Court File No. CV-09-8062-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TERRACE BAY PULP INC.

Applicants

FIFTEENTH REPORT OF ERNST & YOUNG INC.

DATED JUNE 27, 2010

INTRODUCTION

1. On March 11, 2009 (the "**Filing Date**"), Terrace Bay Pulp Inc. ("**Terrace Bay**" or the "**Applicant**") filed for and obtained protection from the Ontario Superior Court of Justice (the "**Court**") under the Companies' Creditors Arrangement Act (the "**CCAA**"). Pursuant to the Order made by this Honourable Court dated March 11, 2009 (the "**Initial Order**"), Ernst & Young Inc. ("**EYI**") was appointed as Monitor (the "**Monitor**") in this proceeding (the "**CCAA Proceeding**"). The Initial Order provided a period of time during which proceedings against the Applicant and its property were stayed (the "**Stay Period**"). The initial Stay Period expired on April 10, 2009, but has been extended from time to time, most recently by Order of this Honourable Court made on April 30, 2010. Absent a further extension, the Stay Period will expire on June 30, 2010.

2. On May 31, 2010, this Honourable Court made an Order, (the "**Creditors' Meeting Order**") authorizing and establishing the procedure for creditors of Terrace Bay with Affected Claims to consider and vote on a Plan of Compromise and Arrangement (the "**Plan**", which term as used in this Fifteenth Report means the plan of compromise and arrangement attached to the Information Circular (as defined below), as amended and restated from time to time). Pursuant to the Creditors' Meeting Order, the meeting of creditors to vote on the CCAA Plan (the "**Creditors' Meeting**") was to be held on June

21, 2010. The Creditors' Meeting Order also provided a process to be followed to adjourn the Creditors' Meeting and for the filing of amendments to the Plan.

3. Pursuant to the Creditors' Meeting Order, notice of the Creditors' Meeting, the information circular to which the original Plan (the "**Original Plan**") was appended (the "**Information Circular**") and a proxy form were served on Eligible Voting Creditors (as defined in the Creditors' Meeting Order).

4. As reported in the Fourteenth Report, the Creditors' Meeting was adjourned by the Monitor to the same location and time on June 28, 2010. Since the Fourteenth Report, the Original Plan has been amended in response to issues raised by key stakeholders. The first amended Plan (the "**First Amended and Restated Plan**") is dated June 24, 2010. The second amended Plan (the "**Second Amended and Restated Plan**"), is dated June 25, 2010.

PURPOSE

5. The purpose of this fifteenth report of the Monitor (the "**Fifteenth Report**") is to:

(a) supplement the Fourteenth Report and update this Honourable Court and creditors in relation to the activities of Terrace Bay and the Monitor since the fourteenth report of the Monitor dated June 23, 2010 (the "**Fourteenth Report**") and, in particular, the nature of the amendments to the CCAA Plan made in the First Amended and Restated Plan and the Second Amended and Restated Plan (all of such amendments, collectively, the "**Plan Amendments**");

(a) update this Honourable Court and creditors in relation to certain settlements negotiated with Terrace Bay with certain of its key creditors and the agreements of such creditors to vote in favour of the Plan, as amended; and

(b) report on certain amendments to the Creditors' Meeting Order that are required principally as a result of the Plan Amendments.

TERMS OF REFERENCE

6. In preparing this Fifteenth Report, the Monitor has been provided with, and in making the comments herein it has relied upon, unaudited financial information, Terrace Bay's books and records, financial information prepared by Terrace Bay, and discussions with management of Terrace Bay ("**Management**"). The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information and, accordingly, the Monitor expresses no opinion or other form of assurance in respect of such information contained in this Fifteenth Report. Some of the information referred to in this Fifteenth Report consists of forecasts and projections. An examination or review of the financial forecast and projections, as outlined in the Canadian Institute of Chartered Accountants ("**CICA**") Handbook, has not been performed. Future oriented financial information referred to in this Fifteenth Report was prepared based on Management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, and even if the assumptions materialize, the variations could be significant.

7. The Monitor requested that the Applicant bring to its attention any significant matters which were not addressed during the course of the Monitor's specific inquiries. This Fifteenth Report is based solely on the Information made available to the Monitor by the Applicant.

8. All references to monetary amounts in this Fifteenth Report are in Canadian dollars unless otherwise noted.

9. Capitalized terms not defined in this Fifteenth Report are as defined in the Plan.

THE PLAN AMENDMENTS

10. The principal Plan Amendments are as follows:

    (a) amendments to reflect an agreement with the Township of Terrace Bay (the "**Township**") in relation to realty taxes owing, including the amendment of the

Plan to include a new class of Affected Creditors, the "**Township Class**", comprised of the Township, together with other corresponding amendments;

(b) amendments to the definition of "Excluded Claims" in section 3.3 of the Plan to: (i) include a judicial review application brought by Aroland First Nation, Constance Lake First Nation, Eabametoong First Nation et al. (the "**Matawa First Nations Litigation**"), and (ii) clarify that, where a portion of a Claim arising from a cause of action for which Terrace Bay is covered by insurance, a Claim to the proceeds paid pursuant to such insurance is included in the definition of Excluded Claim as an Excluded Claim; and

(c) amendments to include additional conditions of implementation of the Plan relating to (i) the Township Agreement, (ii) payment in full by the Applicant of the secured claim of Lucky Star Holdings Inc. (the "**Lucky Star Claim**") as provided for in paragraph 3.3(i) of the Plan, and (iii) the Applicant having entered into agreements with certain Persons (the "**CLA Claimants**") who have filed Claims asserted to be secured by a Lien under the *Construction Lien Act* (Ontario) (the "**CLA**"**)** or taken other steps satisfactory to the Applicant to resolve such Claims.

TOWNSHIP AGREEMENT

11. The Applicant is indebted to the Township in the amount of approximately $4,112,940.28 (the "**Tax Arrears**") for municipal realty taxes and interest on the Applicant's Terrace Bay mill property (the "**Property**"). The Monitor has been advised by the Applicant that of this amount, $1,413,643.04 relates to taxes outstanding as of the date of the Initial Order (the "**Pre-Filing Tax Arrears**"). The balance represents taxes that have become due after the date of the Initial Order, which remain unpaid (the "**Post-Filing Tax Amount**") and interest on the outstanding taxes.

12. Neenah Paper Company of Canada ("**Neenah**") and the Applicant filed appeals with the Ontario Assessment Review Board (the "**ARB**") of the assessments of the Property relating to the 2005 and 2006 taxation years. Neenah owned the Property for the 2005 taxation year and a portion of the 2006 taxation year. The Applicant also filed appeals

with the ARB of assessments relating to the 2007 and 2008 taxation years. The parties, including Neenah, entered into minutes of settlement to resolve the appeals several months ago but the implementation of the settlement was delayed by the CCAA Proceeding. The Monitor has been advised by the Applicant that the Township has advised the Applicant that once the assessments are finalized the Applicant will be entitled to a refund of municipal realty taxes for the years 2005, 2006, 2007 and 2008 in the amount of approximately $2,197,349.47 (the "**Tax Refund**") and that the Township will set this amount off against the Tax Arrears. The Monitor has been advised by the Applicant that it estimates that $97,329.50 of the Tax Refund is attributable to the period when Neenah owned the Property. The Monitor has made no independent verification of this calculation. The Applicant proposes to pay this amount to the Monitor to be held in escrow, so that the issues of entitlement between Neenah and the Applicant can be dealt with at a later date.

13. The Applicant requested a mutually agreeable payment plan for the balance owing on the Tax Arrears and additional tax relief. After lengthy negotiations, the Township and the Applicant have negotiated the Township Agreement, which is subject to the Township receiving the approval of the town council at a meeting that the Monitor is advised by the Applicant is scheduled for Tuesday June 29, 2010. The Township Agreement contains the following terms and conditions:

(a) the Township will set off the Tax Refund against the Pre-Filing Tax Arrears, other than $618,304.04 (the "**Tax Relief Amount**"), and thereafter against the post-filing balance of the Tax Arrears leaving a balance outstanding (the "**Deferred Post-Filing Tax Amount**");

(b) the Deferred Post-Filing Tax Amount will be repaid by December 31, 2012 in equal instalments on the regular tax instalment dates, commencing with the first instalment date after the execution of the Township Agreement (the "**First Instalment Date**"). This instalment date will be in October, 2010;

(c) TBPI will pay all current tax instalments on and after the First Instalment Date as they become due;

(d) the amount of the Township's claim for the purposes of the Plan (the "**Township Claim**") will be allowed in the amount of $618,304.04;

(e) the Township will vote in favour of the Plan;

(f) the Applicant will consent to the lifting of the stay of proceedings provided for in the Initial Order to allow for the issuance of final ARB Orders in connection with the 2005, 2006, 2007 and 2008 assessment appeals as soon as possible; and

(g) the Applicant will withdraw its assessment appeals for the 2009 and 2010 taxation years as soon as possible, and will not appeal assessments in connection with the Property for the 2011 and 2012 taxation years provided that the assessment of the Property does not exceed the assessed value for the 2008 taxation year, and then only in relation to any such increase.

14. The Township has advised the Applicant that due to constraints under the Ontario *Municipal Act*, the Township can only provide the proposed tax relief under a CCAA plan. Accordingly, the Plan has been amended to include a provision providing for:

(a) the Township Class; and

(b) the Applicant's obligation to pay the Tax Relief Amount to be cancelled on the date the last instalment of the Deferred Post-Filing Tax Arrears is paid, provided that the Applicant has complied with its obligations under the Township Agreement. If the Applicant is in default of its obligations under the Township Agreement, the Tax Relief Amount and the balance of the Deferred Post-Filing Tax Amount will become immediately payable and all rights and remedies of the Township, including under the *Municipal Act*, may be exercised by the Township.

15. The Plan Amendments, among other things, reflect the addition of the Township Class, the treatment of the Township Claim pursuant to the Plan and corresponding adjustments to definitions, meeting and other provisions of the Plan to reflect and give effect to the Township Agreement and the inclusion of the Township Class in the Plan.

AMENDMENTS TO EXCLUDED CLAIMS

16. The following amendments have been made to the definition of Excluded Claims under the Plan:

(a) Matawa First Nations Litigation - The Plan has been amended to classify any Claim relating to the Matawa First Nations Litigation to be an Excluded Claim. This Claim relates to a judicial review application (the "**JRA**") that remains ongoing against Terrace Bay and other respondents relating to certain sustainable forest licenses transferred to Terrace Bay. On October 16, 2009 this Honourable Court permitted the stay of proceedings to be lifted to extend the date by which the moving parties in the JRA have to perfect the JRA to December 31, 2010. On December 15, 2009, a further Order was made in the JRA proceeding, extending the time for perfection of the JRA to December 31, 2010. In the Notice of Motion filed in connection with the motion to extend the time to perfect the JRA, the moving parties recite that they had been engaged in certain discussions with the Province to resolve issues relating to the JRA, which might result in such application being discontinued. The treatment of the claim as an Excluded Claim recognizes that the JRA involves issues other than monetary claims, may be resolved and that the moving parties in the JRA are pursuing relief against respondents to the JRA in addition to Terrace Bay.

(b) Claims Covered by Insurance - At the request of a Person who has asserted that there may be insurance coverage for a Claim, the language of section 3.3(c) of the Plan has been amended to specifically state that the definition of Excluded Claims include a portion of a Claim arising from a cause of action for which the Applicant is covered by insurance, but only to extent of such coverage and any proceeds paid pursuant to such coverage;

(c) Township Claim – For greater certainty, the Plan provides that the Township Claim is not an Excluded Claim.

CONDITIONS TO PLAN IMPLEMENTATION

17. The Plan Amendments include changes to section 8.2 of the Plan to add the following conditions of plan implementation:

    (a) Township Agreement – a condition that the Applicant shall have entered into the Township Agreement and that all conditions precedent to be completed under such agreement shall have been satisfied or waived, subject only to the completion of the transactions contemplated under the Plan; and

    (b) Construction Lien Claims – a condition that the Applicant shall have entered into agreements with the CLA Claimants or taken other steps satisfactory to the Applicant to resolve such Claims. Five parties have registered claims for lien under the CLA against the Property and filed Proofs of Claim asserting their Claims to be secured, namely Skyway Canada Limited ("**Skyway**"), Peterson Machine & Supply Inc. ("**Peterson**"), Vector Construction Ltd. ("**Vector**"), KMH Engineering Inc. ("**KMH**") and Great West Timber Limited ("**Great West**"). The Monitor has sent Notices of Revision or Disallowance (a "**Disallowance Notice**") to each of the CLA Claimants, in the case of all but KMH, allowing their construction lien Claims as unsecured claims against Terrace Bay. In the case of KMH, the Monitor disallowed its construction lien Claim as a secured claim against the Applicant and, because KMH did not have a contract with the Applicant, also disallowed its construction lien Claim as an unsecured claim against the Applicant. KMH has asserted a separate unsecured Claim against the Applicant for services rendered to the Applicant (the "**Other KMH Claim**"), which Claim was not revised or disallowed by the Monitor.

    Agreements have been reached by the Applicant with Vector, KMH and Skyway, as a result of which these creditors have agreed not to dispute the Disallowance Notices sent by the Monitor and to withdraw any Notices of Dispute sent to the Monitor. Vector, KMH and Skyway have also agreed to (i) discharge all registrations made against the property pursuant to the CLA, and (ii) vote their unsecured Claims in favour of the Plan. The Monitor has been advised by the

Applicant that the other two lien claimants, namely Great West and Peterson, will (i) withdraw their dispute of the disallowance of their Claims as secured Claims, (ii) vote their unsecured claims in favour of the Plan, and (iii) discharge all registrations made pursuant to the CLA; and

(c) Payment under Section 3.3(i) of the Plan – a condition that there be no impediment to the payment of the Lucky Star Claim.

SERVICE OF FIRST AMENDED PLAN AND SECOND AMENDED PLAN ON ELIGIBLE VOTING CREDITORS

18. In accordance with the Creditors' Meeting Order, on Thursday June 24, 2010, the First Amended and Restated Plan, and a blackline highlighting the changes made to the Original Plan, were: (a) served on the Service List, (b) emailed to each Affected Creditor who had filed a Proxy that contained an email address or who subsequently provided an email address to the Monitor, (c) posted on the Monitor's Website, and (d) filed with the Court. Given the time constraints, the First Amended and Restated Plan included general amendments in relation to the Township Agreement that reflected the fact that the Applicant would be proposing amendments to the Plan to provide for a separate class for the Township and the cancellation of the Tax Relief Amount. It also included the above-referenced amendments relating to the Matawa First Nations Litigation.

19. The cover note to the persons to whom the First Amended and Restated Plan was sent stated that the principal amendments included an agreement to be entered into with the Township of Terrace Bay with respect to municipal realty taxes and interest owing by Terrace Bay and agreements or other arrangements to be entered into with certain creditors who have claimed liens pursuant to the CLA and that Terrace Bay was continuing to negotiate with these creditors to resolve their claims and concerns. Readers were also cautioned to read all amendments to the Plan. Persons with questions regarding the amendments were invited to contact the Monitor.

20. On Friday, June 25, 2010, the Second Amended and Restated Plan, and a blackline highlighting changes made to the First Amended and Restated Plan, were: (a) served on the Service List, (b) emailed to each Affected Creditor who had filed a Proxy that

contained an email address or who subsequently provided an email address to the Monitor, and (c) posted on the Monitor's Website. Due to the time of its completion and service on June 25, 2010, the Second Amended and Restated Plan will be filed with the Court on June 28, 2010.

21. The cover note to the persons to whom the Second Amended and Restated Plan was sent on June 25, 2010, updated the notice sent on June 24, 2010, and advised that the terms of the agreement with the Township had been formalized (subject to approval of the Township council) and that the Plan had been amended to, among other things, create a separate class for the Township Claim. Readers were also cautioned to read all amendments to the Plan. Persons with questions regarding the amendments were invited to contact the Monitor.

22. Approximately six Affected Creditors filed proxies which did not include email or fax address information. The Monitor made several attempts to contact such persons by telephone, but they did not respond. The total amount of the claims of these six creditors is approximately $9,264, which, given the proxies received to date, is unlikely to affect the outcome of any vote at the Creditors' Meeting.

MOTION TO AMEND THE CREDITORS' MEETING ORDER

23. The changes to the Plan to reflect the Township Agreement required the creation of the Township Class. The Creditors' Meeting Order, however, was granted on the basis of the Original Plan, which only provided for a single class of unsecured creditors. As a result of the need to include an additional class, corresponding changes are required to the Creditors' Meeting Order and a motion is being brought by the Applicant to amend that Order on June 29, 2010. The amendments to the Creditors' Meeting Order also include that the Monitor be provided with a period of five Business Days following the Creditors' Meeting for the Unsecured Class within which to file a report with this Honourable Court on the results of the Creditors' Meetings. Provided that the Plan is approved by the required majorities of creditors, the Sanction Hearing is currently scheduled to proceed on July 13, 2010.

CONCLUSION AND RECOMMENDATIONS OF THE MONITOR

24. The Applicant has been working diligently since the Original Plan was circulated to meet with and resolve issues with its key stakeholders with a view to obtaining their support for a Plan. As reflected in this Fifteenth Report, substantial progress has been made in these regards.

25. In relation to the Township Agreement, given the unique legal framework relating to municipal taxes, the proposed terms of the Township Agreement and the treatment of the Township Claim under the Plan, the Monitor supports the Plan being amended by the Applicant to classify the Township in a separate class from other Affected Creditors. The Monitor is of the view that Affected Creditors with Unsecured Claims will not be prejudiced by the requested amendments as the Township Agreement provides the Applicant and its stakeholders with the benefit of (a) additional tax savings (not otherwise available were it not for the Township Agreement and the Second Amended and Restated Plan), and (b) a reasonable repayment plan for the Tax Arrears, both of which will assist the Company going forward and increase the likelihood of a successful outcome to this restructuring.

26. The Monitor has reviewed the Plan Amendments and agreements with the CLA Claimants and believes that they are appropriate in the circumstances to permit the Applicant to move forward with the Second Amended and Restated Plan.

27. The Monitor recognizes that the Plan Amendments were proposed very close in time to the rescheduled date of the Creditors' Meeting, but recognizes that this was done, of necessity, to accommodate the agreements reached with and concerns raised by key stakeholders. The Service List in the CCAA Proceeding and substantially all creditors who had filed proxies were provided with the First Amended and Restated Plan and the Second Amended and Restated Plan by email. The Plan, as amended, was posted on the Monitor's website and creditors were invited to contact the Monitor with questions. As such, the Monitor believes the actions taken to notify the Service List and persons who had delivered proxies in relation to the Original Plan to be appropriate. The Monitor intends to have available at the Creditors' Meeting on June 28, 2010, blacklined copies of

the Plan, as amended from the Original Plan, to facilitate review of the Plan Amendments and to overview the Plan Amendments with Eligible Voting Creditors in attendance at the Creditors' Meeting, prior to directing a vote on the resolution to approve the Plan.

28. The Monitor has reviewed the amendments currently proposed to be made by the Applicant to the Creditors' Meeting Order and believes them to be necessary and appropriate. Subject to its review of the motion materials and draft Order, the Monitor anticipates that it will be in a position to support the motion to amend the Creditors' Meeting Order.

29. The Monitor recommends that the Court approve this Fifteenth Report and the actions and activities of the Monitor as described herein.

ALL OF WHICH is respectfully submitted on this the 27th day of June, 2010.

ERNST & YOUNG INC.
In its capacity as the Court-Appointed
Monitor of Terrace Bay Pulp Inc.

Per:

Alex Morrison
Senior Vice President

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TERRACE BAY PULP INC.

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Proceeding commenced at TORONTO

FIFTEENTH REPORT OF ERNST & YOUNG INC.

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