexpert.ca>, RBC Book of Authorities at Tab 17.

Court may consider the conduct of the parties when considering whether to approve such a transaction.

117. In this case, RBC does not oppose the Credit Bid Transaction and respects the contractual right of the First Lien Agent to Credit Bid under the Intercreditor Agreement, notwithstanding that the Consenting First Lien Lenders and the Applicants have not respected the Second Lien Lenders' contractual rights.

118. However, RBC submits that the targeted harm directed against the Second Lien Lenders by the Consenting First Lien Lenders should be considered by the Court in determining what terms, if any, it may impose as a condition to Court approval of the Credit Bid Transaction.

119. This approach is consistent with the approach taken in cases in the U.S.[98]

120. A court has wide powers in a CCAA proceeding to do what is just in the circumstances. Pursuant to section 11 of the CCAA, the Court is given broad discretionary power to make any order that it considers appropriate in the circumstances. Accordingly, the Court overseeing these CCAA Proceedings has the power to issue any order that it considers appropriate in the circumstances of this case.[99]

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[98] *See, e.g., In re the Free Lance-Star Publishing Co. of Fredericksburg*, 512 B.R. 798, 807-808 (Bankr. E.D. Va. 2014) (limiting secured creditor's right to credit bid based on, among other things, such creditor's inequitable conduct), RBC Book of Authorities at Tab 18.
In re Aloha Airlines, Inc., 2009 WL 1371950, at *8 (May 14, 2009) (denying secured creditor right to credit bid due to misconduct, including creating side deals with competitor regarding sale of confidential information), RBC Book of Authorities at Tab 19.
[99] CCAA at Section 11; *Nortel Networks Corporation et al (Re)*, 2014 ONSC 477 at para. 54, RBC Book of Authorities at Tab 20.

121. RBC submits that, for all the foregoing reasons, it is just in the circumstances of this case to order payment of the Second Lien Interest and the Second Lien Fees forthwith and in any event as a condition precedent to the closing of the Credit Bid Transaction, if approved by the Court.

ISSUE 3: Should RBC, in its capacity as a First Lien Lender, receive payment of the RBC Consent Fee?

122. For the reasons that are set out herein, RBC, as a First Lien Lender, is entitled to the RBC Consent Fee notwithstanding that it did not execute the Support Agreement and is the only First Lien Lender that is not a Consenting First Lien Lender.

(a) RBC Is Contractually Entitled To Its Ratable Share of the Consent Fee

123. The Support Agreement provides that the Initial First Lien Early Consent Fee and each Additional First Lien Early Consent Fee are payable to Consenting First Lien Lenders who execute the Support Agreement or a joinder agreement.[100]

124. The amount of any such Consent Fee is predicated upon the amount of Loans that any Consenting First Lien Lender holds under the First Lien Credit Agreement.[101]

125. The First Lien Credit Agreement and, in particular, the sharing provisions contained therein entitle RBC to its share of the Consent Fee. RBC's claim to its ratable portion of

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[100] Term Sheet at pp. 9-10 of the Support Agreement, RBC Compendium of Agreements at Tab 4. See also calculation of Consent Fee at Exhibit "G" to First Vowell Affidavit, which Greg Nordal on behalf of the Applicants confirmed was an accurate calculation (See Nordal Trans., pp. 14-15 at questions 50-53).

[101] Term Sheet at pp. 9-10 of the Support Agreement, RBC Compendium of Agreements at Tab 4.

these amounts is grounded in Section 2.14 of the First Lien Credit Agreement, which provides, in relevant part, as follows:

> If, other than as expressly provided elsewhere herein, **any Lender shall obtain on account of the Loans made by it**, or the participations in L/C Obligations and Swing Line Loans held by it, **any payment** (whether voluntary, involuntary, through the exercise of any right of setoff, or otherwise) **in excess of its ratable share** (or other share contemplated hereunder) thereof, such Lender shall immediately (a) notify the Administrative Agent of such fact, and (b) purchase from the other Lenders such participations in the Loans made by them and/or such subparticipations in the participations in L/C Obligations or Swing Line Loans held by them, as the case may be, as shall be necessary to cause such purchasing Lender to share the excess payment in respect of such Loans or such participations, as the case may be, pro rata with each of them . . . [emphasis added].

126. Section 2.14 of the First Lien Credit Agreement applies to "any payment," however received. That payment also has to be made "on account of" the Loans made by such First Lien Lender. The U.S. Supreme Court has held, in the context of interpreting the U.S. Bankruptcy Code, that the words "on account of" do not mean "in exchange for" but rather that the phrase means "because of."[102]

127. The ability to receive a Consent Fee, and the amount thereof, each depend directly on the aggregate principal amount of Loans held by each First Lien Lender and as a result RBC is entitled to its ratable or *pro rata* share.

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[102] *Bank of America Nat'l Trust And Sav. Assn. v. 203 North LaSalle St. Partnership*, 526 U.S. 434, 450 (2003), RBC Book of Authorities at Tab 21.; *see also Univ. of Texas Southwestern Medical Cen. V. Nassar*, 113 S.Ct. 2517, 2527 (2013) (the ordinary meaning of "because of" is "by reason of" or "on account of"), RBC Book of Authorities at Tab 22.

128. Pursuant to Section 10.01 of the First Lien Credit Agreement, no amendment can be made to Section 2.14 [cited above referring to each Lender's ratable share] without the written consent of each Lender.[103]

129. Moreover, RBC submits that the Additional First Lien Early Consent Fee is clearly an interest payment made to First Lien Lenders. The Additional First Lien Early Consent Fee is described as follows:

> a monthly cash consent fee calculated based on an annual rate of 10% less the interest rate paid under the Existing First Lien Credit Agreement (including the Default Rate) in respect of the outstanding principal amount owing to such Early Consenting First Lien Lenders under the Existing First Lien Credit Agreement.[104]

130. Under Section 2.09 of the First Lien Credit Agreement, each First Lien Loan is entitled to interest.[105] No matter how the Consenting First Lien Lenders dress up each Additional First Lien Early Consent Fee, each such payment is an excess interest payment on account of their Loans and it is calculated as such.[106]

131. As a result, the amounts paid to the Consenting First Lien Lenders were payments made to them because of their First Lien Lender's Loans under the First Lien Credit Agreement and RBC is entitled to its ratable share (i.e. 12%) of all such amounts paid. RBC's rateable share of the Consent Fee is $1,559,492.[107]

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[103] Section 10.01(d) of the First Lien Credit Agreement, RBC Compendium of Agreements at Tab 2.
[104] Term Sheet, p. 10 at Schedule "A" of the Support Agreement, RBC Compendium of Agreements at Tab 1.
[105] Section 2.09 of the First Lien Credit Agreement, RBC Compendium of Agreements at Tab 2; the First Nordal Affidavit at Exhibit "D".
[106] See calculation of Consent Fee at Exhibit "G" to First Vowell Affidavit, which Greg Nordal on behalf of the Applicants confirmed was an accurate calculation (See Nordal Trans., pp. 14-15 at questions 50-53).
[107] Nordal Trans., p. 15 at question 54.

(b) The Consent Fee provisions of the Support Agreement Violate the Intercreditor Agreement

132. Section 5.3 of the Intercreditor Agreement provides that the First Lien Loan Documents may be "amended, supplemented or otherwise modified in accordance with their terms," in most circumstances "without notice to, or the consent of the Second Lien Agent or the Second Lien Claimholders." However, Section 5.3 contains a proviso, which requires the consent of the Second Lien Agent for any such amendment, supplement or modification that would:

> (1) increase the "Applicable Margin" or similar component of the interest rate by more than 3% per annum (excluding increases resulting from the accrual of interest at the default rate); (2) extend the scheduled maturity of the First Lien Credit Agreement or any Refinancing thereof beyond the scheduled maturity of the Second Lien Credit Agreement or any Refinancing thereof; or (3) contravene the provisions of this [Intercreditor] Agreement.[108]

133. As noted herein, the Support Agreement contravenes the provisions of Intercreditor Agreement by preventing the Second Lien Lenders from being paid in accordance with the terms of the Intercreditor Agreement.

134. In addition, the payment of the Consent Fee under the Support Agreement has the effect of increasing the "Applicable Margin" under the First Lien Loan Documents by more than 3%. The "Applicable Margin" represents the spread above the "Base Rate" in effect at any time, and the sum of those two amounts equals the non-default interest rate payable under the First Lien Credit Agreement. When the First Lien Credit Agreement is

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[108] Section 5.3 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

in default, as it was when the Support Agreement was executed, the interest rate increases by the "Default Rate" of 2%.[109]

135. As of September 10, 2014, the "Base Rate" was 3.25%, the "Applicable Margin" was 1.50% and the Default Rate was 2.00%, for an aggregate interest rate under the First Lien Loan Documents of 6.75%. The Support Agreement increases that rate to 10%, meaning that the Applicable Margin was increased by 3.25%. RBC submits that this modification of the First Lien Credit Agreement required the consent of the Second Lien Agent, which consent was neither requested nor obtained.[110]

(c) The Support Agreement is Coercive

136. In addition, RBC submits that the Support Agreement is a coercive contract aimed at getting one party, RBC, to relinquish its rights as a Second Lien Lender.

137. The Support Agreement imposes the following burdens on any Consenting First Lien Lender that also holds Second Lien Loans:

(a) Each Consenting First Lien Lender must agree not to sell any of its Second Lien Loans, except to (x) if such Consenting First Lien Lender is a fund, to another fund managed by such Consenting First Lien Lender, (y) another Consenting First Lien Lender or (z) a transferee that agrees to be bound by the Support Agreement;[111]

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[109] Sections 1.01, definitions of "Applicable Rate", "Base Rate" and "Default Rate" of the First Lien Credit Agreement, RBC Compendium of Agreements at Tab 2.
[110] First Vowell Affidavit at Exhibit "G".
[111] Section 4(b)(i) of the Support Agreement, RBC Compendium of Agreements at Tab 4.

(b) Each Consenting First Lien Lender could not accelerate, enforce or take any other action to enforce payment of its Second Lien Loans;[112]

(c) Each Consenting First Lien Lender could not exercise any default-related rights or remedies with respect to its Second Lien Loans;[113]

(d) The Companies were required to not comply with any term of the First Lien Credit Agreement requiring compliance with the Second Lien Credit Agreements;[114]

(e) The Companies were required not to make any payment in connection with the Second Lien Credit Agreement, including (x) any interest or other payment that is due or that may become due pursuant to the Second Lien Credit Agreement, and (y) any payment for fees, costs or expenses to any legal, financial or other advisor to the Second Lien Agent;[115] and

(f) The Consenting First Lien lenders were precluded from terminating the Support Agreement if the Companies failed to comply with the Second Lien Credit Agreement.[116]

138. The creation of the Consent Fee, and the manner in which it was to be paid, was a bald assertion of the proposition that "if you are with us, then you will be rewarded and if you are not with us, you will be penalized." RBC submits that this Court should not condone

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[112] Section 4(d)(v) at p. 8 of the Support Agreement, RBC Compendium of Agreements at Tab 4.
[113] Section 4(d)(vi) at p. 8 of the Support Agreement, RBC Compendium of Agreements at Tab 4.
[114] Section 5(o) at p. 11 of the Support Agreement, RBC Compendium of Agreements at Tab 4.
[115] Section 5(q)(viii) at p. 12 of the Support Agreement, RBC Compendium of Agreements at Tab 4.
[116] Section 11(a)(iii)(iii) at p. 17 of the Support Agreement, RBC Compendium of Agreements at Tab 4.

tactical jockeying in circumstances where the same parties are now seeking relief from the Court that would have the effect of condoning and rewarding those efforts.

139. The Support Agreement that RBC was invited to sign as First Lien Lender was an attempt by the First Lien Agent and the Consenting First Lien Lenders to coerce RBC as First Lien Lender to use its interest as a First Lien Lender to extinguish all Second Lien debt obligations. The extinguishment of this debt would have been accomplished – not through a Plan of Arrangement, a negotiated resolution, or by court Order – but by virtue of RBC's position as a First Lien Lender which also happened to be the Second Lien Agent.

ISSUE 4: Is RBC entitled to raise the issues it has in this CCAA Proceeding and on these Motions?

140. RBC is entitled to participate in these CCAA Proceedings and to make the submissions and seek the relief it is seeking, all within the parameters of its contractual obligations under the Intercreditor Agreement and otherwise.

(a) RBC's Rights as Second Lien Agent and a Second Lien Lender

141. The operative provisions of the Intercreditor Agreement for which the Consenting First Lien Lenders rely in challenging RBC's right to make submissions and seek certain relief are found in Section 3.1, entitled "Enforcement". The prohibitions on certain actions in sections 3.1(a) and (b) [addressing the exercise of enforcement remedies against

Collateral] are specifically qualified by 3.1(c) ("*Notwithstanding the foregoing*...") and 3.1(d) which follows is stated to be expressly "*Subject to sections 3.1(a)* ***and (c)***..."[117]

142. The effect of this is that the Second Lien Lenders have an unqualified right pursuant to section 3.1(c) to "file a claim or statement of interest with respect to the Second Lien Obligations provided that an Insolvency or Liquidation Proceeding has been commenced...**and take such other action as it deems in good faith to be necessary to protect its rights in such proceeding**."[118] [emphasis added]

143. RBC also submits that Section 6.11 of the Intercreditor Agreement does not limit RBC's rights to make any of the submissions it is making in respect of these motions. Section 6.11 of the Intercreditor Agreement provides as follows:

> Neither the Second Lien Collateral Agent nor any other Second Lien Claimholder shall, in an Insolvency Proceeding or in connection with the exercise of the First Lien Collateral Agent's remedies in respect of the Collateral provided for in Section 3.1 (subject to the terms and conditions of Section 5.1(b)), oppose any sale or disposition of any Collateral of any Loan Party **that is supported by the First Lien Claimholders** and the Second Lien Collateral Agent and each other Second Lien Claimholder will be deemed to have consented under Section 363 of the Bankruptcy Code (or any similar provisions of any other Bankruptcy Law or any order of court of competent jurisdiction) to any sale supported by the First Lien Claimholders and to have released their Liens on such assets (but not the proceeds of such sale). [emphasis added][119]

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[117] Section3.1(a)(b)(c) and (d) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[118] Section 3.1(c) of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.
[119] Section 6.11 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

144. RBC submits that the Credit Bid Transaction is not "supported by the First Lien Claimholders" as such term is defined in the Intercreditor Agreement, resulting in Section 6.11 creating no bar to the Second Lien Lenders bringing any issues before the Court.

145. The Intercreditor Agreement contains two distinct concepts, each of which is a separate defined term: (i) First Lien Lenders, and (ii) First Lien Claimholders. The former is defined by reference to the First Lien Credit Agreement – the latter is not. The use of First Lien Claimholders in section 6.11 therefore cannot be considered inadvertent, or to have the same meaning as reference to First Lien Lenders. The definition of First Lien Claimholders encompasses a broader group than First Lien Lenders, as follows:

> "**First Lien Claimholders**" means, at any relevant time, the holders of First Lien Obligations at that time, including the First Lien Collateral Agent, the First Lien Lenders, any other "Secured Party" (as defined in the First Lien Credit Agreement) and the agents under the First Lien Loan Documents.[120]

146. The definition of First Lien Claimholders contains no qualifiers. It includes the holders of First Lien Obligations (not a majority thereof), including the First Lien Lenders (not a majority thereof) and any Secured Party (which includes RBC in a separate capacity under the cash management arrangements). Accordingly, the Credit Bid Transaction cannot be said to be "supported by the First Lien Claimholders" pursuant to Section 6.11 as such term is defined in the Intercreditor Agreement.

147. It is submitted that in order for Section 6.11 of the Intercreditor Agreement to represent a contractual hurdle to RBC taking any position, the plain language would have to be

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[120] Section 1.1 of the Intercreditor Agreement, RBC Compendium of Agreements at Tab 1.

altered and/or words would have to be imported into the definition of "First Lien Claimholders" to make it mean "Required Lenders", as such term is used in the First Lien Credit Agreement.

148. However, any attempt to define "First Lien Claimholders" by reference to the definition of Required Lenders or First Lien Lenders under the First Lien Credit Agreement would violate Section 8.1 of the Intercreditor Agreement, which states that its terms govern in the event of any inconsistencies with the First Lien Loan Documents.

149. RBC submits that any such attempt to interpret the definition of "First Lien Claimholders" other than in accordance with its plain meaning would both be contrary to New York law, Ontario law and to the agreements entered into by the parties.

150. "Under New York law, a written contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language they have employed."[121] "Where . . the contract is clear and unambiguous on its face, the intent of the parties must be gleaned from within the four corners of the instrument, and not from extrinsic evidence."[122]

151. Similarly, under Canadian law, the Court must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract.[123]

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[121] *Cruden v. Bank of N.Y.*, 957 F.2d 961, 976 (2d Cir. 1992), RBC Book of Authorities at Tab 23.
[122] *Rainbow v. Swisher*, 72 N.Y. 2d 106, 531 N.Y.S. 775, 527 N.E.2d 258 (1988), RBC Book of Authorities at Tab 24.
[123] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53 at para 47**,** RBC Book of Authorities at Tab 25.

152. The definition of "First Lien Claimholders" is clear and unambiguous—it means all such claimholders. It is undisputed that certain of the First Lien Claimholders do not support the Credit Bid Transaction, as RBC did not execute the Support Agreement. RBC submits that under New York law as under Ontario law, that is the end of the inquiry and Section 6.11 of the Intercreditor Agreement presents no impediment to any submissions RBC may make on the motions.

(b) RBC's Rights as an Unsecured Creditor

153. It cannot be disputed that the Applicants and the Consenting First Lien Lenders view RBC as an unsecured creditor as it relates to its Second Lien Obligations, alleging that there is no value in the Collateral (as defined in the Intercreditor Agreement) to allow for any recovery on account of the Second Lien Obligations.

154. Section 3.1(e) of the Intercreditor Agreement provides RBC with broad rights as an unsecured creditor. In particular, Section 3.1(e) provides that:

> Except as otherwise specifically set forth in Sections 3.1(a) and (d), the **Second Lien Collateral Agent and the Second Lien Claimholders may exercise rights and remedies as unsecured creditors against the Company** or any other Grantor that has guaranteed or granted Liens to secure the Second Lien Obligations in accordance with the terms of the Second Lien Loan Documents and applicable law . . ."[124] [emphasis added]

155. RBC's rights to participate as an unsecured creditor are subject only to what is "otherwise specifically set forth" in Sections 3.1(a) and 3.1(d) of the Intercreditor Agreement.

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[124] Intercreditor Agreement, Section 3.1(e).

Nothing in Section 3.1(a), Section 3.1(d), nor any other provision of the Intercreditor Agreement specifically prevents RBC from taking the position that the Company has treated RBC unequally and prejudicially vis-à-vis other unsecured creditors.

156. RBC would be, by far, the largest unsecured creditor of the Company. Yet RBC has received no payments since the Support Agreement was executed, even on account of it having *unsecured* claims, while all other unsecured creditors of the Company have been paid in full as amounts became due in the ordinary course.[125]

157. RBC is not seeking payment "in preference to other parties rights".[126] Rather RBC has not been paid even on a *pari passu* basis with the other unsecured creditors during the year prior to the commencement of these CCAA Proceedings. It has been exclusively targeted in this regard.

158. In addition, nothing in Section 3.1(a) or Section 3.1(d) specifically limits RBC's rights to raise any of the issues it has raised before this Court.

159. Section 3.1(a)(1) of the Intercreditor Agreement prevents RBC from exercising remedies with respect to Collateral during the Standstill Period. There is no Standstill Period, and RBC is not seeking to exercise remedies with respect to Collateral as an unsecured creditor. Nor is RBC objecting to any of the statutory or other remedies of the First Lien Lenders described in Sections 3.1(a)(2) or (3) of the Intercreditor Agreement. Its position

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[125] Trans. Nordal, pp. 21-24 at questions 76-84.
[126] As suggested in the Gropper Opinion.

is simply that, in exercising (or choosing to forbear from exercising) those remedies the Consenting First Lien Lenders cannot breach their contractual obligations to the Second Lien Lenders, or induce the Company to do so.

160. RBC's motion is based on the fact that the Company and the First Lien Lenders have violated provisions of the Intercreditor Agreement, the First Lien Credit Agreement and the Second Lien Credit Agreement and applicable law.

161. Section 3.1(d) also does not limit RBC's rights as an unsecured creditor. First, as with Section 3.1(a), nothing in Section 3.1(d) constitutes a waiver of RBC's rights as an unsecured creditor or as a secured creditor, to argue that the Company and the First Lien Lenders have violated contracts or applicable law. Second, the lead-in language to Section 3.1(d) provides that, whatever limitations that section may impose on RBC's rights as an unsecured creditor, they are subject to Section 3.1(c) of the Intercreditor Agreement, as addressed above.

162. Accordingly, RBC submits that all issues raised in these CCAA Proceedings to date and in this Factum are properly raised by RBC.

ISSUE 5: How, if at all, does the Gropper Opinion impact the Motions before the Court?

163. RBC respectfully submits that, for the reasons set out below, the Gropper Opinion[127] does not assist in the determination of any issues before the Court.

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[127] Gropper Affidavit at Exhibit "B".

164. The author of the Gropper Opinion has unfortunately not been provided with the necessary facts by instructing counsel, and is therefore proceeding under the mistaken assumption that:

 (a) there has been a "sale or other disposition of Collateral" by the First Lien Lenders; [128]

 (b) there has been "Collateral or proceeds thereof received by the Second Lien Collateral Agent or any Second Lien Claimholder in connection with the exercise of any right or remedy in contravention of the [Intercreditor] Agreement..."[129]; and

 (c) the Second Lien Agent and Second Lien Lenders are seeking payment of interest, fees and expenses "in preference to other parties' rights".[130]

As set out herein, these are incorrect factual statements or erroneous assumptions upon which the Gropper Opinion is based.

165. The Gropper Opinion answers questions that are not in dispute, and does not (and cannot, as a US law expert) assist the Court with the issues that are before the Court – matters solely within the jurisdiction of the Canadian Court applying Canadian legal principles to Collateral located in Canada.

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[128] Page 9 of Gropper Opinion (first full para).
[129] Page 9 of Gropper Opinion (middle of second para).
[130] Page 9 of Gropper Opinion (third full para). Rather than a preference over other parties, what the Second Lien Lenders seek is to be treated fairly and equitably on the exact same basis as all other creditors, including those (unsecured) who are subordinate in interest to the Second Lien Lenders.

166. There is no Collateral located in the US, and the CCAA proceeding is the sole process for determining the rights of the parties under the relevant agreements, within the statutory and common law framework of the Canadian insolvency system.

167. The Gropper Opinion acknowledges that pursuant to the governing law clause contained in section 3.1(b) of the Intercreditor Agreement, although the First Lien Credit Agreement and Intercreditor Agreement are governed by New York law, the laws of Canada and decisions of the Canadian Court govern the Credit Bid Transaction, as all Collateral is located in Canada. [131]

168. While the loan agreements and the Intercreditor Agreement are governed by New York law, the unambiguous language of the agreements and the application of those provisions to the facts of this case are matters that are within the purview of the CCAA Court. As Justice Newbould indicated in his June 30, 2015 decision in these CCAA Proceedings, "The provisions of the Intercreditor Agreement that I had to deal with were in plain English that one would think would not have required a great deal of input of U.S. counsel."[132]

169. The Gropper Opinion simply does not address the issues that are before the Court on these motions. In various places Gropper describes his task as being to opine on :

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[131] The relevant portion of Section 3.1(b) of the Intercreditor Agreement provides: "Until the Discharge of First Lien Obligations has occurred, whether or not any Insolvency or Liquidation Proceeding has been commenced by or against the Company or any other Grantor, subject to Section 3.1(a)(1), the First Lien Collateral Agent and the First Lien Claimholders shall have the right to enforce rights, exercise remedies (including setoff and the right to credit bid their debt <u>which, to the extent the Collateral is located in Canada, will be subject to applicable law in Canada or any order of a Court that has jurisdiction over such matters in Canada</u>) . . ." [emphasis added]

[132] *Nelson Education Limited. (Re)*, 2015 ONSC 4225 at para. 10.

(a) the *enforceability* of the Intercreditor Agreement as a matter of New York law, as well as certain related issues that arise under the First and Second Lien Credit Agreements;[133]

(b) whether the provisions of the Intercreditor Agreement that provide that the First Lien Lenders have control over the form and substance of a sale of Collateral and that the consent of the First Lien Lenders to a sale results in the deemed consent of the Second Lien Lenders is *valid and enforceable* as a matter of New York law;[134]

(c) the *validity and enforceability* of provisions of the First Lien Credit Agreement that give the First Lien Agent control over the release of Collateral and that require the First Lien Agent to follow the directions of the Required Lenders under the First Lien Credit Agreement;[135] and

(d) whether the Required Lenders under the First Lien Credit Agreement have the *authority* to require the First Lien Agent to credit bid their entire debt.[136]

170. With respect to each of these points, RBC is not asserting that any provisions of the First Lien Credit Agreement or Intercreditor Agreement are unenforceable. The issue for the Court on these motions is not one of enforceability, but of the application of the terms of the agreements to the facts in this case.

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[133] Gropper Opinion, page 4 (bottom of page)
[134] Gropper Opinion, page 4 (bottom).
[135] Gropper Opinion, page 6 (halfway down the page)
[136] Gropper Opinion, page 7.

171. RBC is not challenging that the First Lien Agent can, in accordance with the terms of the First Lien Credit Agreement, act on directions of the Required Lenders and take steps that include a credit bid of the First Lien Obligations and other enforcement rights in respect of Collateral. RBC has also not suggested that the Required Lenders under the First Lien Credit Agreement do not have the *authority* under the First Lien Credit Agreement to credit bid the first lien debt. The Gropper Opinion, as it relates to credit bidding generally, or the bare provisions of the First Lien Credit Agreement, is therefore irrelevant to the motions.

172. RBC submits that all rights and remedies of the First Lien Agent and First Lien Lenders pursuant to the First Lien Credit Agreement are subject to the provisions of the Intercreditor Agreement. In summary, RBC's position is simply that the Gropper Opinion was not required and is not relevant to the determination of the issues before the Court.

ISSUE 6: Is it Appropriate for the Court to grant the Non-Customary Relief requested by the Applicants in this case?

173. RBC, in its capacity as a First Lien Lender, submits that it is not appropriate for the Court to grant the Non-Customary Relief in this case.

(a) The Release

174. RBC acknowledges that the Court has the jurisdiction to approve releases in favour of debtors and third parties under agreements reached prior to the presentment of a plan in

certain circumstances. However, it is not customary for the Court to grant a release, such as the one requested by the Applicants, in the context of an approval and vesting Order.

175. In this case, where there has not been a plan of arrangement[137] containing releases that was approved by the creditors and the release being proposed is not on consent and is overly broad, RBC submits that the Court ought not to grant such a release.

176. The Asset Purchase Agreement contains a release at Section 5.12, however, the only parties releasing any claims contractually are the Applicants, the Purchaser and their Affiliates. The Asset Purchase Agreement does not purport to have the First Lien Lenders release any claims. Specifically, the operative language of the release in Section 5.12 states:

> ...each of the Parties on behalf of itself and its Affiliates **does hereby forever release** and discharge the other Party hereto, its Affiliates, the Secured Lenders and each of their respective and former direct and indirect shareholders, officers, directors, employees, auditors, advisors (including, without limitation, financial advisors), legal counsel and agents (the "[**APA**] Released Parties") [138]

177. The scope of the proposed Court Ordered release is much broader than the one contained in the Asset Purchase Agreement. The Applicants are requesting that the Court Order

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[137] Pursuant to section 6.9(b) of the Intercreditor Agreement, in the event the Applicants commence any restructuring proceeding in Canada and put forward a plan, the Applicants, the First Lien Lenders and the Second Lien Lenders agreed that the First Lien Lenders and the Second Lien Lenders should be classified together in one class. While the Second Lien Lenders have contractually agreed that they will only vote in favour of a plan if it satisfies one of two conditions, there is no contractual restriction on their ability to vote against a plan. Accordingly, this results in RBC's support being required for any plan to succeed. RBC Compendium of Agreements at Tab 1.

[138] Affidavit of Dean Mullett sworn on May 11, 2015 at Exhibit "B". Section 5.12 of the Asset Purchase Agreement at p. 47. "Parties" is defined in the preamble to be the Applicants and the Purchaser and "Secured Lenders" is defined in Section 1.2 as the lenders from time to time under the First Lien Credit Agreement.

that the Applicants, the Purchaser, their respective Affiliates, the First Lien Agent, the Supplemental Agent, the First Lien Lenders and each of their respective and former direct and indirect shareholders, officers, directors, employees, auditors, advisors (including, without limitation, financial advisors), legal counsel and agents (the "**Proposed Court Released Parties**") forever release all claims of another Proposed Court Released Party.

178. In other words, the Applicants request that the proposed Court Ordered release be reciprocal among each of the Proposed Court Released Parties and they have expanded the scope of the proposed released parties to include the First Lien Agent and the Supplemental Agent.

179. In addition, the Applicants are asking the Court to release the Proposed Court Released Parties from actions and dealings relating to agreements that were either executed and/or negotiated prior to these CCAA Proceedings at a time where the Court had no oversight of the Applicants or the other parties to those documents, including relating to any actions, omission, transactions, dealings or other occurrence existing or taking place prior to the Closing Date in connection with Nelson, Nelson's business, the Sale Agreement, the Transaction, and the Support Agreement.

180. The Applicants also ask the Court to release actions relating to the Supplemental Support Agreement (as defined in the Nordal Affidavit), and the Payment and Settlement Agreement and the transactions contemplated by those documents. The Applicants, in their own motion record in support of the Sale Approval Motion, have not even put these

documents before the Court, yet they are asking the Court to release actions relating to them.[139]

181. Based on the foregoing, RBC submits that the release ought not to be granted.

(b) The Stockholders and Registration Rights Agreement

182. The Applicants seek an Order that the Stockholders and Registration Rights Agreement shall be:

> binding all holders of common shares of Purchaser Holdco and any Persons entitled to receive common shares of Purchaser Holdco in connection with the Transaction immediately upon issuance of the common shares of Purchaser Holdco to such Persons, with the same force and effect as it the Persons were signatories to the Stockholders and Registrations Rights Agreement.[140]

183. RBC submits that this relief is not appropriate and should not be granted by the Court.

184. The agreement does not relate in any way to the Applicants. In fact, the Applicants are not a party to the Stockholders and Registration Rights Agreement that they are requesting the Court exercise its jurisdiction to bind parties to, by Court Order.

185. The Agreement is a contract among the Purchaser's parent company, Purchaser Holdco, and the holders of Purchaser Holdco's common shares. Pursuant to documents that have not been put before the Court, after implementation of the Credit Bid Transaction, the

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[139] Applicants' Motion Record returnable August 13, 2015.

[140] Paragraph 10 of the draft Approval and Vesting Order at Tab 3 of the Sale Approval Motion.

First Lien Lenders will be the holders of 100% of the shares of Purchaser Holdco. The Court is being asked to meddle in the corporate governance of Purchaser Holdco and to bind the First Lien Lenders to terms as future shareholders of Purchaser Holdco with respect to their rights and obligations of shareholders.

186. RBC submits that extending the Court's jurisdiction in these CCAA Proceedings and exercising it to assist the Purchaser's parent company with its corporate governance is not appropriate. The Purchaser and its parent company either have the contractual right to bind all First Lien Lenders to terms as future shareholders, or they do not.

PART VI - RELIEF REQUESTED

187. For the reasons set out herein, RBC respectfully requests that this Court,

(a) Order and direct Nelson Education to pay to RBC, in its capacity as Second Lien Agent,

(i) the Second Lien Fees incurred by the Second Lien Agent prior to the Filing Date in the amount of CDN$1,316,181.73; and

(ii) the Second Lien Interest outstanding as at the Filing Date in the amount of US$15,365,998.83;

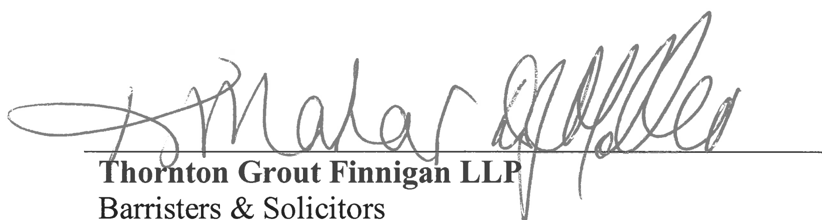
(b) Declare that RBC, in its capacity as First Lien Lender, is entitled to its proportionate share of the Consent Fee and directing Nelson Education and/or the Consenting First Lien Lenders to pay the RBC Consent Fee in the amount of US$1,559,492;

(c) Declare and direct that the Second Lien Fees, the Second Lien Interest and the RBC Consent Fee shall be paid to RBC forthwith from cash on hand, and in any event prior to the conclusion of the Credit Bid Transaction if same is approved by the Court; and

(d) Award RBC its costs on this motion on a full indemnity basis.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 11TH day of August, 2015.

August 11, 2015



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SCHEDULE "A"
LIST OF AUTHORITIES

No. **Case**

1. *Nelson Education Ltd. (Re)*, 2015 ONSC 3580.

2. *Report of the Model First Lien/Second Lien Intercreditor Agreement Task Force* A.B.A. Bus Law 809-883.

3. *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept 9, 2014) *aff'd,* 531 B.R. 321 (S.D.N.Y. 2015) *appeal filed,* Docket No: 15-1682 (2d Cir. May 22, 2015); *U.S. Bank N.A. v. Wilmington Savings Fund Society, FSB (In re MPM Silicones, LLC)*, 531 B.R. 321 (S.D.N.Y. 2015) *appeal filed,* Docket No: 15-1682 (2d Cir. May 22, 2015).

4. Lawrence Safran et al, "The Weakest Link in Intercreditor Agreements Breaks Again in *Momentive*" (16 October 2014), online: Latham & Watkins <http://www.lw.com>.

5. Donald S. Bernstein et al, "*Momentive* Ruling Highlights Risks to Senior Creditors Under Intercreditor Agreements" (7 October 2014), online: Davis Polk <http://www.davispolk.com>.

6. *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010).

7. *Peter Dalton v. Educational Testing Service*, 87 N.Y.2d 384 (1995).

8. Restatement (Second) of Contracts section 205, comment d (1981).

9. *Steven E. Kader v. Paper Software, Inc.*, 111 F.3d 337 (2d Cir. 1997).

10. *Fasolino Foods Co. Inc. v. Banca Nazionale Del Lavoro,* 961 F.2d 1052 (2d Cir. 1992).

11. *Louise M. Harris v. Provident Life & Accident Insurance Company.*, 310 F.3d 73 (2d Cir. 2002).

12. *Bhasin v. Hrynew*, 2014 SCC 71, 2014 CSC 71.

13. *Drouillard v. Cogeco Cable Inc.,* 2007 CarswellOnt 2624 (Ont. C.A.).

14. *Correia v. Canac Kitchens*, 2008 ONCA 506.

15. *Susan Winter Woodling v. The Garrett Corporation, et al.*, 813 F.2d 543 (2d Cir. 1986).

16. *Vasquez v. Delcan Corp.,* 1998 CarswellOnt 2784 (Gen. Div.).

No.	Case
17.	*Credit Bidding in Canada Recent Developments,* Lexpert July 2011.
18.	*In re Free Lance-Star Publishing Co.*, 512 B.R. 798 (Bankr. E.D. Va. 2014).
19.	*In re Aloha Airlines Inc,* 2009 1371950 (Bankr. D. Haw. May 14, 2009).
20.	*Nortel Networks Corporation et al (Re)*, 2014 ONSC 4777.
21.	*Bank of America National Trust Savings Association v. 403 North Lasalle Street Partnership,* 526 U.S. 434 (1999).
22.	*University of Texas Southwestern Medical Center v. Naiel Nassar,* 133 S. Ct. 2517 (2013).
23.	*Stanley C. Cruden, et al v. Bank of New York.*, 957 F.2d 961 (2d Cir. 1992).
24.	*Blanche B. Rainbow v. Gerald W. Swisher,* 72 N.Y. 2d 106 (1988).
25.	*Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53.

SCHEDULE "B"
RELEVANT STATUTES

***Companies' Creditors Arrangement Act*, (R.S.C., 1985, c. C-36), Section 11**

General power of court

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

***Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3**

Advance notice

244. (1) A secured creditor who intends to enforce a security on all or substantially all of

- (*a*) the inventory,
- (*b*) the accounts receivable, or
- (*c*) the other property

of an insolvent person that was acquired for, or is used in relation to, a business carried on by the insolvent person shall send to that insolvent person, in the prescribed form and manner, a notice of that intention.

Period of notice

(2) Where a notice is required to be sent under subsection (1), the secured creditor shall not enforce the security in respect of which the notice is required until the expiry of ten days after sending that notice, unless the insolvent person consents to an earlier enforcement of the security.

No advance consent

(2.1) For the purposes of subsection (2), consent to earlier enforcement of a security may not be obtained by a secured creditor prior to the sending of the notice referred to in subsection (1).

Exception

(3) This section does not apply, or ceases to apply, in respect of a secured creditor

(*a*) whose right to realize or otherwise deal with his security is protected by subsection 69.1(5) or (6); or

(*b*) in respect of whom a stay under sections 69 to 69.2 has been lifted pursuant to section 69.4.

Idem

(4) This section does not apply where there is a receiver in respect of the insolvent person.

***Investment Canada Act*, (R.S.C., 1985, c. 28 (1st Supp.)) s. 10(1.1)**

Exempt transactions — Part IV
(1.1) Part IV does not apply in respect of the acquisition of control of a Canadian business in connection with the realization of security granted for a loan or other financial assistance and not for any purpose related to the provisions of this Act, if the acquisition is not subject to approval under the *Bank Act,* the *Cooperative Credit Associations Act*, the *Insurance Companies Act* or the *Trust and Loan Companies Act*.

U.S. Code – Title 11 Bankruptcy, Section 363(k)

363(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

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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. (collectively, the "**APPLICANTS**")

Court File No.: CV15-10961-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at **Toronto**

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