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The hearing of evidence and arguments into U.S. Steel's scheme to claim $2.2 billion from the Stelco steel company it acquired in 2007, and began to wreck within a year, concluded on January 27. To call the testimony "evidence" is a stretch, as almost everything presented in the *Companies' Creditors Arrangement Act* (CCAA) case has been opinions either for or against U.S. Steel.

To most observers, the case is not based on any law and violation of commercial law but on

monopoly right versus public right. The U.S. monopoly wants to say white is black, that its payments to buy and operate Stelco do not represent equity ownership but a third party loan to a company it bought and owned. U.S. Steel is pushing its irrational stance to the limit insisting its equity is debt to itself. In a bankruptcy case, equity is last in line in the distribution of liquidated assets while a secured loan would jump to the head of the queue. $2.2 billion is at stake.

That such an absurd matter occupies the concerns and time of the court and provincial government rather than directly solving the problem of a steel industry in crisis speaks volumes of how dysfunctional Canada's economy and political and legal systems have become and require a new direction. Not only is Stelco in CCAA bankruptcy protection with pensions, benefits, production and jobs under threat of liquidation but so is Essar Steel in Sault Ste. Marie. Even if U.S. Steel loses the court case, it does not save Stelco from liquidation and all the negative results from such a disaster. Nor does a court victory Keep Stelco Producing, which at this point requires the people to stand up and demand a self-reliant Canadian steel industry that serves Canada's economy and public interest.

The Province of Ontario, which stands to lose not only a $150 million loan to U.S. Steel but also millions in pension and benefits funding, hired a U.S. expert to expose plainly the U.S. Steel claim as fraud. Dr. John D. Finnerty presented to the court a report on what constitutes debt and equity according to established standards. He analyzed the Stelco acquisition and the funds U.S. Steel used in the purchase and operations to determine their status according to the standards.

Finnerty, a financial economist and expert on bankruptcies, said in both the case of the U.S. Steel transfer of funds to its wholly-owned subsidiary as a term loan and as a revolver loan, the manner of their implementation suggested equity. He said there are "15 factors commonly considered in U.S. tax courts and bankruptcy court matters in determining whether debt should be reclassified as equity."

Regarding the term loan, he said eight of the 15 factors were more consistent with equity from a financial economics perspective, one factor was more consistent with debt and six were indeterminate.

Regarding the revolving loan, of the 15 factors, 10 were more consistent with equity, one with debt and four were indeterminate. He elaborated each of the factors and explained his conclusions. He compared the practice of U.S. Steel regarding its loans to its Canadian subsidiary to the norm in third party arm's length loans and presented his conclusions.

Stelco at the time of acquisition would not have been able to obtain a loan with the terms and amount its new owner U.S. Steel provided Finnerty said. He elaborated Stelco's history and financial situation at the time of acquisition and said it fit into the "non-investment grade sector" regarding the selling of company bonds.

The fact that the U.S. Steel term loan to its subsidiary had a 30-year maturity date was very unusual according to Finnerty. He challenged the findings of U.S. Steel expert witness Austin

Smith who also submitted a report and had testified earlier in the case. He said her conclusions that over 18 per cent of the companies she analyzed had maturity dates of 30 years or more did not take into account the number of those companies that were of the "investment grade sector" and the number that similar to Stelco at the time would be considered in the non-investment grade sector. Looking solely at those that fit into the non-investment sector, the longest maturity dates were 12 years and very few were for even that length. All the loans with 30 years or more before maturity, which Austin Smith referred to in her findings, were investment grade, Finnerty said, unlike the U.S. Steel loan to its subsidiary.

He then questioned the administration of the term loan and the practice of U.S. Steel in waiving interest payments. Not enforcing the terms of the agreement in favour of the lender was not consistent with how third party arm's length lenders handle a loan of this nature. The transfer in this case can only be seen as money from the headquarters of a company allocating funds to one of its branches in the form of equity.

In 2008, before U.S. Steel began to destroy Stelco's productive capacity, the Canadian subsidiary made two transfers of funds to the U.S. owners for a total of $100 million. This occurred almost two years before the terms of any agreement from the takeover required a first payment. The Canadian subsidiary, which was making substantial profits in the period from 2007 through part of 2008, transferred the profits from operations to the owners in Pittsburgh. Finnerty said this transfer of money has all the hallmarks of a dividend payment rather than any payment of a borrower to a third party lender.

The terms of U.S. Steel's cash payment in 2007 to the acquired and now wholly owned subsidiary in Canada allowed the subsidiary to transfer profits to the owners anytime without this triggering a penalty for early repayment of an interest bearing loan. Finnerty said this does not occur in the business world as no third party arm's length lender would offer such terms to a borrower. Why would a lender want to hand over large sums without guarantees that the funds would at least collect interest over a certain period rather than be soon returned? The paperwork alone is substantial involving a great deal of work-time. Finnerty said that lenders simply would not lend out money on that basis. The movement of funds between U.S. Steel and its subsidiary has to be viewed as flows within a company's equity structure distributed according to some plan.

Later, between 2010 and 2013, U.S. Steel waived interest payments on the term loan to its Canadian subsidiary amounting to over $400 million or 45 per cent of the total interest accrued over the life of the loan. U.S. Steel did not enforce its rights under the term loan agreement. Finnerty said this practice is not how lenders handle loans. Such a non-payment of interest would probably trigger a default on a normal third party loan, not a friendly, "Oh by the way, you do not have to pay for the time being even" without any changes to the terms of the agreement. The amount of the non-payment of interest, at the very least, would have to be seen and written into the agreement as a new loan with additional interest due.

U.S. Steel began the revolver loan to its Canadian subsidiary only when the U.S. government

changed its tax laws so that the payment of interest on such loans would not be taxed. This in itself is suspicious and may involve a form of "legal" fraud. Finnerty said a pattern emerged that saw the parent-owner U.S. Steel provide funds to its Canadian subsidiary, which were then used by the subsidiary to pay interest on the revolving loan. The "interest income" from Canada could then classified as U.S. tax free interest income under the new regulations and the amount given to the Canadian subsidiary could be used to lower any U.S. net income for U.S. Steel tax purposes. Finnerty characterized this practice as money "making a round trip" from U.S. Steel to Canada and back to U.S. Steel.

Advances of funds from U.S. Steel to its acquired Canadian subsidiary using money from the revolving loan in the United States to pay interest on the very loan from which money was being drawn was done without changing any terms within the original agreements. Finnerty said this practice "repeatedly put USS at the bottom of the pecking order," regarding the distribution of assets if and when the Canadian subsidiary went into bankruptcy protection because it has to be considered movement of equity to and fro. Finnerty found this practice "confounding in a major company," especially given how things turned out, one could add. The administration of funds from U.S. Steel to its wholly-owned subsidiary was more consistent with equity than a loan, he concluded.

Under cross examination Finnerty insisted that the words in a contract or loan agreement must be judged by looking at the implementation of the agreement. Is there a divergence from form and substance, he asked? How does the word "loan" hold up under scrutiny of its implementation? Finnerty insisted that the word "loan" in the terms of the agreements is not consistent with the implementation. The transfer of money was an intra-company movement of funds, which can only be considered equity and not a loan.

Report on the Final Day of the Court Hearing

On January 27, Justice H. Wilton-Siegel, the Ontario Superior Court judge presiding over the USS case started the day by saying there appeared to be "something strange going on" and asked for clarification on U.S. Steel's submission the day before that it had paid one supplier on the same day U.S. Steel Canada filed for bankruptcy protection under the *Companies' Creditors Arrangement Act* (CCAA). U.S. Steel Canada received the supplies before the filing day. It had a contract that guaranteed payment, it said. U.S. Steel Canada also paid three other suppliers who made pre-filing deliveries to U.S. Steel Canada and with whom U.S. Steel also had contracts of guaranteed payments. These three payments were also made post-filing for CCAA.

U.S. Steel's position was that those four otherwise unsecured creditors' payments became part of U.S. Steel's secured claim against U.S. Steel Canada because of the security agreement in the revolver loan. "That is just plain wrong" the judge said regarding the three post-filing payments U.S. Steel is claiming now as secured debt. The suppliers were unsecured creditors at pre-filing and the payments could not become part of the secured claim of U.S. Steel given that the

payments were made post-filing. The judge said he would look at the payment made on the day of the filing under CCAA, which was to Cliffs Natural Resources for iron pellets, but wanted to see the contract with Cliff as the U.S. Steel lawyers said U.S. Steel and U.S. Steel Canada signed a letter transferring the contract from U.S. Steel to U.S. Steel Canada, referred to as a title change. The judge wanted to see if the contract with Cliff allowed that.

United Steelworkers' (USW) Lawyer Gord Capern began by objecting to submissions made by U.S. Steel the day before that suggested "labour disputes" and/or failed discussions with the union (for concessions) just prior to entering CCAA were a cause of U.S. Steel Canada's difficulties. All the parties had repeatedly agreed in case conferences they would avoid "conduct issues" in the court, he said, so he would make his remarks brief. But he felt compelled to object to any suggestion that the union was at all responsible for U.S. Steel Canada's troubles.

The judge set the tone for the closing arguments by saying it appeared the parties were in agreement on the facts and both sides wanted to look at the issues not from a perspective of formal or legal definitions of words but from the perspective of what actually happened. "The substantive reality has to be determined," he said. The dispute is on the interpretation of the events.

USW lawyer Capern and the two lawyers for the Province, Alan Mark and Peter Ruby, then went through the history of U.S. Steel buying Stelco to show how U.S. Steel Canada was integrated into U.S. Steel by U.S. Steel, who had full control of all aspects from what it produced, who formed the board of directors, where U.S. Steel Canada got its supplies, sales, funding, payments, etc. It ran the business and provided funds initially through the term loan to keep it producing what was in the best interest of the company as a whole and in such a way as to take advantage of tax loopholes.

U.S. Steel was anticipating making a billion dollars a year off of synergies when it purchased Stelco. It did not expect to get back the money from the term loan. The loan was a tax shelter and a means to manage cash flow. That is characteristic of equity. It expected to make its money off the synergies but the market crashed. Because of the total control of U.S. Steel over U.S. Steel Canada, U.S. Steel had the power to organize the success of U.S. Steel Canada by giving it work.

Lawyers for USW and the Province argued that U.S. Steel did not need to put the security agreement into the revolver loan agreement and U.S. Steel Canada did not have to sign it because U.S. Steel had to continue pouring money into the operation in order to fill its obligations to its customers and suppliers. It could not just pull the plug. Its use of the funds was more like equity than debt.

U.S. Steel rebutted by reiterating that the law says you should go by the initial intent of the parties who signed legal debt agreements in terms of both the term loan and the revolver loan and any oddity that followed like the waiving of interest had reasonable explanations -- such as that it enabled them to take advantage of a new tax loophole and/or because of changed market conditions. Debt agreements indicate the parties' intent that it is debt, not equity, U.S. Steel lawyers said.

The Province pointed out that this was the first case in Canada under the CCAA where the

parent/subsidiary relationship has become the centre of the dispute. U.S. Steel had massive interests in U.S. Steel Canada. U.S. Steel Canada had massive debt to U.S. Steel and zero independence. Neither the terms of the loans nor their implementation were consistent with institutional lending. The purpose of the CCAA is to restructure the failing company in a way that is fair to all stakeholders, the Province's lawyer said. Companies and their subsidiaries can make any arrangement they want but it is the duty of the courts to look at the substance of the issue. A simple test is: Did the agreements the parent and subsidiary entered into result in the parent benefiting primarily from repayments and interest or from residual payments? The first indicates debt, the second indicates equity.

Both sides carried on all day giving their logic and the judge asked many questions for clarification and to challenge some of the arguments. He said at the end of the day it will take a week or two for him to release his decision.

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