

CANADA
PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL
NO: 500-11038474-108

S U P E R I O R C O U R T
Commercial Division
*Designated tribunal under the
Companies' Creditors Arrangement Act¹*

IN THE MATTER OF THE PROPOSED
PLAN OF COMPROMISE AND
ARRANGEMENT OF WHITE BIRCH
PAPER HOLDING COMPANY AND
VARIOUS SUBSIDIARIES AND
AFFILIATES

DEBTORS

- and -

ERNST & YOUNG INC.

MONITOR

REPORT OF THE MONITOR – SEPTEMBER 27, 2011

INTRODUCTION AND BACKGROUND

1. On February 24, 2010, on a Motion made by White Birch Paper Holding Company (“**White Birch**”) and various of its affiliates (collectively referred to as the “**Applicants**”), the Superior Court of the Province of Québec for the District of Montréal (“**Court**”), sitting as the designated tribunal pursuant to the *Companies' Creditors Arrangement Act* (“**CCAA**”)¹ issued an order (“**Initial Order**”) declaring that the Applicants are debtor companies to which the CCAA applies, appointing Ernst & Young Inc. (“**EYI**” or “**Monitor**”) as monitor and granting certain relief to the Applicants and various partnerships in which the Applicants have an interest (“**Partnerships**”) (the Applicants and the Partnerships are hereinafter referred to collectively as “**WB Canada**”)². The Initial Order has since been extended and is now scheduled to expire on November 18, 2011.
2. Also on February 24, 2010, Bear Island Paper Company, LLC (“**Bear Island**”), a subsidiary of White Birch with activities in the U.S., commenced a case under the provisions of Chapter 11 of the U.S. *Bankruptcy Code*³ (the “**Code**”) (Bear Island and WB Canada are hereinafter referred to collectively as “**WB Group**” or “**Companies**”). The information regarding the proceedings initiated by Bear Island under the Code, together with the “first day orders” made by the

¹ *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

² The entities subject to the Initial Order are White Birch Paper Holding Company, White Birch Paper Company, Stadacona General Partner Inc., Black Spruce Paper Inc., F.F. Soucy General Partner Inc., 3120772 Nova Scotia Company, Arrimage De Gros Cacouna Inc., Papier Masson Ltée., Stadacona Limited Partnership, F.F. Soucy Limited Partnership, and F.F. Soucy, Inc. & Partners, Limited Partnership.

³ *U.S. Code*, title 11, chapter 11.

Bankruptcy Court for the Eastern District of Virginia, Richmond Division (“US Court”) at the request of Bear Island, can be found on the website of the claims agent retained by Bear Island, Garden City Group, Inc., at www.gardencitygroup.com/cases/bip.

3. Also on February 24, 2010, some of the entities within WB Canada⁴ applied for relief under the provisions of Chapter 15 of the Code. On February 26, 2010, the U.S. Court issued a temporary restraining order under the provisions of Chapter 15 of the Code, and on March 5, 2010, it granted a preliminary injunction, pending a more complete hearing to be held on March 22, 2010. At the hearing held on March 22, 2010, the U.S. Court granted recognition of the Canadian proceedings under the CCAA as foreign main proceedings, recognised White Birch Paper Company as the duly appointed foreign representative, declared that all of the provisions of section 1520 of the Code apply to the proceedings initiated by some of the entities within WB Canada, and gave full force and effect to the Initial Order⁵ in the U.S., provided that the Initial Order⁵ is not revoked, terminated or expired.
4. The orders granted by this Court and by the U.S. Court (collectively, the “Courts”), together with the relief provided under the CCAA and the Code⁶ (collectively the “Orders”) provide, among other things, for a stay of proceedings against the entities comprising WB Group while they restructure their business and financial affairs.
5. The present report is intended to provide the Court with information on the progress of WB Group’s restructuring efforts. This report is presented under the following headings:
 - 5.1. Introduction and background;
 - 5.2. Terms of reference and disclaimer;
 - 5.3. Status of Proceedings in Canada;
 - 5.4. Status of Proceedings in the U.S.; and
 - 5.5. Overall comments and recommendations.

TERMS OF REFERENCE AND DISCLAIMER

6. In preparing this report, EYI has relied upon unaudited financial information, company records, company prepared financial information and projections, discussions with management and employees of WB Group, and information from various other sources.

While we reviewed various documents and believe that the information therein provides a fair summary of the transactions as presented to us or as reflected in the documents presented to us, such work does not constitute an audit or verification of such information for accuracy,

⁴ The entities which requested relief under Chapter 15 of the Code are White Birch Paper Company, Stadacona General Partner Inc., Papier Masson Ltée., Stadacona Limited Partnership, F.F. Soucy Limited Partnership, and F.F. Soucy, Inc. & Partners, Limited Partnership.

⁵ As amended, modified or extended from time to time by the Court.

⁶ Sections §361 and §362 of the U.S. *Bankruptcy Code*.

completeness, or compliance with generally accepted accounting principles. Accordingly, EYI expresses no opinion or other form of assurance in respect of such information.

Some of the information used in preparing this report consists of financial projections. We caution the reader that these projections are based upon assumptions about future events and conditions that are not ascertainable, and that the actual results may vary from the projections, even if the assumptions materialize, and the variations could be significant.

In the course of our mandate, we have assumed the integrity and truthfulness of the information and explanations presented to us, within the context in which it was presented. To date, nothing has come to our attention which would cause us to question the reasonableness of this assumption.

Finally, we have requested that management bring to our attention any significant matters which were not addressed in the course of our specific inquiries. Accordingly, this report is based solely on the information (financial or otherwise) made available to us.

This report has been prepared for the use of this Court and WB Group's stakeholders as general information relating to the entities comprising WB Group and their operations. Accordingly, the reader is cautioned that this report may not be appropriate for any other purpose. We will not assume responsibility or liability for losses incurred by the reader as a result of the circulation, publication, reproduction or use of this report contrary to the provisions of this paragraph.

7. Terms not otherwise defined herein shall have the meaning ascribed to them in the Initial Order, or in previous reports of the Monitor, as the case may be.

STATUS OF PROCEEDINGS IN CANADA

8. The Initial Order was made on February 24, 2010 and was extended on several occasions since that date. The most recent order of the Court extending the Initial Order was made on August 22, 2011, and grants an extension until November 18, 2011.
9. As mentioned in the most recent reports of the Monitor⁷, the Companies' restructuring activities, at this stage, continue to be focused on the sale process, as the Companies are preparing for the closing of the transaction that was approved by the Court by order made on September 28, 2010⁸, which transaction contemplates the sale of substantially all of the Companies' assets and undertakings to BD White Birch Investments Inc. and certain of its subsidiaries ("BDWBI").
10. The conditions to closing have not yet been fulfilled. We understand from our discussions with Management and counsel for BDWBI that negotiations have taken place with the union representing the employees, but that an agreement has not yet been reached on the terms of a new collective bargaining agreement. We understand that the main hurdle is still the issue of the pension benefits on a going forward basis.

⁷ Reports of the Monitor dated December 7, 2010, February 18, May 9 and August 17, 2011, each addressing requests by the Companies for an extension of the delay to file a plan of arrangement.

⁸ A motion for permission to appeal from this judgment was filed on October 15, 2010, and the Court of Appeal denied permission to appeal by judgment rendered on October 25, 2010.

11. Based on the information provided to the Monitor, a negotiation session was scheduled to commence in the week of September 6 to 9, 2011. This meeting occurred, although the issues have not yet been resolved. At the request of the Companies, a conciliator was appointed by the government, to facilitate the negotiations. The negotiations were apparently suspended by the conciliator, who requested that a technical committee be formed to analyse the issues separating the parties and make recommendations to the conciliator. The report of the technical committee is expected around the end of September 2011. No schedule has yet been set to recommence the negotiations, although the Monitor expects these will recommence shortly after the report of the technical committee is available.

STATUS OF PROCEEDINGS IN THE U.S.

12. As indicated earlier in this report, Bear Island commenced a case under the provisions of Chapter 11 of the Code on February 24, 2010. The exclusivity period provided for under the Code⁹, during which a debtor has the exclusive right to file a plan, has been extended on several occasions, but was scheduled to expire on August 24, 2011.
13. In view of the impending expiry of the exclusivity period, Bear Island has prepared and filed a plan and a draft disclosure statement.
14. A hearing is scheduled for October 5, 2011 in the US Court, to consider the proposed disclosure statement and assess whether or not it constitutes adequate disclosure¹⁰.
15. The plan filed by Bear Island is essentially a liquidation plan that is conditional upon the occurrence of a closing of a transaction with BDWBI. The plan and draft disclosure statement contemplate essentially a pro rata distribution amongst creditors of a fund (“**Fund**”) comprised of the proceeds of the sale to BDWBI that are allocated to Bear Island; proceeds of the settlement or prosecution of causes of action for fraudulent preferences, void or voidable transactions; and proceeds from the disposition of any remaining asset during the wind down of the activities of Bear Island.

It should be noted that the plan contemplates that WB Canada will share in the distribution of the proceeds of the Fund, based on an admitted intercompany claim of approximately US\$136M, representing 17.6% of the scheduled claims.

16. While the plan and the draft disclosure statement provide for a distribution from the Fund, the plan and the draft disclosure statement as filed do not indicate what would be the allocation of the proceeds of the sale to BDWBI, as between Bear Island and WB Canada.

⁹ U.S. Code, title 11, chapter 11, U.S. Code, title 11, chapter 11, §1121(b).

¹⁰ U.S. Code, title 11, chapter 11, U.S. Code, title 11, chapter 11, §1125(b).

17. During the period from the filing of the plan and draft disclosure statement, on August 24, 2011, to September 22, 2011, representatives of the Companies have consulted with the Monitor in an attempt to develop an appropriate basis of allocation of the proceeds of the sale to BDWBI between Bear Island and WB Canada. The Monitor understands that parallel consultations were held also with a number of other stakeholders, such as the Official Unsecured Creditors' Committee ("UCC"), BDWBI and the First Term Loan¹¹ lenders, although the Monitor has not been invited and has not taken part in these discussions.
18. In the course of the discussions with the Monitor, several different models of allocation have been explored, which yield a wide range of different results. Depending upon the formula used to allocate assets and the principles adopted to allocate the responsibility for the repayment of the Interim Financing facility, the results of the allocation models yielded a greater allocation to Bear Island in some cases, and a greater allocation to WB Canada in other cases, by a wide margin. The main factors influencing the allocation are summarized below:
 - 18.1. Whether the allocation for the assets sold is based on a standard formula derived from the historical breakdown in working capital (current assets minus assumed current liabilities) as between Bear Island and WB Canada, or on the actual break down in working capital on a set date. In the past, the break down in working capital has been approximately 20% for Bear Island and 80% for WB Canada, although more recently the break down has been in the range of 10% to 15% for Bear Island and 85% to 90% for WB Canada.
 - 18.2. The manner in which the responsibility for the repayment of the Interim Financing facility is allocated between the co-borrowers, namely Bear Island and certain entities comprising WB Canada. At the time the Interim Financing facility was negotiated, the Companies' cash flow forecasts suggested that a portion of the borrowings would be necessary for Bear Island and a portion for WB Canada, and the aggregate requirements were built into the Interim Financing Credit Facility. In fact, the drawings under the Interim Financing facility were all made by WB Canada, although the Interim Financing facility was necessary for all entities within WB Group in order to provide the required degree of confidence to the trade suppliers that the Companies had the necessary resources to pay for the merchandise supplied and services rendered after the commencement of the restructuring proceedings.

Depending on the perspective, an argument can be made that the responsibility for the repayment of the Interim Financing facility lies with the entities that made the draws under the credit facility. Another argument can be made that the responsibility for the repayment should be shared amongst all of the entities that benefitted from the availability of funds, since the DIP was negotiated for the benefit of both WB Canada and Bear Island equally, and was necessary to satisfy the creditors of both WB Canada and Bear Island that the Companies had the resources to carry on business.

The difference in approach leads to widely different results.

19. The problem of determining which specific formula to use to allocate the working capital is compounded by the fact that the amount that needs to be allocated is not known with certainty. The amount that will ultimately be available for distribution to the creditors depends upon the

¹¹ As defined in the Monitor's 1st report dated February 23, 2010.

timing of the closing of the transaction with BDWBI, which has not yet been established, and the amount to be distributed will depend on the funds that will be left over, if any, after repayment of the Interim Financing facility. At this juncture, the models of allocation prepared by the Companies for the purpose of completing the disclosure statement and the plan are based on cash flow projections and historical results, and the actual amounts may be different when the residual amounts are calculated at the time of the closing.

20. As mentioned earlier, the basis of allocation had not yet been disclosed, as of the date of drafting of this report, notwithstanding the fact that the hearing on the adequacy of the disclosure statement is scheduled for October 5, 2011. The Monitor has been informed that the disclosure statement will be amended to reflect a range of values based on various allocation alternatives, and that Bear Island will not seek an approval by the US Court of any definitive allocation but rather will suggest that the Companies and the creditors continue to seek a consensual allocation, with such an allocation being subject to the approval of the US Court at the latest at the hearing to confirm a plan¹².

Based on the most recent information made available to the Monitor, which is still subject to adjustment, the range in values could provide an allocation of net proceeds to WB Canada that varies between US\$23.4 million and US\$0.5 million, or an allocation of between 88.5% and 1.8% of the funds estimated to be available for distribution to the unsecured creditors.

21. The Monitor is concerned that the First Term Loan lenders and the UCC may favour an allocation methodology that results in an allocation that favours the estate of Bear Island, and thus prejudices the rights of creditors with claims against WB Canada.

The Monitor understands that the First Term Loan lenders consist in large part of the purchaser for the assets of the Companies or companies or entities related to the purchaser, and that an allocation that favours Bear Island as compared with WB Canada would benefit primarily the First Term Loan lenders, at the expense of the other creditors that have filed claims in the proceedings in Canada.

22. The Monitor considers it would be necessary to ensure that stakeholders in Canada are given an opportunity to express their views on the proposed allocation if a consensual allocation formula is to be devised, and that the allocation of proceeds to each respective estate is made after a joint hearing in which the views of the interested stakeholders from Canada and the U.S can be expressed, if a consensual allocation cannot be reached.

OVERALL COMMENTS AND RECOMMENDATIONS

23. As mentioned above, Bear Island will seek approval of its disclosure statement, at a hearing scheduled to be held on October 5, 2011. The Monitor has been informed that Bear Island will not seek a definitive approval of any allocation, but rather will suggest that the discussions continue amongst stakeholders with a view to arrive at a consensual basis of allocation, with such an allocation being subject to the approval of the US Court at the latest at the hearing to confirm a plan.

¹² U.S. Code, title 11, chapter 11, U.S. Code, title 11, chapter 11, §1128 and §1129

24. Although there is no urgency to resolve the issue of allocation at this time, the Monitor considers it would be appropriate to ensure that the proposed allocation is discussed in a context where the views of Canadian stakeholders can be expressed in order to arrive at a consensual allocation formula.
25. In the event that it becomes impossible to develop a consensual allocation formula, the Monitor considers it would be preferable to debate the allocation in a context of a joint hearing between the Court and the U.S. Court, in order to avoid, if at all possible, conflicting outcomes between the decisions of the US Court and those of this Court with respect to the proper manner in which the proceeds from the sale transaction with BDWBI are distributed amongst WB Canada and Bear Island and the repayment of the Interim Financing facility is assumed by WB Canada and Bear Island.

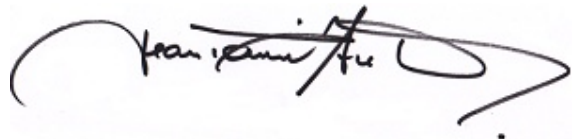
All of which is respectfully submitted this 27th day of September 2011.

ERNST & YOUNG INC.

In its capacity as the monitor appointed by the Court
in the matter of the proposed compromise and
arrangement of White Birch Paper Holding Company *et al.*

A handwritten signature in black ink, appearing to read 'M. Rosenthal', written over a light blue rectangular background.

Per: Martin P. Rosenthal, CA, CIRP
Senior Vice-President

A handwritten signature in black ink, appearing to read 'Jean-Daniel Breton', written over a light blue rectangular background.

Per: Jean-Daniel Breton, CA, CIRP
Senior Vice-President