

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MAINE**

In re:

MONTREAL MAINE & ATLANTIC
RAILWAY, LTD.

Debtor.

Bk. No. 13-10670

Chapter 11

**CHAPTER 11 TRUSTEE'S MOTION FOR ORDER APPROVING
COMPROMISE AND SETTLEMENT WITH IRVING PAPER LIMITED,
IRVING PULP & PAPER, LIMITED, AND J. D. IRVING, LIMITED**

Robert J. Keach, the chapter 11 trustee in the above-captioned chapter 11 case, moves this Court for an order, pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure, approving a compromise and settlement with Irving Paper Limited, Irving Pulp & Paper, Limited, and J. D. Irving, Limited (collectively, “the Irving Entities”) and affiliates of the Irving Entities (together with the Irving Entities, the “Irving Companies”) on the terms set forth in this motion. The compromise and settlement resolves a dispute between the chapter 11 trustee and the Irving Companies concerning the trustee’s attempts to recover money from the Irving Entities pursuant to the applicable sections of chapter 5 of the Bankruptcy Code. The chapter 11 trustee believes, in the exercise of his sound business judgment, that approval of the compromise and settlement is in the best interest of the estate of Montreal Maine & Atlantic Railway, Ltd. In further support of this motion, the movant states as follows:

JURISDICTION, VENUE, AND STATUTORY BASIS

1. The District Court has original but not exclusive jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334(b). Pursuant to 28 U.S.C. § 157 and Rule 83.6 of the District Court’s local rules, the District Court has authority to refer and has referred this chapter 11 case to the Bankruptcy Court.

2. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2) and the Bankruptcy Court has constitutional authority to enter final judgment in this proceeding.

3. Venue over this chapter 11 case is proper in this district pursuant to 28 U.S.C. § 1408, and venue over this proceeding is proper in this district pursuant to 28 U.S.C. § 1409.

4. The relief sought in this motion is predicated upon Rule 9019 of the Federal Rules of Bankruptcy Procedure (“Bankruptcy Rules”) and Rules 9013-1 and 9019-1 of the Bankruptcy Court’s local rules.

BACKGROUND

5. On August 7, 2013 (the “Petition Date”), Montreal Maine & Atlantic Railway, Ltd. (“MMA”) filed a voluntary petition for relief under 11 U.S.C. § 101 *et seq.* MMA’s bankruptcy filing was precipitated by the train derailment in Lac-Mégantic, Québec on July 6, 2013 (the “Derailment”). The Derailment set off several massive explosions, destroyed part of downtown Lac-Mégantic, and is presumed to have killed 47 people. The Derailment also precipitated the filing by Montreal Maine & Atlantic Canada Co. (“MMA Canada”), MMA’s subsidiary, under Canada’s *Companies’ Creditors Arrangement Act*.

6. On August 21, 2013, the United States Trustee appointed Robert J. Keach (the “Trustee”) as the chapter 11 trustee pursuant to 11 U.S.C. § 1163.

7. MMA is a Delaware corporation that, since January 2003, has operated in an integrated, international shortline freight railroad system (the “System”) with MMA Canada. MMA and MMA Canada have fully-integrated business operations and accounting, with the MMA collecting most of the generated revenue and transferring to MMA Canada the funds required to pay its expenses.

8. The System has 510 route miles of track in Maine, Vermont and Québec and operates from its head office in Hermon, Maine. The System is a substantial component of the

transportation system of Northern Maine, Northern New England, Québec, and New Brunswick. Prior to the Petition Date, MMA employed approximately 179 people and operated about 15 trains daily.

9. As part of its ordinary course operations, MMA, in conjunction with two railroads affiliated with the Irving Entities, New Brunswick Southern Railway Company Ltd. (“NBSR”) and Maine Northern Railway Company (“MNR” and together with NBSR, the “Irving Railroads”) transport paper, pulp, wood products, and chemicals (the “Irving Freight Shipments”) to and from manufacturing and processing facilities operated by one or more of the Irving Companies. Pursuant to haulage agreements among MMA and the Irving Railroads, MMA regularly receives from and delivers to the Irving Railroads, at interchange points where their respective rail lines connect, rail cars containing Irving Freight Shipments. In accordance with these haulage agreements, MMA bills the Irving Companies for the entire amount of freight charges owing with respect to the Irving Freight Shipments. The Irving Companies contend that MMA is obligated, upon receipt of payment, to remit to the Irving Railroads their share of such charges attributable to the rail services provided by the Irving Railroads in connection with such shipments. The Irving Companies are among MMA’s largest customers and the Trustee contends that, as of August 28, 2013, the Irving Companies owed MMA a past due, outstanding balance of approximately \$885,733 on certain invoices. A true and correct copy of an MMA receivables aging is attached hereto as **Exhibit A**. The highlighted amounts on Exhibit A represent the past due invoices that total the outstanding balance of approximately \$885,733, which the Trustee claims to be due from the Irving Companies.

10. In addition to the interchange of Irving Freight Shipments, MMA and the Irving Railroads interchange freight shipments for third party shippers unrelated to the Irving Companies.

As of August 7, 2013, MMA owed NBSR approximately \$2.3 million and MNR approximately \$144,000 for freight charges earned by NBSR and MNR in connection with interline shipments.

11. On August 30, 2013, the Trustee filed the *Motion for Order Pursuant to 11 U.S.C. § 542(b)* [D.E. 124] (the “Section 542(b) Motion”) to recover the outstanding balance of \$885,733 from the Irving Companies.¹ The Irving Companies raised certain defenses against the Section 542(b) Motion. First, the Irving Companies allege that no money is owed to MMA and therefore nothing can be recovered pursuant to section 542(b). This allegation is based, in part, on a series of assignments effectuated on July 12, July 23, and July 30, 2013, pursuant to which NBSR transferred approximately \$1.3 million of NBSR’s claim against MMA to the Irving Companies. Following those assignments, on July 31, 2013 the Irving Companies setoff approximately \$761,000 of the debt owed by MMA against the amount owed by the Irving Companies to MMA. The Irving Companies contend that section 553(a) does not operate retroactively to limit or disallow a setoff effectuated before the petition date. They also contend that the setoff cannot be avoided pursuant to 11 U.S.C. § 547(b) and cite, in support of that contention, legislative history suggesting a Congressional intent to leave setoffs outside the operation of section 547.

12. Second, the Irving Companies and NBSR contend that the parties had a longstanding agreement and course of dealing that created an implied trust over a substantial portion of the money paid by the Irving Companies to MMA. In short, they contend that payments by the Irving Companies would be made only after MMA agreed to make immediate and concurrent payment of amounts owed by MMA to the Irving Railroads, which included the Irving Railroad’s share of the freight charges attributable to the Irving Freight Shipments. The Irving Companies refer to this as the “cash swap.” The parties do not disagree about the existence

¹ The Section 542(b) Motion also sought relief against Great Northern Paper. That aspect of the Section 542(b) Motion was resolved by a prior order of the Bankruptcy Court, and is not implicated by this motion.

of the “cash swap” as a longstanding practice; there is disagreement about the correct legal conclusion or conclusions to be drawn based on the existence of the “cash swap.”

13. The Trustee believes that NSBR’s transfer of claim to the Irving Companies is precisely the kind of improper setoff contemplated by section 553(a)(2)(B), and that section 547 operates to avoid that setoff. Further, the Trustee believes that because no written trust agreement exists between MMA and the Irving Companies, and because MMA was permitted to comingle the funds paid by the Irving Companies, there can be no implied trust agreement. The Irving Companies contend that a formal trust agreement is not required to create an implied or resulting trust. Moreover, the Irving Companies dispute the Trustee’s contention that MMA was permitted to comingle funds paid by the Irving Companies. They maintain that the agreement for a simultaneous swap of cash was, as a practical matter, intended to prevent the comingling of funds.

14. After the Section 542(b) Motion was filed, the Trustee and the Irving Companies engaged in formal and informal discovery. They also discussed the relative strengths and weaknesses of each party’s claims and defenses. The Irving Companies have indicated that, if the Court were to rule against them on both of their defenses, they would take an appeal.

15. The Trustee and the Irving Companies have reached a compromise and settlement to resolve the Section 542(b) Motion. The terms of that compromise and settlement are as follows:

a. The Irving Companies shall pay (a) \$150,000 to MMA’s estate, which payment shall be made within 2 business days after the entry of an order granting this motion (assuming that such order is not subject to any stay pending appeal); and (b) \$381,000 to MMA’s estate within 2 business days after an order on this motion has become final and non-appealable. The total amount payable to the estate on account of the compromise described herein is \$531,000, which is approximately 60% of the estate’s maximum gross recovery (\$885,000);

b. The Irving Companies’ payment of \$531,000 will be in full and final satisfaction of any and all claims and causes of action arising out of the invoices

attributable to the highlighted amounts on Exhibit A; and the Irving Companies shall be released from any and all liability related to such invoices;

c. The Trustee retains his right to bring any and all causes of action against the Irving Companies with respect to amounts owed by the Irving Companies to MMA that are not covered by the invoices attributable to the highlighted amounts on Exhibit A; and

d. The Irving Companies retain their rights to raise any and all defenses with respect to amounts owed by the Irving Companies to MMA that are not covered by the invoices attributable to the highlighted amounts on Exhibit A.

RELIEF REQUESTED

16. Pursuant to Rule 9019(a), the Trustee requests that the Court: (1) approve the compromise and settlement with the Irving Companies; and (2) approve service of the motion in the manner set forth herein.

BASIS FOR RELIEF

17. Rule 9019(a) provides that “[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.” Fed. R. Bankr. P. 9019(a). This Court has sound discretion to determine whether the proposed compromise is fair and equitable and in the best interest of the bankruptcy estate. *See Jeffrey v. Desmond*, 70 F.3d 183, 185 (1st Cir. 1995). In making this determination, the Court should consider: (i) the probability of success in the litigation of the claim being compromised; (ii) the difficulties, if any, to be encountered in the matter of collection; (iii) the complexity of the litigation involved, and the expense, inconvenience and delay attending it; and (iv) the paramount interest of creditors and a proper deference to their reasonable views. *See id.*, at 184; *In re High Voltage Eng’g Corp.*, 397 B.R. 579, 601 (Bankr. D. Mass. 2008). The *Jeffrey* factors are not, however, exclusive. *See In re Healthco, Int’l, Inc.*, 136 F.3d 45, 50 (1st Cir. 1998). Deference should be given to the trustee’s business judgment if the trustee can demonstrate that the settlement falls within a “range of reasonableness.” *In re Fibercore, Inc.*, 391 B.R. 647, 655 (Bankr D. Mass. 2008).

18. The Trustee believes that the terms of the compromise and settlement are fair and equitable, and that such compromise is in the best interest of MMA's estate. The factors articulated in Jeffrey warrant approval of the compromise and settlement. The Trustee believes he has a reasonable probability of successfully litigating the Section 542(b) Motion, but the Irving Companies have raised novel and nuanced defenses that are, at a minimum, credible. As is the case with all litigation, there is risk that the Trustee might not prevail. The second Jeffrey factor is not applicable to this proceeding, because, upon information and belief, the Irving Companies have sufficient resources to satisfy any judgment that might be entered against them. However, they have indicated an intent to appeal any adverse judgment and, as a result, any actual recovery could be months, if not years, down the road. This would unduly burden the estate with further expense and cause the Trustee to expend time that could otherwise be effectively utilized in managing MMA's operations.

19. In addition, a settlement with the Irving Companies also provides other benefits to the Estate. As mentioned above, MMA has numerous contractual relationships with NBSR and MNR, and the Irving Companies are a large customer of MMA. Given the significance of these relationships and the Irving Companies' expressed interest in acquiring some of MMA's assets or operations, the compromise and settlement represents sound business judgment. Finally, the settlement amount is approximately 60% of the total outstanding balance owed. Because the costs associated with continued litigation would necessarily reduce the recovery realized, the settlement amount falls squarely within the range of reasonableness.

20. Accordingly, the Trustee believes the motion should be granted because the compromise and settlement is in the best interest of MMA's estate.

NOTICE

21. Notice of this motion was served on the following parties on the date and in the manner set forth in the certificate of service: (1) the United States Trustee; (2) MMA's counsel; (3) the non-insider holders of the twenty (20) largest unsecured claims against MMA or, if applicable, the lawyers representing such holders; (4) applicable federal and state taxing authorities; (5) the holders of secured claims against MMA, or if applicable, the lawyers representing such holders; (6) counsel for the Irving Entities; and (7) others who have, as of the date of the motion, entered an appearance and requested service of papers in the chapter 11 case. In light of the nature of the relief requested in the motion, the Trustee requests that the Court approve service of the motion on the parties set forth above.

WHEREFORE, the Trustee requests that the Court enter an Order: (1) granting this motion; (2) approving, pursuant to Bankruptcy Rule 9019, the compromise and settlement; (3) finding that service to the parties and in the manner set forth is appropriate; and (4) granting such other further relief as may be appropriate.

Dated: October 1, 2013

ROBERT J. KEACH,
CHAPTER 11 TRUSTEE OF MONTREAL
MAINE & ATLANTIC RAILWAY, LTD.

By his attorneys:

/s/ Michael A. Fagone
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 Montreal, Maine & Atlantic Railway
 AR Aging Report (Irving Only)
 Run Date: 8/28/2013

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<u>CustomerNo</u>	<u>CustomerName</u>	<u>Total</u>	<u>Current</u>	<u>30 Days</u>	<u>60 Days</u>	<u>90 Days</u>	<u>120 Days</u>
IRVPAPS	IRVING PAPER	\$554,198.07	\$63,446.08	\$181,097.38	\$246,550.88	\$56,849.38	\$6,254.35
IRVPULP	IRVING PULP & PAPER	\$205,489.00	\$0.00	\$60,656.34	\$144,832.66	\$0.00	\$0.00
JDIRSTJ	J D IRVING LTD	\$159,230.85	\$10,628.08	\$71,305.40	\$52,806.54	\$10,446.79	\$14,044.04
MAI5600	MAINE NORTHERN RAILWAY	\$157,494.84	\$46,214.13	\$49,268.14	\$16,999.55	\$12,708.66	\$32,304.36
MNR	MAINE NORTHERN RAILWAY CO.	\$110,811.43	\$50,658.63	\$0.00	\$0.00	\$41,969.30	\$18,183.50
IRVPULP	IRVING PULP & PAPER	\$40,889.28	\$0.00	\$4,054.50	\$12,163.50	\$24,671.28	\$0.00
IRVOILS	IRVING OIL COMMERCIAL GP	\$3,138.75	\$147.25	\$1,038.50	\$1,116.00	\$837.00	\$0.00
NEW0651	NEW BRUNSWICK SO. RWY - C/R	\$725.60	\$22.12	\$0.00	\$147.30	\$17.14	\$539.04
IRVWOOD	IRVING WOODLANDS LLC	\$200.00	\$0.00	\$0.00	\$0.00	\$0.00	\$200.00
JDIRSTL	J D IRVING LTD	\$25.00	\$0.00	\$0.00	\$0.00	\$0.00	\$25.00
NEW0671	NB SOUTHERN RAILWAY	\$2.97	\$0.00	\$13,800.00	\$8,179.00	\$0.00	-\$21,976.03
10		\$1,232,205.79	\$171,116.29	\$381,220.26	\$482,795.43	\$147,499.55	\$49,574.26