Court File No. CV-11-9367-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N :

INTERNATIONAL FOREST PRODUCTS CORPORATION

Applicant

\- and -

ST. MARYS PAPER CORP.

Respondent

APPLICATION UNDER SUBSECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c.B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, C. C.43, AS AMENDED

RESPONDING MOTION RECORD

(Motion Returnable October 7, 2011)

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TAB 1

Court file no. CV-11-9367-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

INTERNATIONAL FOREST PRODUCTS CORPORATION

APPLICANT

and

ST. MARYS PAPER CORP.

RESPONDENT

AFFIDAVIT OF GORDON P. ACTON

I, Gordon P. Acton, of the City of Sault Ste. Marie, in the District of Algoma, make oath and say as follows:

1) I am the President of St. Marys Paper Corp. (hereinafter referred to as "SMPC") and as such have personal information of the matters hereinafter deposed to except where stated to be based on information and belief.

2) SMPC is a specialty paper producer located in the City of Sault Ste. Marie, District of Algoma. It is one of the area's major employers with 1000 direct and indirect jobs relying on the operation of the Paper Mill itself. While the Mill has been closed since March of 2011, the bulk of the employees are willing, ready and able to return to work, continue to receive vacation pay and have not given up recall rights.

3) A major asset of the SMPC is as the sponsor, prime investor, and steam host of a Co-Generation Facility ("Co-Gen") project to be built on SMPC land immediately adjacent to the paper mill, which will produce steam for use in the papermill, and electricity which will be sold to the Ontario Power Authority pursuant to the terms of a ten year Power Purchase Agreement that has been successfully negotiated and executed. The Power Purchase Agreement is attached hereto as **Exhibit "A"**. This will create 400 direct jobs during the $150,000,000.00 (One-Hundred and fifty million dollar) construction project, and 150 full time jobs during the Co Gen's operation. The commissioning of Co-Gen is expected to take place in April of 2014. Presently SMPC has a commitment of a $25 million dollar grant, and a $25 million dollar subordinated loan guarantee from the Province of Ontario, and an additional $25 million from an experienced and financially capable diversified energy company with experience in co gen projects who wishes to partner with SMP on the co gen project. The co gen project has been discussed with several institutional and chartered bank lenders, and is a project which is such lenders are prepared to provide the required 75 million debt financing.

4) As such, the SMPC operation has a significant impact on the Sault Ste. Marie economy and the prejudice of IFP's actions will be felt by the company and the community the whole.

5) The value of the security held by IFP is significantly higher than the debt owed to IFP. The value of the collateral is not declining but rather is increasing and as such

IFP's position on their debt is secure. But for the fact that IFP has actively cut-off all business revenue of SMPC, there would be no financial crisis at the Mill. I will discuss the following issues in more detail below.

6) It is critical to realize that the actions of IFP jeopardize the Power Purchase Agreement that we have negotiated with the Province and threaten to overturn a quarter billion dollar revenue stream for the area to cover a debt that is likely less than $5,000,000.00 (5 million dollars).

7) The assets of SMPC are significantly understated in the IFP material.

8) The assets are made up of three (3) main categories:

1) Real Property;

2) Inventory, Equipment and other Chattels;

3) Co-generation Project/Power Purchase Agreement;

9) The current ownership group purchased the subject property from a Bankruptcy Trustee, RMS Richter on July 9, 2007. A copy of the asset purchase agreement is attached hereto as **Exhibit "B"**. The purchase price for the subject mill was $9,283,000.

Real Property

10) The subject site is improved with a complex of 36 major interconnected Mill

structures. Complex totals the sum of 515,307 square feet. The structures are generally steel framed industrial buildings of various sizes and heights enclosing the ground wood pulping and paper making operation.

11) The Assessment Review Board has recently ruled that the value of the real property of SMPC is $3,280,000.00. Copies of the decisions in this regard are attached hereto as **Exhibit "C".**

12) The property is located in Sault Ste. Marie immediately adjacent to other industrial users such as Essar Steel Algoma Inc. and Tenaris Algoma Tubes. The real property is located on approximately 35 acres in the heart of Sault Ste. Marie with access to water, rail transportation, the International Bridge to Sault Ste. Marie Michigan and the Trans Canada Highway.

13) There are no reasons to expect a significant change in the value of the property as a Super Calendar Paper Mill over the foreseeable future.

Inventory and Equipment

14) The Mill operation houses three paper making machines, various super calendar machines, winders, re-winders and associated equipment. They are made primarily of ferrous and non-ferrous metals and in a worst case liquidation scenario could be sold for the metal scrap value.

15) At the time of the purchase by the current ownership group, a valuation of the equipment had been prepared by Gordon Brothers who estimated that the equipment, on June 22, 2006 was worth between $4,598,439.00 and $9,181,850.00. This report did not include the following assets in the valuation:

> The appraisal does not include a valuation of the raw materials, work-in-process, or finished goods inventories. GBG has been retained to conduct an appraisal of the inventory, but those results are reported in a separate appraisal report. The value of purchased repair parts or replacement parts has not been considered. No product line-dedicated tooling or computer software is valued in this report.

The scrap value of the plant, therefore, is higher than reported in the Gordon Brothers' report.

16) During the sale, the mill underwent a competitive bid process which resulted in a number of scrap bids for the equipment. Attached hereto as **Exhibit "D"** is the summary of bids received by RMS Richter.

17) As can be seen from the summary, the Danbury group made a scrap bid of $8,750,000 to liquidate the equipment in the mill which SMPC believes is the best evidence of the scrap value of the machinery and equipment as at May 7, 2007. This establishes the scrap value of the metal at SMPC in the amount of $8,750,000.00.

18) In the Danbury bid, the bidder intended to scrap out the facility for a profit after purchasing it and paying out all labour, material and transportation costs to realize and income from the scrap metal.

19) I have investigated the price for scrap metal by contacting Essar Steel Algoma Inc., a local integrated steel making facility and purchaser of scrap metal. I am informed by Edward Bumbacco, General Manager of Purchasing at Essar Steel Algoma Inc., and verily believe it to be true that scrap prices paid by Essar were on average $232 per ton in 2007 and have averaged $366 per ton in 2011, YTD. This represents an increase of 57%.

20) The market price for ferrous scrap metal has risen more than 50% since May of 2007. This market price has been driven by the Essar Steel Algoma facility located immediately west of the SMPC facility. Based on this information, the 2011 market value for the scrap located at SMPC would be in excess of $13,700,000.00 to a scrap dealer still enabling that firm to make a profit. It may be possible to sell the scrap at a higher value directly to Essar Steel Algoma.

21) The scrap value of the facility does not degrade over time and is not dependent upon the paper market. It is only subject to the market price of scrap metal and not any changes to the assets themselves. This is important to understand in considering that it is not accurate for IFP to state that the value of their collateral in the equipment is decreasing. This will not depend on whether or not the facility operates nor whether or not the equipment is winterized.

Inventory

22) Two internal documents related to inventory are attached hereto as **Exhibits "E"**

and "F". The most recent document shows the spare parts inventory and demonstrates the book value of the spare parts located at SMPC. The book value was adjusted because of the 2007 bankruptcy and purchase. But the estimated potential liquidation value is shown for this inventory at $2,916,902.00. This would be in addition to the scrap prices obtained for the machinery and equipment.

23) Exhibit "F" being the second internal document shows the recent major capital projects that are completed and have been installed in the Mill, totaling some $180,000,000.00. This demonstrates that there are components of the Mill that could be sold for far in excess of the scrap value of the metal. For example, the quality control systems shown on the project listing are the latest Honeywell Da Vinci Platforms which are still the standard today.

24) In addition to the onsite assets, SMPC owns 60% of a remote tourism business called Ontario Wilderness Vacations as well as a 22,000.00 square foot off site warehouse. The market value of these two assets is in excess of $1,000,000.00.

25) It appears based on the foregoing that the assets over which IFP has security have a present market value in excess of $19,000,000.00. As such even if the debt to IFP were as stated which is not admitted but denied there is more than ample value to secure the debt.

Co-Generation Facility

26) When the present ownership group purchased SMPC, it was the collective vision to run the facility not only as a manufacture of super calendar paper but to establish a

Co-Generation Facility with the Paper Mill.

27) In short, the Co-Generation Facility would generate electricity using wood waste from the Paper Mill to produce electricity and steam. The electricity would be sold into in the Provincial Power Grid and the steam would be used for the paper making process. This is referred to as a combined heat and power Co-Generation Facility.

28) In furtherance of this plan, Shareholders of SMPC have established a sister company called St. Marys Renewable Energy Corp. ("SMREC") and have successfully negotiated a Power Purchase Agreement with the Ontario Power Authority in the form attached hereto. This document is the necessary permission to construct and attach the Co-Generation Facility to the Ontario Power Grid and commits the Ontario Power Authority to purchase power from the Co-Generation Facility at a set, and financially lucrative rate for a minimum of ten (10) years. This project is set to generate free cash flow of $250,000,000.00 per year of operation and has a net present value of the project in excess of $25,000,000.00 presently.

29) The negative impact on this asset of a receivership will be discussed below.

Risk that Value of Collateral will Reduced over Short Term

30) The value of the collateral held by IFP will not decrease over the short term.

31) The Mill is currently in a warm idle and can be restarted at anytime within four (4)

to six (6) weeks.

32) There is no reason to believe that the value of the real property or improvements will change substantial. There is no danger to the owner's title to the buildings nor to the buildings themselves. This is especially true due to the fact as the Mill is not in operation there is limited access to the facility by personnel and therefore, limited opportunity for any substantial damage to the property. The security staff remain on site and accordingly, there is no danger to the value of the real property or improvements.

33) I have contacted Essar Steel Algoma, a steel producer located in Sault Ste. Marie adjacent to SMPC. I am informed by Edward Bumbacco, General Management of Purchasing for Essar Steel Algoma Inc. and verily believe it to be true that Essar Steel was paying $232.00 per ton of scrap metal in 2007 and in 2011 year to date is averaging $366.00 per ton, an increase of 57%.

34) Scrap value of the equipment is increasing. This change has been marketed since 2007 when the current ownership group purchased the property and continues to increase at present. As such, the value of the equipment from a scrap point of view continues to increase.

35) The scrap value of the equipment is not dependent on any factors apart from the market value for scrap metal and as such, an activity at the Mill plays no role in the value of the equipment as scrap metal. Accordingly, there is no danger that this

component of IFP's collateral will decrease in value over the short term. To the contrary, the collateral appears to be increasing in value.

Value of SMPC Product Held by IFP

36) The latest information of SMPC is that IFP is holding 2,512 tons of paper produced by SMPC prior to the March 2011 shut down.

37) The current prevailing price for 33 lbs. Super Calendar paper is $812.00 per ton. This would mean the value of the inventory held by IFP is presently $2,039,744.00.

38) When IFP ordered this paper they valued the product at $700.00 per ton and paid SMPC 50% of that value. This amounts to $879,200.00. Accordingly, the value of the unsold inventory to SMPC is $1,160,544.00 minus financing costs.

39) This amount cannot be accurately calculated due to the fact that IFP has refused to produce accurate sales information about this inventory to SMPC.

40) There is demand for Super Calendar paper at the prevailing price as documented by RISI on a daily basis.

41) The failure to sell this inventory and continue the revenue stream to SMPC is choking off SMPC's ability to survive as a business and is a clear failure of IFP to follow its contractual obligations and its obligation to mitigate its losses.

42) Additionally, the value of Super Calendar paper is directly related to its brightness. The paper yellows with age; which means that the longer IFP holds the

paper in its inventory, the less its value will be on eventual sale.

43) IFP also charges SMPC storage costs which continue to mount on the unsold inventory.

44) It is not commercially reasonable for IFP to store this paper and to fail to sell it at the prevailing price currently reported by RISI.

Negative Effects Of A Receivership On The Co-Generation Project

45) A Receivership would be a breach of the Power Purchase Agreement and would kill the Co-Generation Project eliminating a $150,000,000.00 project in Algoma District and 150 direct jobs to be created by the Co-Generation Facility. It is the company's understanding that if the Power Purchase Agreement was breached, negotiations would have to start over. We believe that it would not be possible to renegotiate another Power Purchase Agreement on similar terms.

46) Additionally, the survival of St. Mary's Paper Corporation would be terminated due to the loss of its major asset, a fundamental component of a modern fiber industry business.

Loss Of Provincial Funding For Co-Gen Project

47) The $25 million prosperity fund grant to SMPC for the construction of the co-gen project would be canceled if the receivership process occurs. The Events of Default of the agreement are clear on this issue.

48) Attached hereto as **Exhibit "G"** is a copy of the Prosperity Fund Agreement.

49) Article 8 Events of Default reads:

(e) if the Recipient (i) is dissolved, liquidated or wound up or makes a proposal in writing to be dissolved; (ii) admits in writing its inability generally to pay its debts as they become due; (iii) makes a general assignment, arrangement or composition with or for the benefit of its creditors; (iv) institutes a proceeding seeking a judgment of bankruptcy or a receiving order or an order adjudicating or declaring it to be bankrupt or insolvent or seeking liquidation, winding-up, reorganization, arrangement, adjustment, protection, relief or composition of it or its debt under any law including the Companies Creditors Arrangement Act or the Bankruptcy and Insolvency Act; (v) has a resolution passed for its winding-up, official management or liquidation; (vi) seeks or becomes subject to the appointment of an administrator, liquidator, receiver, receiver-manager, trustee or similar official for it or for all or substantially all its assets; (vii) has a secured party take possession of a substantial or material portion of its assets or has a distress, execution, attachment, sequestration or other legal process levied or enforced on or against a substantial or material part of its assets; (viii) ceases to carry on business; or (ix) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts or events;

(a) if any bankruptcy, reorganization, arrangement or insolvency proceedings for relief under any bankruptcy or similar laws for the relief of debtors, including, without limitation, any of the proceedings or petitions described in subparagraph (e) above are instituted against the Recipient and are consented to by the Recipient or, if contested by the Recipient , are not dismissed within thirty (30) days; and

Loss Of Co-Gen Project

50) The co-gen project requires a host to utilize the Useful Heat Output (15% of the thermal load) of the project.

51) If SMPC is in receivership and is not operating when the project commercial operation date occurs the project price would revert to zero and the project would not operate.

52) The financiers and potential partners for the project will not support the project if

it is in receivership as a result of this clause in the Power Purchase Agreement.

53) Power Purchase Agreement is attached.

PPA, Prosperity Fund And Loan Guarantee Impacts Of Receivership

54) Requirement for the existence and operation of SMP as the Host under the PPA and the Ontario Loan Agreements.

Requirements Under The PPA:

1. Parties to the PPA are St. Mary's Renewable Energy LP who executed the PPA through its general partner St. Mary's Renewable Energy Corp. and the Ontario Power Authority. SMP is not a direct signatory nor party to the Agreement but is referred to in the Agreement as hereinafter described.

2. SMREC LP is the Supplier under the PPA and SMP is the Host under the PPA. The Facility described the Exhibit A has a Host – Developed Project using renewable biomass as its primary fuel. The Facility supplies Useful Heat Output to the adjacent existing Pulp and Paper Mill owned and operated by St. Mary's Paper Corp.

3. The definition of Useful Heat Output (UHO) is on page 25 of the PPA and Minimum UHO Requirement at page 17. When read together with description of Useful Heat Output section 15.7 and the description of the payment of the monthly payment for production of electricity section 3.4 require the Host to be delivered a minimum of 15% of the UHO on an annual basis failing which contract price is reduced by the UHO Price Reduction Factor. If the host is not receiving any thermal load from the supplier during the first three years of commercial operation the price of power would be $0.00 per MW.

4. The Useful Heat Output means thermal energy produced and used for gainful commercial or industrial purpose which is manufacturing or other industrial process as approved by the Buyer where such use...is not a use within the Facility...fuel heating is not a use outside of the Facility for applications such heating rivers, lakes, or the atmosphere ...most be used for a gainful commercial or industrial purpose does not include the use of the thermal energy primarily for generating electricity.

5. The Supplier may restate the Contract Price permitted in accordance with its Proposal. No restatement was contained in the Proposal of SMREC LP. Section 2.11 (a)(i) states a Restatement shall not be permitted if the Proposal

does not specific and incremental Contract Price expressed in the same format.... In any event, a Restatement is not allowed earlier than 3 years from the Commercial Operation Date (see section 2.11(a)(ii)(a).

6. If Restatement is allowed the reduction in the Conduct Price is not reduced by the UHO being less than 15% given that Restatement is usually as a result of the failure of the Host.

7. If the Host Facility (meaning the Facility is owned or operated by the Host that utilizes the Useful Heat Output generated by the Facility) is subject to a Host Facility Force Majeure (definition at page 13) then the Supplier shall promptly notify the Buyer providing particulars and elect whether or not it shall operate the facility to produce electricity during the period of the Host Facility Force Majeure in which case the Supplier shall be paid for delivered electricity in accordance with section 3.4 and operational data for the Facility during the Host Facility Force Majeure shall not be included in the calculation of ...the percentage of energy generated by the Facility attributable to Useful Heat Output sold by the Supplier to the Host Facility and capacity checks do not take into account generated and delivered UHO to the Host Facility (see page 83 clause 11.1(j).

Change Of The Host

8. The Host can be changed from St. Mary's Paper Corp. pursuant to section 2.12(b) which allows that the Host may be sold provided the supplier has provided written notice to the Buyer and the new owner of the Host Facility has agreed in writing to assume the Off Take Agreement.

Change Of Control

9. Control is defined on page 7 of the PPA as "Ownership interests equal to 50% of the votes or have a de facto control. The Supplier shall not permit or allow a Change of Control of the Supplier except with the written consent of the Buyer which consent may not be unreasonable withheld.

10. If the Facility is a Host Facility and the Buyer has **not** been provided a guaranty in the form of Exhibit P the ownership in the Supplier by the Host shall not be less than 30% except with the prior written consent of the Buyer which consent prior to the Commercial Operation Date may be unreasonably withheld and after the Commercial Operation Date may not be unreasonably withheld (note we have not provided a guaranty as per Exhibit P).

11. Withstanding the above section 16.7 states that any change of Control in respect of the Supplier will not be permitted until the 3rd anniversary of the Commercial Operation Date.

Provisions Of The Provincial Loans

12. Pursuant to the Loan Agreement dated the 8th day of December 2010 clause 4.1(h) and section 1.14 of Schedule D SMP will continuously employ not less than 166 full-time employees at its Paper Mill in Sault Ste. Marie, Ontario.

Twenty-Five Million Dollar Grant And Twenty-Five Million Ontario Loan Guaranty

13. In order to obtain the new Minister's signature on the twenty-five million dollar ($25,000,000.00) grant and loan guaranty we expect that the Bureaucrats would insist on a go forward plan consistent with the language in the Provincial Loan Document, to show that at least the 166 full-time workers will be employed at SMP. Product may well change but the necessity to have an industrial entity producing a product I believe is clear.

55) The following expenditures will be required at the mill during the period from today leading up to the receivership hearing.

	Oct 8 - 17, 2011	
$000		
Receipts	0	
Cash Disbursements		
Payroll	34	Manning of gatehouse, environment and asset monitoring, HR Acct'g
Employee Health Tax	2	Priority payable on payroll
Standard Life- pension	12	Priority payable – deducted from wages and company matched
Industrial Alliance – benefits/life	20	Dental/Drug/Life Ins
Bell Canada	2	Main telephone lines
Telus-cell phones/AT&T (US)	3	Cell phones/Blackberries
Public Utility Commission	8	Water/Sewer
Total Cash Disbursements	81	

56) Additionally, we have, as a result of IFP's institution of this application, had to pay legal retainers in the amount of $100,000 to resist the receivership application and preserve the Cogeneration project.

57) At present we have not received the Municipal Tax refund and at present the amount has not been calculated, however it is estimated to be approximately $1,000,000.00 to $1,500,000.00 net of the Solicitor's Lien. Efforts are under way to calculate the amount of that refund. At present MPAC and the City of Sault Ste. Marie have not indicated whether or not they will appeal the decision of the Assessment Review Board. SMPC does not intend to appeal the decision.

58) There is a Solicitors Lien against the municipal tax refund in the amount of $414,892.88 evidenced by an Order of the Superior Court of Justice dated July 7th, 2011 which order is attached hereto as **Exhibit "H"**. These funds will be paid out of the refund before the remainder of the funds will be paid to SMPC.

59) SSMPC continues to keep dialogue open with IFC. SMPC is continuing both to attempt to resolve IFP's concerns and also to provide information about significant ongoing financing efforts necessary to take out IFP as a creditor. The last in a series of letters wherein SMPC has been attempting to resolve matters with IFP is attached hereto as **Exhibit "I"**.

SWORN BEFORE ME)
at the City of Sault Ste. Marie, in the)
District of Algoma, this 6th day of)
October, 2011.

A Commissioner, etc.

GORDON P. ACTON

INTERNATIONAL FOREST PRODUCTS CORPORATION -and- ST. MARYS PAPER CORP.

APPLICANT RESPONDENT

(Short title of proceeding)

Court file no. CV-11-9367-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

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INTERNATIONAL FOREST PRODUCTS CORPORATION and **ST. MARYS PAPER CORP.**
Applicant Respondent

Court File No. CV-11-9367-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at TORONTO

RESPONDING MOTION RECORD

(MOTION RETURNABLE OCTOBER 7, 2011)

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