

October 4, 2016

Andrew J. Hatnay
ahatnay@kmlaw.ca

Via Regular Mail

Dear Sir/Madam:

**Re: U.S. Steel Canada Inc. ("USSC")
Representation of Non-USW Active and Retired Employees of USSC in its CCAA
proceedings**

We are writing in our capacity as Representative Counsel to all non-USW employees and retirees of USSC in the CCAA proceedings to provide a status report.

As you are aware, on September 16, 2014, USSC obtained court protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (the "CCAA"). The judge supervising the case is Mr. Justice Wilton-Siegel of the Ontario Superior Court of Justice (Commercial List) (the "CCAA Judge").

The file has been very active. We work very closely on a large number of issues with the following Court-Appointed Representatives to ensure that your interests are represented and protected:

- Frank Dalimonte, active employee and Division Manager, Maintenance, Services and Utilities, LEW;
- Gary Dallin, President of SSPO and former Stelco Manager, Metallurgy & Quality Control, Cold Roll & Coated;
- George Hanson, Vice-President of SSPO and former Stelco Metallurgist, HW Plate & Strip Division;
- Timothy Huxley, former Stelco Vice-President, Corporate Affairs;
- Ron McClure, former Stelco Chief Human Resources Officer;
- William Missen, former Stelco Senior Vice-President, Commercial;
- Pat Mousseau, SSPO Director, PAC Chair, CFP Liaison and former Foreman Mobile Equipment, LESC; and

- Paul Wendling, Secretary of SSPO and former Stelco Superintendent, HW Plate & Strip Division.

Sale and Restructuring/Recapitalization Process (“SARP”)

The primary objective of USSC in its CCAA proceeding is to market itself for sale to find a buyer for the business. It is not proceeding with an internal reorganization or restructuring at this time while it is under CCAA protection.

On April 2, 2015, USSC commenced its first sales process called the “Sale and Restructuring/Recapitalization Process” (“**SARP**”). USSC's parent company, United States Steel Corporation (“**USS**”) who had acquired all of Stelco in 2007 and thereafter took over control of its operations and management, submitted bids in the SARP. USS sought to acquire only some of the assets of USSC. None of the bids by USS were acceptable to all of the major stakeholders of USSC and there were no other tangible bids. The SARP was not successful and USSC terminated this process on October 9, 2015.

In September 2015, the CCAA Judge ordered a Mediation to proceed with all the major stakeholders of USSC and an outside mediator. The Mediation proceeded for several days among the major stakeholders but it did not result in a settlement or an acceptable transaction. Following the Mediation, USS announced that it intended to entirely disengage from USSC and would not be bidding on any USSC assets in the future.

USSC then began to proceed as an independent company while still under CCAA protection. USS remains involved as a party to an agreement that it entered into with USSC after the Mediation to provide "transition" services to USSC while USS disengages its operations and management from USSC. USS also wants the return of funds it says it loaned to USSC after the acquisition of Stelco in 2007 (discussed further below).

The Sales and Investment Solicitation Process

On January 12, 2016, USSC commenced a second sales process, this time called the Sales and Investment Solicitation Process (“**SISP**”). USS was not a bidder in this sales process. The SISP generated many bids by interested purchasers. The SISP has been ongoing for several months and there have been many discussions and negotiations with prospective buyers.

On September 21, 2016 the Province of Ontario announced that a Memorandum of Understanding (“**MOU**”) had been signed with a bidder called Bedrock Industries Group (“**Bedrock**”). The terms of the MOU are currently confidential. We have been provided with the terms of the MOU on a confidential basis, and have met with the Province and Bedrock on numerous occasions.

We have been supportive of this step forward with Bedrock, and we are working with Bedrock and the other stakeholders on the details for a potential transaction with a positive outcome for the employees and retirees of USSC.

The USS Secured Claims Trial

Although USS announced after the Mediation that it is disengaging from USSC, USS is demanding repayment of amounts that it claims that it loaned to USSC in the past to fund USSC operations after USS acquired Stelco. These USS claims were contested by the Province of Ontario, USW, and Representative Counsel on the basis that they were not "loans" but rather USS's investment in its Canadian operations after acquiring Stelco and as such, were in the nature of "equity". If the USS claims are equity, it would mean that USS could only be paid after the claims of all other USSC creditors are paid, including after the claims of employees and retirees.

This issue proceeded to a trial. On February 29, 2016, following an eight day trial before the CCAA Judge, he released his decision finding in favour of USS that the money it advanced were loans, not equity. The USS secured claims are for approximately \$122,471,525 and an unsecured claim of \$1,975,745,038.

We, the Province, and USW have appealed the decision to the Ontario Court of Appeal. The appeal is expected to be heard in the winter or spring of 2017.

The Pension Benefits Act deemed trust priority for pension plan beneficiaries

The USS claim decision described above was limited to the determination of whether the USS claims at issue should be classified as either "debt" or "equity". The issue of the *priority* of future distributions of USSC assets among creditors of USSC was not before the court at the trial and remains to be decided or negotiated.

We have asserted a first priority claim in this proceeding in favour of the USSC registered pension plan beneficiaries based on the statutory deemed trust provisions in the Ontario *Pension Benefits Act* for all amounts that are owing, or will be owing, by USSC to the registered pension plans. We say that based on the *Indalex* case from the Supreme Court of Canada, such amounts are to be paid in priority to any secured claim of USS over certain property of USSC specified in the Ontario *Personal Property Security Act* (section 30(7)) as "an account or inventory and its proceeds".

As a result of the Cash Conservation Order (discussed below), and USSC's suspension of pension contributions, we have estimated that by the end of 2016, based on the regular PBA funding rules which are currently in place, the amount not paid by USSC to the registered pension plans (both Salaried and USW) will be approximately \$213,664,116.

Thus, although the CCAA Judge found that USS claims are debt, not equity, the USS claims are: a) subject to an upcoming appeal before the Ontario Court of Appeal; and, b) subject to our

argument for subordination to the PBA deemed trust priority for pension plan members over the assets of USSC that are "an account or inventory and its proceeds".

The Cash Conservation and Business Preservation Order

In July and August, 2015, USS directed that USSC customer orders planned for production by USSC be instead sent to its steel mills in the United States. The loss of these orders caused immediate and significant financial losses to USSC. USSC and its advisors were unable to stop these transfers.

On September 17, 2015, as a direct consequence of the USS "mill loading incident" , USSC brought a motion before the CCAA Judge entitled the "Cash Conservation and Business Preservation Motion" ("**Cash Conservation Order**") so it could stop making a number of required payments to the pension plans, employee and retiree benefits, and other payment obligations. On October 9, 2015, the Court issued the Cash Conservation Order which allowed USSC to suspend payment of the following:

- a) contributions to USSC's nine registered defined benefit pension plans, other than normal cost contributions, and to the RCA Trust fund that pays certain retirees supplemental pension benefits;
- b) monthly supplementary pension benefits to certain retirees pursuant to unfunded individual retirement benefit contracts and individual retiring allowance contracts;
- c) other post-employment benefits ("**OPEBs**") including retiree health and dental benefits, but not life insurance (see below) to retirees;
- d) salary-continuance payments to terminated USSC employees;
- e) amounts owing to Ontario Pension Benefits Guarantee Fund in respect of assessments; and
- f) municipal taxes.

We negotiated with USSC for two changes to the Cash Conservation Order prior to the order being issued by the CCAA Judge:

- a) USSC agreed to continue to pay life insurance premiums so that the group life insurance policy remains in place for retirees, since these benefits could not be readily reinstated if the group life insurance policy premiums are not paid and the policy lapses; and
- b) the suspension of OPEBs and other employee and retiree benefits is a temporary *suspension*, and not a final *termination* of those benefits.

Motion to the Court to reinstate Health Benefits

In the months following the Cash Conservation Order, and with the assistance of certain Representatives who came forward to support USSC to proceed independently of USS, USSC's cashflow began to improve. Representative Counsel and the USW began discussions with USSC during this past summer to amend the Cash Conservation Order to reinstate Health Benefits.

We first attempted to negotiate a resolution for the reinstatement of Health Benefits. USSC offered a one-time payment of \$2.7 million to be used in a manner similar to the Transition Fund (discussed below). Representative Counsel and the USW requested full reinstatement of Health Benefits until December, 2016, at which time the situation would be reviewed.

The parties were not able to reach a resolution and on August 17, 2016, the USW and Representative Counsel brought a motion before the CCAA Judge to amend the Cash Conservation Order to reinstate Health Benefits. We argued, among other things, that USSC is no longer in the financial position it found itself in at the time of the USS mill loading incident described above, and that it had approximately \$160.1 million cash on hand. Since the Health Benefits only cost approximately \$3.6 million a month to reinstate, we argued that USSC cannot justify that it needs to conserve \$3.6 million per month in order to continue with its activities while under CCAA protection (i.e., the sales process) and therefore Health Benefits should be reinstated. The company and Monitor, as well as USS, forcefully argued against reinstating Health Benefits for the retirees.

On August 19, 2016, the CCAA Judge dismissed our request to reinstate the Health Benefits. On September 12, 2016, the CCAA Judge released his Endorsement (i.e., his reasons) which stated, among other things, that the parties did not meet the legal test that he had developed that there must be a fundamental improvement in the *profitability* of USSC's business since the Cash Conservation Order in order for Health Benefits to be reinstated. His Honour agreed with the recommendation of the Monitor that USSC can make a one-time contribution of \$2.7 million on the same terms as the Transition Fund.

We and the USW have filed motions for leave to appeal the decision of the CCAA Judge to the Ontario Court of Appeal, which are currently pending. We will keep you apprised of these proceedings on our website and toll-free hotline.

Province of Ontario Transition Fund

On December 17, 2015, the Ontario government announced that it had established the Ontario Transition Fund funded with \$3 million of provincial funds to assist retirees of USSC who are impacted by the company's suspension of Health Benefits. The Transition Fund was made available as of January 1, 2016 and consists of two parts:

- a) Drug Benefit Coverage (Tranche 1): to pay for prescription medication costs, limited to a maximum 30 day supply of each prescription drug; Applicants will be able to submit claims for prescriptions directly to Green Shield following the same process used under the Suspended USSC OPEB Plan.

- b) Emergency Coverage (Tranche 2): for urgently required dental and other health services.

Since its creation, the Transition Fund has had a number of updates including:

- a) Expanding to cover prescription drug repeats of 30-days supplies. Meaning that once a member had claimed 30 days' worth of prescriptions they would need to wait a period of time before processing the next prescription. The next claim would be allowed when a plan member is 80 per cent of the way through their current claim (e.g., day 24 of a 30-day claim); and
- b) An additional \$2.7 million was provided by the Ontario government and approved by the CCAA Court on September 6, 2016.

At this time, the other provisions of the Transition Fund remain the same. If you have any questions regarding benefits that are covered by the Transition Fund, please check our firm's website or call our toll-free hotline at 1-866-777-6341.

The Settlement Agreement between USSC, USS and the federal government

When USS sought to purchase Stelco in 2007, it needed to obtain the approval of the federal government under the *Investment Canada Act* ("ICA"). To obtain such approval, USS gave the federal government a number of Undertakings (i.e., promises) setting out commitments it would achieve if the Canadian government approved the acquisition. These Undertakings included production commitments, pension contributions, and employment level promises. Based on the Undertakings, the federal government approved USS's acquisition of Stelco.

Soon after obtaining the approval of the acquisition by the federal government, USS breached the Undertakings.¹ The Canadian government sued USS (the first time the federal government has done so under the ICA) for their breaches of the Undertakings. In 2011, USS, USSC and the federal government settled the litigation and signed a "Settlement Agreement". They also agreed among themselves to keep the Agreement secret.

Shortly after USSC filed for CCAA protection in September 2014, we, the USW, and the City of Hamilton requested a copy of the "Secret Settlement Agreement" from USS, USSC and the federal government so we could review the new obligations of USS, USSC, and the federal government and whether those obligations had been fulfilled. They refused to produce the Agreement, and took the position that the Agreement was confidential under the provisions of the ICA.

¹ For an interesting discussion on USS's acquisition of Stelco, see the recent article in *The Globe & Mail, Report on Business Magazine*, October 2016

We and the USW brought a motion before the CCAA Judge for an order requiring USS, USSC and the federal government to produce the Agreement. The CCAA Judge dismissed the motion based on his interpretation of certain provisions of the ICA, which he held operate to keep the Agreement confidential among the three parties.

We appealed to the Ontario Court of Appeal. On January 26, 2016 the Ontario Court of Appeal released a decision allowing our appeal holding that the Settlement Agreement was not confidential under the provisions of the ICA and that the CCAA Judge had erred in his interpretation. However, instead of ordering the release of the Settlement Agreement to us, the Ontario Court of Appeal directed that the Agreement be released to the CCAA Judge by the Monitor for him to review (who had not seen it), and also ordered that the CCAA Judge determine whether to release the Agreement to us under the law of "settlement privilege", i.e., the law applicable to certain litigation confidential communications.

On April 29, 2016, we and the USW brought another motion before the CCAA Judge for an order to have the Settlement Agreement provided to Representative Counsel and USW on a "counsel eyes only" basis. We brought this motion in order to be in the same position as USS, USSC, and Monitor's counsel as well as now the CCAA Judge, who had at this point all seen the Settlement Agreement, in anticipation of another motion we planned to bring for the production of the Settlement Agreement based on the Court of Appeal's reasons.

On May 4, 2016, the CCAA Judge dismissed this motion finding that he did not have the discretion to grant a "counsel-eyes only" order for the release of the Agreement to us and USW counsel only.

After this, we were provided with written assurances by the federal government and USSC that USS had complied with all the new Undertakings it had agreed to in the Settlement Agreement. We are in discussions with the USW about next steps with respect to the production of the Settlement Agreement.

Next Steps

1. The SISP negotiations and discussions with Bedrock, the Province of Ontario, and other stakeholders are actively ongoing on a confidential basis. Further information about the MOU and a potential transaction will be provided as soon as possible.
2. Employee and retiree pension and benefit claims will need to be resolved based on the results of the negotiations with Bedrock (or any other bidders), which may involve additional processes that have not yet been finalized.

We will continue to provide updates to you as the CCAA proceeding continues, as well as post updates to our firm website for USSC employees and retirees.

You can access our website at www.kmlaw.ca/usscrepcounsel, e-mail at usscrepcounsel@kmlaw.ca, or call our toll-free hotline at 1-866-777-6341 if you have any questions or inquiries.

Yours truly,

KOSKIE MINSKY LLP

A handwritten signature in black ink, appearing to read "AJH", with a long horizontal flourish extending to the right.

Andrew J. Hatnay
AJH:vdI

c Client Committee
Barbara Walancik, James Harnum, Amy Tang, *Koskie Minsky LLP*

Schedule "A" – Pension Benefits Guarantee Fund

We are providing this Schedule in response to common questions that we receive regarding the Pension Benefits Guarantee Fund ("PBGF").

The PBGF is a fund established under the Ontario *Pension Benefits Act*, which provides limited protection, subject to specific maximums and exclusions, to members and beneficiaries of an underfunded privately sponsored single-employer defined benefit pension plan upon wind-up in the event of the plan sponsor's insolvency. The PBGF is exclusive to Ontario and no other province has a similar fund. The PBGF applies to pensions in respect of employment in Ontario only. For example, if a member worked 7 years in Ontario and 2 years in Québec as an employee of Stelco or USSC, the PBGF would only apply to the pension for employment in Ontario.

The PBGF does not guarantee 100% of your pension benefit entitlement. In general, subject to specific maximums and exclusions, the PBGF covers the unfunded portion of the first \$1,000 per month of your monthly pension. Your monthly pension above \$1,000 per month will be paid in accordance with the funded ratio of the Plan.

The following simplified examples demonstrate how the PBGF works for members of an underfunded pension plan on its wind-up. These examples do not take into account the administrative costs associated with the wind-up of a plan. Those costs are typically charged to the fund of the pension plan and thus would ultimately be incurred by the plan members, thus potentially further reducing the monthly pension amount where the plan is underfunded on its wind-up.

EXAMPLE #1:

Joe has a pension benefit entitlement of \$2,000/month. On plan wind-up, it is determined that the pension plan's funded ratio is 80% (i.e. a 20% wind-up solvency deficiency). Therefore, the plan can only pay 80% of the benefit promised or \$1,600/month (i.e. a 20% reduction).

The PBGF applies to Joe's plan. The PBGF guarantees that the unpaid 20% of Joe's first \$1,000 in monthly pension is paid, or an additional \$200 per month. The amounts payable to Joe under the plan and the PBGF would be as follows:

- First \$1,000/month is fully guaranteed (the plan pays \$800/month and the PBGF pays \$200/month) + any monthly pension in excess of \$1,000/month is paid at the plan funded ratio (80% of \$1,000/month = \$800/month)

After the PBGF is applied, Joe's pension benefit entitlement will be **\$1,800/month** (\$1,600/month from the plan + \$200/month PBGF supplement).

In summary, the PBGF fund would cover the 20% loss on the first \$1,000/month, which amounts to only \$200/month; the remaining \$200/month in lost pension income is not covered. The net result is a pension benefit of \$1,800 per month.

EXAMPLE #2:

Jane has a pension benefit entitlement of \$1,000/month. On plan wind-up, it is determined that the pension plan's funded ratio is 70%. Therefore, the plan can only pay 70% of the benefit promised or \$700/month.

The PBGF applies to Jane's plan. The PBGF guarantees that the unpaid 30% of Jane's first \$1,000 in monthly pension is paid. After the PBGF is applied, Jane's pension benefit entitlement will be **\$1,000/month** (the plan pays \$700/month and the PBGF pays \$300/month).