Court File No. CV-09-8062-OOCL

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.

FIRST REPORT OF ERNST & YOUNG INC.

DATED APRIL 6, 2009

INTRODUCTION

1. On March 11, 2009, Terrace Bay Pulp Inc. ("**Terrace Bay**" or the "**Applicant**") filed for and obtained protection under the *Companies' Creditors Arrangement Act* (the "**CCAA**"). Pursuant to an Order of this Honourable Court dated March 11, 2009 (the "**Initial Order**"), Ernst & Young Inc. ("**EYI**") was appointed as Monitor (the "**Monitor**") in the CCAA proceeding. The Initial Order provided for a stay of proceedings through April 10, 2009 (the "**Stay Period**").

PURPOSE

2. The purpose of this first report of the Monitor (the "**First Report**") is to update this Honourable Court with respect to:

   (a) The ongoing activities of the Monitor and the Applicant to raise financing or identify a purchaser to re-start the mill;

   (b) The reporting provided to Terrace Bay's first secured lender, Nexcap Finance Corporation ("**Nexcap**");

   (c) The review of Nexcap's security position;

   (d) Certain statutory lien claims filed or asserted against Terrace Bay;

(e) Discussions ongoing between Terrace Bay and the Independent Electricity System Operator (the "**IESO**");

(f) The receipts and disbursements from March 11 through March 29, 2009;

(g) Terrace Bay's updated cash flow forecast for the period from March 30 to July 5, 2009; and

(h) The Monitor's recommendation regarding the Applicant's application to extend the stay up to and including June 30, 2009.

BACKGROUND

3. Terrace Bay operates a pulp mill in the Town of Terrace Bay, Ontario (the "**Town**"), which is located on the north shore of Lake Superior. Terrace Bay's customers include large tissue and paper producers in North America and abroad. The primary raw material for Terrace Bay's products is wood chips which, when the mill was operating, were sourced from nearby sawmills.

4. The owner of Terrace Bay, Lucky Star Holdings Inc. ("**Lucky Star**") purchased Terrace Bay from its former owner, Neenah Paper Inc. in 2006. Lucky Star owns and operates a number of woodland and sawmill operations in Northern Ontario and some of these entities sold raw materials to Terrace Bay.

5. Due to the current difficulties in the global pulp and paper market, the Applicant determined that the most prudent course of action was to idle the mill until such time as the market for its products improved to such a level that it was no longer unprofitable to run the mill. The mill was idled on February 23, 2009.

6. Activity at the mill is currently limited to two main items. The primary activity is the sale and shipment of existing finished pulp inventory. At the date of the Initial Order, Terrace Bay had approximately 61,000 tons of pulp inventory on hand. This inventory was stored at both the mill and at various warehouses throughout North America.

7. With respect to the preservation of the machinery and equipment, if the mill is not heated over the winter and early spring months, the machinery and equipment would be significantly damaged due to cold weather. Such damage would both render the equipment prohibitively expensive to repair and decrease the likelihood of any buyer or financier expressing an interest in supporting Terrace Bay in the future.

8. In addition to keeping the mill warm and selling inventory, employees at the mill also maintain a pump house to supply the Town with drinking water. It is anticipated by the Applicant that the Town will shortly transition to its own water supply. Although the date for such a transition is not yet known with any degree of certainty, the Applicant advises the Monitor that it expects that the transition will occur within the not too distant future. The Applicant is the dominant source of employment for residents of the Town and another nearby community, Schreiber, Ontario.

9. Subsequent to the date of the Initial Order, the Toronto Dominion Bank appointed Deloitte & Touche Inc. as receiver of Buchanan Forest Products Ltd. ("**BFPL**"), which is an affiliated company of Terrace Bay. Terrace Bay traditionally purchased a significant portion of its pulp logs and bush chips from BFPL.

10. In the materials supporting Terrace Bay's initial application, the Applicant indicated that while the mill was shut down, it would be undertaking a process to either find a buyer for the mill or to find a capital source to refinance Terrace Bay's activities. These activities will be detailed further later in this report of the Monitor to this Honourable Court (the "**First Report**").

TERMS OF REFERENCE

11. In preparing this First Report, EYI has been provided with and in making the comments herein relied upon, unaudited financial information, Terrace Bay's books and records, financial information prepared by Terrace Bay, and discussions with management of Terrace Bay. EYI has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information and, accordingly, EYI expresses no opinion or other form assurance in respect of such information contained in this First

Report. Some of the information referred to in this First 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 First 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, even if the assumptions materialize, and the variations could be significant.

UPDATE ON TERRACE BAY'S RESTRUCTURING PROCESS

12. As summarized in the Applicant's motion material in support of the Initial Order, the Applicant had three objectives (the "**Restructuring Process**"), with respect to the re-starting of the mill. These included:

    (a) The commencement of a process to seek out proposals for the refinancing of the business;

    (b) The development of a plan to restructure the business to ensure continued mill viability; and

    (c) The commencement of a marketing process to sell the mill as a going concern.

13. Since March 11, 2009, the Applicant has been engaging in activities to accomplish the Restructuring Process. These activities include, among other things, updating Terrace Bay's financial projections to reflect the current status of the mill and working with the Monitor to develop information materials to send to potential financiers and/or purchasers that may be interested in supporting Terrace Bay with a view to re-starting operations at the mill.

14. The Initial Order directed that the Monitor and the Applicant were authorized to conduct a process for the solicitation of offers for a financing or sale of the Property (as it was defined in the Initial Order) and to take such necessary or advisable steps that were

required to affect the Restructuring Process. The Initial Order requirements were as follows:

(a) Preparation of a Confidential Information Memorandum (a "**CIM**") and identification of potential purchasers by March 23, 2009;

(b) Dissemination of the CIM to interested parties on execution of confidentiality agreements by April 6, 2009; and

(c) Issuing a deadline of April 24, 2009 for the receipt of expressions of interest.

15. The Monitor can advise this Honourable Court that the CIM has been updated and to date the Monitor has contacted over 50 parties regarding the opportunity to either provide financing or purchase Terrace Bay. To date, a number of parties have executed confidentiality agreements and received a copy of the CIM.

16. The Monitor will continue to correspond with interested parties and expects that the process will extend beyond April 6, 2009 given the significant number of parties contacted by the Monitor.

17. The Monitor will continue to update this Honourable Court as the Restructuring Process continues.

REPORTING TO NEXCAP AND ITS ADVISORS

18. As detailed fully in the Initial Order, Terrace Bay is required to provide certain reporting to Nexcap and its advisors. Nexcap has retained PricewaterhouseCoopers Inc. ("**PwC**") as financial advisor with respect Terrace Bay. Since the date of the Initial Order, Terrace Bay has provided weekly reports detailing cash flow (including a variance analysis against the cash flow forecast submitted with the Applicant's motion materials), sales and inventory levels.

19. In addition to the above reporting, PwC attended at Terrace Bay's facility between March 18 and 20, 2009.

20. Pursuant to the Initial Order, Terrace Bay with the assistance of the Monitor will continue to respond to requests for information by Nexcap and PwC.

REVIEW OF SECURITY

21. Paragraph 8 of the Initial Order provides that the Applicant is entitled to pay Nexcap any surplus cash flow in permanent reduction of its credit facility after estimated operating costs

22. The Monitor has requested its counsel, Lang Michener LLP ("**Lang Michener**"), to undertake a review of Nexcap's security position. Attached as Appendix A to this First Report is the opinion of Lang Michener to the Monitor with respect to the general security agreement (the "**Nexcap GSA**") granted by Terrace Bay to Nexcap in relation to personal property of Terrace Bay situated in the Province of Ontario. The Monitor will provide further reports regarding the Nexcap GSA in relation to personal property assets situated outside of Ontario and otherwise as may be required in relation to issues that may arise.

23. Based on Lang Michener's review and subject to certain assumptions and qualifications, including as referenced in the following paragraph of this First Report, it appears that the Nexcap GSA is valid and enforceable in accordance with its terms in relation to, and creates a perfected security interest in, the property and assets of the Applicant described therein constituting personal property to which the *Personal Property Security Act* (Ontario) (the "**PPSA**") applies. Lang Michener's report reflects that there are other parties who have made registrations under the PPSA, some of which appear to relate to equipment specific collateral and one in relation to what is described as a consignment agreement. Nexcap also has registered a Notice of Security Interest pursuant to section 54 of the PPSA, presumably to provide notice of the security interest in collateral that may constitute fixtures located on or affixed to or to be fixed to certain real property owned by Nexcap.

24. As set out in the report provided by Lang Michener to the Monitor, there exists certain deficiencies in the Nexcap GSA in relation to the intended meaning of certain terms that

are used, but have not been defined within, the Nexcap GSA. Lang Michener has reported that it is reasonable to infer that Nexcap and Terrace Bay intended for the Nexcap GSA to incorporate the same defined terms as were used under the credit agreement between Nexcap and Terrace Bay. Lang Michener also recommended that Nexcap have the opportunity to file materials with this Honourable Court to satisfy this Honourable Court that this was the intention of the parties. The Applicant's counsel has notified Nexcap's counsel of the nature of the issues raised by Lang Michener's review of the Nexcap GSA. In order to assist this Honourable Court in relation to any advice and directions or orders being sought by the Applicant in relation to the making of any payments to Nexcap, counsel for Nexcap has been invited to file materials with this Honourable Court to confirm the intended meanings of the undefined terms that are used in the Nexcap GSA.

25. As set forth in the Affidavit of Russell York to be filed in a support of the motion being brought by the Applicant, the Applicant has indicated that there is an issue that it may raise at a future point in time regarding the scope of the property and assets secured by the Nexcap GSA. The Monitor understands this issue to be whether it was intended by the parties to the Nexcap GSA that Nexcap was to be granted security against any property and assets of the Applicant other than inventory and accounts receivable. The Monitor also understands that the Applicant does not propose to advance this issue at the current time, but is reserving its rights to do so at a later date.

LIEN CLAIMS

26. As of April 3, 2009, Terrace Bay has been served with materials from eight parties asserting various lien claims. These claims include (i) five claims pursuant to the *Forestry Workers Lien for Wages Act* (Ontario), and (ii) three claims pursuant to the *Construction Lien Act* (Ontario). The aggregate value of the eight lien claims (the "**Lien Claims**") is approximately $2.7 million.

27. The Monitor understands that an amendment to the Initial Order is being sought to permit the filing and registration of liens under the *Forestry Workers Lien for Wages Act* and the *Construction Lien Act*, as well as the issuance of statements of claim in respect of such

liens, in order to preserve limitation periods as provided for by the relevant statutes, subject to any such proceedings otherwise continuing to be subject to the stay of proceedings provided for by the Initial Order.

STATUS OF DISCUSSIONS WITH THE IESO

28. As a large volume user of hydroelectric power, Terrace Bay purchases its electricity directly from the IESO (formerly, the Independent Electricity Market Operator or "**IMO**"). Terrace Bay has historically received an invoice for electricity and transmission charges in the month following its use. The Applicant has advised the Monitor that the average use of electricity used during the winter months typically totals approximately $1.5 million per month.

29. Prior to the commencement of the CCAA proceedings, the IESO requested that Terrace Bay pledge certain security with respect to the provision of its services as prudential support under the IESO's market rules (the "**Market Rules**"). As a result, Terrace Bay invested in two separate treasury bills, each held under the name of the IMO, in the amount of $1.5 million and $1.8 million, respectively (the "**Treasury Bills**"). In addition, Terrace Bay executed a Pledge of Cash and Treasury Bills dated February 6, 2007 in favour of the IESO. Terrace Bay has advised the Monitor that both of the Treasury Bills have matured and are now being held by the IESO in the form of cash (the "**IESO Collateral**").

30. In early March, 2009, Terrace Bay received an invoice for the February hydro and transmission charges in the amount of approximately $1.38 million (the "**February Invoice**"). As of the date of the commencement of this CCAA proceeding, the sum of approximately $1,529,957, inclusive of the February Invoice and electricity usage up to and including March 10, 2009, was outstanding or owing to the IESO (the "**IESO Obligations**").

31. In light of the IESO's security over the IESO Collateral, the Applicant is discussing arrangements with the IESO, which may result in the IESO agreeing to release its security interest over the IESO Collateral, in exchange for:

(a) a new prudential support amount, reduced to take into account the fact that the mill is currently idled, being posted with the IESO in the amount of $408,000, being an amount calculated under the Market Rules (the "**Reduced Prudential Amount**");

(b) the beneficiaries of the Administration Charge and the Directors' Charge created under the Initial Order (the "**Charges**") agreeing to consent to an Order providing that the Charges will not attach to the Reduced Prudential Amount;

(c) payment of the IESO Obligations,

(d) Terrace Bay agreeing to a protocol for the payment for electricity weekly, in advance, in an amount estimated based on the usage of the prior week, which is currently estimated to be approximately $70,000 per week; and

(e) in the event that the mill resumes operations, it will be on notice to IESO, at which point a new prudential support amount (the "**New Prudential Amount**") will be (i) negotiated on the basis of the Market Rules, subject to the prior consent of the Monitor to the New Prudential Amount, or (ii) referred this Honourable Court for determination.

32. The Monitor understands that the Applicant hopes to have completed its negotiations with the IESO before the return date of its motion, such that it will be in a position to seek an Order from this Honourable Court approving of the agreements reached.

RECEIPTS AND DISBURSEMENTS THROUGH MARCH 29, 2009

33. Attached as Appendix B to this First Report is a summary of Terrace Bay's actual receipts and disbursements from March 10, 2009 to March 29, 2009 (the "**Reporting Period**"). Details of the receipts and disbursements, as well as a variance analysis against the Applicant's cash flow forecast submitted in the Initial Order motion materials (the "**Cash Flow Forecast**"), are provided below:

(a) *Customer receipts* - Customer receipts through March 29, 2009 totalled approximately $5,538,000 compared to an amount of $5,200,000 in the Cash Flow Forecast resulting in a positive variance of approximately $403,000. This variance is temporary and revised receipts amounts have been incorporated in the updated cash flow forecast through July 5, 2009 appended to this First Report as Appendix C (the "**Revised Forecast**").

(b) *GST* - Terrace Bay did not receive any GST refunds during the Reporting Period. Management advises the Monitor that this difference is temporary and that they expect to receive the GST refund at a later date. This receipt has been reflected in the Revised Forecast.

(c) *Other receipts* – Terrace Bay received a refund of approximately $65,000 in respect of a deposit being held by a vendor. This variance is permanent.

(d) *Freight and sales agent* - Payments to Terrace Bay's freight and sales agent totalled approximately $535,000 during the Reporting Period. This resulted in a positive variance of approximately $462,000. This variance is permanent.

(e) *Salaries, wages and payroll withholdings* - Payments for salaries and wages (and the related withholdings) were approximately $255,000 during the Reporting Period and resulted in a positive variance of approximately $5,000. This variance is permanent.

(f) *Benefits and pension* – Payments for benefits and pension were forecast to be $200,000 during the Reporting Period. Actual disbursements were approximately $153,000, which resulted in a positive variance of approximately $47,000. This variance is permanent.

(g) *Utilities and fuel* - The Applicant did not make any payments for utilities or fuel during the Reporting Period. As such a temporary variance of $1,399,000 was realized.

(h) *Opening cash* - Opening cash in the Applicant's filing materials listed opening cash as $299,000. Appendix B lists opening cash as $2,048,000, resulting in a positive variance of $1,749,000. The difference arises due to the fact that restricted cash is now included in the balance. It was previously excluded due to the fact that it was not available for general corporate purposes as it was segregated from the rest of the Applicant's funds.

EXTENSION OF THE STAY OF PROCEEDINGS

34. The stay of proceedings granted by the Initial Order is scheduled to expire on April 10, 2009. Terrace Bay is seeking an extension of the Stay Period to June 30, 2009.

35. Terrace Bay requires an extension of the Stay Period to allow it the required time to:

(a) continue the Restructuring Process; and

(b) allow Terrace Bay to continue to sell finished pulp inventory and collect current and future accounts receivable.

36. It is the Monitor's view that the Applicant is acting in good faith and with due diligence in attempting to pursue the Restructuring Process and sell existing inventory. The Monitor is also of the view that an extension of the Stay Period to June 30, 2009 is in the best interests of Terrace Bay's stakeholders.

MONITOR'S RECOMMENDATION

37. The Monitor recommends that this Honourable Court approve the Applicant's motion seeking the following orders:

(a) extending the Stay Period to June 30, 2009;

(b) approving of the Applicant's proposed dealings and agreements with the IESO if such dealings and agreements are substantially in accordance with those described herein;

(c) seeking advice and directions from this Honourable Court in relation to payments by the Applicant to Nexcap of monies to the extent provided for in the Applicant's cash flow forecasts;

(d) amending the stay provisions of the Initial Order to permit the issuance of statements of claims and registrations that may be required to preserve the Lien Claims, provided that any actions or proceedings by persons asserting the Lien Claims otherwise remain stayed in accordance with the Initial Order; and

(e) approving of the conduct and activities of the Monitor as reported on in this First Report.

All of which is respectfully submitted this 6th day of April, 2009.

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

Per:

Alex Morrison
Senior Vice President

Appendix A

Lang Michener LLP
Lawyers – Patent & Trade Mark Agents

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Canada

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April 6, 2009

VIA EMAIL AND REGULAR MAIL

Ernst & Young LLP
TD Centre
222 Bay Street
16th Floor
Toronto, Ontario M5K 1J7

Attention: Mr. Alex Morrison

Dear Sirs:

Re: Terrace Bay Pulp Inc. (the "Debtor")

In your capacity as the monitor of the Debtor (the "**Monitor**") in relation to the proceedings under the *Companies' Creditors Arrangement Act* ("**CCAA**") commenced in the Ontario Superior Court of Justice (the "**Court**"), you have asked us to provide you with our views in respect of certain security granted by the Debtor in favour of Nexcap Financial Corporation ("**Nexcap**").

In doing so, we have examined a copy of the general security agreement dated July 26, 2007 executed by the Debtor in favour of Nexcap (the "**Security Agreement**").

To assist us in preparing this report, we have also conducted a preliminary review of the credit agreement dated July 26, 2007 between, among others, the Debtor and Nexcap (the "**Credit Agreement**") for the purposes noted in this report.

For the purpose of this opinion, we have not reviewed any other documents, including any other documents purporting to create security interests in respect of all or any part of the Charged Property (as defined below) of the Debtor in favour of Nexcap, or which purport to subordinate the priority of any of Nexcap's security interests under the Security Agreement.

We did not act for the Debtor in connection with the negotiation, execution and delivery of the Security Agreement. The undertaking, business, properties, assets, interests and rights of the Debtor as described in the Security Agreement are collectively referred to herein as the "**Charged Property**").

I. *Scope of Enquiry*

We have considered such questions of law applicable in the Province of Ontario, and such statutes and regulations of the Province of Ontario and of Canada applicable in Ontario (collectively, "**Ontario Law**"), and conducted such searches (as of the dates and detailed in Schedule "A" below) as we considered necessary as a basis for this Report.

Unless otherwise indicated, capitalized terms are as defined in subsection 1(1) of the *Personal Property Security Act* (Ontario) (the "**PPSA**).

II. *Assumptions and Qualifications*

The views and opinions contained in this Report are based on, and are subject to, each of the assumptions and qualifications listed on Schedule "D" to this Report.

III. *Searches*

We have conducted the searches, current as of the dates and at the offices set forth in Schedule "A" for registrations, filings, proceedings or recordings against the name "Terrace Bay Pulp Inc."

Our searches failed to disclose any proceedings, registrations, filings or recordings against those names, other than those disclosed in Schedule "B". For the purposes of this Report, we have relied upon the accuracy, currency and completeness of the indices and filing systems maintained at the public offices at which we have searched or caused searches or inquiries to be conducted.

We have not made any further or independent investigation of original or copied documents other than our review of the Security Agreement and the searches expressly referred to in Schedule "A" to this letter.

We have obtained a corporation profile report (the "**Profile Report**") from the Ministry of Consumer and Business Services Companies and Personal Property Security Branch (the "**Ministry**") in respect of the Debtor.

We have also conducted Real Property Parcel Register searches against the real property currently owned by the Debtor as described in Schedule 5.4 to the Credit Agreement (the "**Real Property**") with a currency date of March 24, 2009 (collectively, the "**Real Property Subsearches**"), a summary of which is attached as Schedule "C" hereto. We confirm your advice that our review based upon and reliance solely upon these Real Property Subsearches (but not full title searches) in giving the opinions set out herein, is satisfactory for your purposes at this time and, without limitation, we confirm that we have not conducted any off-title searches, including, without limitation, searches relating to any outstanding real property taxes or utility charges which may have priority in respect of the subject real properties.

IV. *Registrations*

A. PPSA

Our review included conducting a search (the "**PPSA Search**") of the Ontario Personal Property Registration System against the Debtor. These search results are summarized on Schedule "B" attached to this report. Schedule "B" reflects a registration against the Debtor in favour of Nexcap, as more particularly reported on below.

B. Bank Act

According to our search for registrations under the *Bank Act* (Canada), no interests have been filed under the *Bank Act* against the Debtor in favour of Nexcap or any other creditor.

C. Executions

According to our search for executions filed against the Debtor with the Office of the Sheriff in the Territorial District of Thunder Bay and the Office of the Sherriff in the City of Toronto, no writs of execution have been filed.

D. Real Property

The Real Property Subsearches revealed that a Notice of Security Interest ("**NOSI**") was registered in favour of Nexcap against certain properties as more particularly set out in Schedule "C" attached hereto, which gives notice of a security interest having been created in all "INVENTORY, EQUIPMENT, ACCOUNTS AND OTHER UNDER GENERAL SECURITY AGREEMENT DATED THE 26TH DAY OF JULY 2007." The notice states that the collateral is "located or affixed or is to be affixed to the selected PIN" (property identification number).

V. *Security Documents*

A. The Security Agreement - Registration under the PPSA

The security interests created by the Security Agreement appear to have been originally registered under the PPSA on July 30, 2007 as file number 637713234, against the collateral classifications Inventory, Equipment, Accounts and Other. As set forth on Schedule "B", the original PPSA registration made by Nexcap was amended on July 30, 2007 (to amend the secured party's address), and again on August 3, 2007 (to add MV to the collateral classification). We note that the registration contains no vehicle identification number ("**VIN**") in relation to any motorized vehicles.

The Security Agreement grants, as and by way of fixed and specific mortgage, pledge and charge, to and in favour of Nexcap, and grants to Nexcap a security interest in, the whole of the undertaking of the Debtor and all of the Debtor's property and assets, real and personal, movable and immovable, tangible and intangible, of every nature and kind whatsoever and wheresoever situate, present and future, then or at any time and from time to time owned by the Debtor, or in which the Debtor has any interest or rights of any kind, including Inventory, Accounts, Equipment, Chattel Paper, Documents of Title, Instruments, Intangibles (each as defined in the Security Agreement) and other property described in the Security Agreement.

The foregoing security interests were granted as general and continuing security for all "Obligations". The wording of the Security Agreement, on its face, however, requires an interpretation of which obligations the parties intended to be secured by the security interests that were granted by the Debtor to Nexcap.

Section 2.5 of the Security Agreement provides as follows:

> "The Collateral and any other security given with the Secured Party's consent in replacement thereof, substitution therefor or in addition thereto shall be held by the Secured Party as general and continuing security for due payment and performance of all Obligations, including all costs and amounts payable pursuant hereto and interest on the Obligations at the rate or rates applicable thereto in accordance with the prevailing agreement between the Secured Party and the Debtor."

Collateral is defined in the Security Agreement to mean "all Property, interests in Property, collateral and/or security granted and/or securities pledged to the Agent for the benefit of the Lender Parties, or any Lender by the Borrower and any Other Person pursuant to the "Loan Documents". None of the terms "Property", "Agent", "Lender Parties", "Lender", "Borrower" or "Other Person" is defined in the Security Agreement.

"**Obligations**" is defined in the Security Agreement to mean:

> "all present and future obligations, Indebtedness and liability of the Debtor and/or any other Credit Party...to the Agent and/or the other Lender Parties at any time and from time to time of every kind...arising under any Loan Document, whether direct or indirect, secured or unsecured, joint and/or several, absolute or contingent, due or to become due, matured or unmatured, now existing or hereafter arising..."

Within the definition of "Obligations" there is reference to other capitalized terms that are not defined in the Security Agreement, including "Indebtedness", "Credit Party", "Agent", "Lender Parties" and "Person" (however, there is a definition for "person").

"Loan Documents", referenced in the definition of Obligations, is defined in the Security Agreement, as meaning, collectively, "this Agreement, the Notes, the Security Documents, all Compliance Certificates, and all other agreements, documents, instruments ...executed or delivered to the Agent or any Lender...in connection with any of the foregoing or the *Loan*..." [emphasis added].

The definition of Loan Documents does not expressly reference the Credit Agreement (which agreement is defined in the Security Agreement as the "Loan Agreement"). The Security Agreement also contains no definition of "Loan", leaving one to infer that the reference to Loan in the definition of Loan Documents was intended to include the loan obligations of the Debtor to Nexcap under the Loan Agreement.

Section 1.1 of the Security Agreement states that, "except as expressly provided herein, terms which are defined in the *Personal Property Security Act* (Ontario) shall have the same meaning where used herein. This reference does not assist in relation to certain of the capitalized terms that are not defined in the Security Agreement or the PPSA.

We have reviewed the Loan Agreement, which does contain a definition in relation to the capitalized terms referenced above that are not defined in the Security Agreement. If the term "Loan", as it appears in the definition of Loan Document, is construed to include the loan to the Debtor under the Credit Agreement, then this loan could be construed as falling within the definition of Obligations for which the security under the Security Agreement was given.

The difficulties referenced above would have been avoided had the Security Agreement included a term to the effect that capitalized terms not defined therein had the same meanings as under the Loan Agreement. Reading the Security Agreement, together with the Loan Agreement, it is reasonable to infer that this is what the Debtor and Nexcap intended. In providing this report to you we have assumed that the Court, if called upon to determine this issue, would construe the Security Agreement as if the capitalized terms without definitions had the same meanings as the same defined terms in the Loan Agreement. It would not be unreasonable, however, for the Monitor to suggest that Nexcap file further materials with the Court to confirm this to be the case and/or or seek a declaration that the Security Agreement should be interpreted in this manner.

B. The Security Agreement - Registration of NOSI Against the Real Property

Section 34(2) of the PPSA provides that a security interest in fixtures is subordinate to the interest of (a) a subsequent purchaser for value of an interest in the real property; or (b) a creditor with a prior encumbrance of record on the real property to the extent that the creditor makes subsequent advances if the subsequent purchase or subsequent advance under a prior encumbrance of record is made or contracted for without knowledge of the security interest and before notice of it is registered in accordance with section 54. We note that under section 54(1) of the PPSA, a notice of security interest ("NOSI") may be registered against real property where the collateral is or includes fixtures or goods that may become fixtures (as well as or crops, or minerals or hydrocarbons to be extracted, or timber to be cut). Section 54(5) of the PPSA provides that where a NOSI is registered under section 54(1), every person dealing with the collateral shall be deemed for the purposes of subsection 34(2) of the PPSA to have knowledge of the security interest. The NOSI registered against the Real Property appears to be in the form that was required under section 54 of the PPSA at the time of its registration.

C. Conclusion

Subject to the qualifications and assumptions set out in this Report, including Schedule D and including the above assumption regarding how the Court would interpret the Security Agreement (which cannot be known for certain unless the Court is requested to do this), the Security Agreement is valid and enforceable in accordance with its terms against, and creates a perfected security interest in, the Debtor's Charged Property constituting personal property to which the PPSA applies.

VI. *Other PPSA Registrations*

As reflected on Schedule "B", the PPSA Search revealed other registrations against the Debtor in favour of various secured parties. We confirm that we have not been requested to review any of the other security held by the secured parties listed on Schedule "B" (other than in relation to Lucky Star Holdings Inc., which we will report on separately) and, accordingly, any such review is beyond the scope of this Report.

VII. *Applicable Law*

The opinions expressed in this opinion letter are limited to Ontario Law in force as at the date of this opinion letter.

VIII. *Reliance*

The opinions expressed in this opinion letter may be relied upon only by Ernst & Young LLP for the purposes of acting as monitor of the Debtor. These opinions may not be quoted from or referred to in any other document without our prior written consent and may not be:

(i) Relied upon for any purpose or in connection with any other transactions, except in connection with or during the course of judicial or administrative proceedings in which the foregoing opinions may be relevant;

(ii) Relied upon by any other person; or

(iii) Disclosed or furnished (in whole as in part, in its original form or by copy) to any other person, except in connection with, or during the course of, judicial or administrative proceedings in which the opinions contained herein maybe relevant.

IX. *Other Jurisdictions*

We are engaging local counsel in the Province of Quebec and the United States, being the only locations where the Monitor believes the Debtor may have assets, to provide us with a report regarding the security registered against the Debtor in those jurisdictions and will report to you separately once these results have been received.

Yours truly,

Lang Michener LLP

Lang Michener LLP

SCHEDULE "A"

SEARCHES

Corporate Search

We obtained a Profile Report from the Ministry dated March 18, 2009 for the Debtor. The Profile Report did not disclose any former names of or predecessor corporations of the Debtor.

Executions Search

We obtained a Sheriff's Certificate for the Sheriff's Office of the Territorial District of Thunder Bay and for the Sherriff's Office of the City of Toronto, each dated March 23, 2009, and each of which disclosed no writs of execution or certificates of lien in such Sheriff's hands in respect of the Debtor.

Bank Act Search

As of March 19, 2009, no registrations under the *Bank Act* (Canada) against the Debtor were disclosed from our searches at the office of the Agency of the Bank of Canada in Ontario.

PPSA Search

We carried out searches against the Debtor at the Ontario Personal Property Security Registry maintained by the Ministry. We obtained certificates in respect of the Debtor dated of March 18, 2009, with a file currency of March 17, 2009, disclosing the registrations summarized on Schedule "B" below.

Real Property Searches

We carried out searches against the real property currently owned by the Debtor as listed on Schedule 5.4 to the Credit Agreement. The searches are each dated March 24, 2009 and disclose certain charges, notice and/or instruments registered on title as summarized in Schedule "C" below.

SCHEDULE "B"

PPSA SEARCH SUMMARY

Personal Property Security Act (Ontario, current to March 17, 2009)

The following abbreviations are used to identify collateral classifications under the *Personal Property Security Act*:

A – Accounts
CG – Consumer Goods
E – Equipment
I – Inventory
O – Other
MV – includes Motor Vehicle

Terrace Bay Pulp Inc.

Reference File No.	*Registration No.*	*Debtor*	*Secured Party*	*Collateral*	*General Collateral Description/Comments*
650228301 (3 years)	20081128 1446 1530 6243	Terrace Bay Pulp Inc. 21 Mill Road Terrace Bay, ON P0T 2W0	**Liftcapital Corporation** 300 The East Mall, Suite 401 Toronto, ON M9B 6B7	E, O	Material handling equipment together with all parts, attachments, accessories, additions, batteries, chargers, repair parts, and other equipment placed on or forming part of the goods described herein with any proceeds thereof and therefrom including, without limitation, all goods, securities, instruments, documents of title, chattel paper and intangibles (as defined in the Personal Property Security Act).
644895315 (5 years)	20080506 1529 1862 0609	Terrance Bay Pulp Inc. 1120 Premier Way Thunder Bay, ON P7B 0A3 (ON Corp. #2101997)	**Lucky Star Holdings Inc.** 1120 Premier Way Thunder Bay, ON P7B 0A3	I, E, A, O, MV No fixed maturity date	Amount: 13000000 Debenture dated May 5, 2008
644895333 (5 years)	20080506 1530 1862 0610 20090311 0930 1862 2196 (Amendment – add/include accounts and other Section 1 on line 10 of the collateral classification to registration number 20080506 1530 1862 0610.)	Terrance Bay Pulp Inc. 1120 Premier Way Thunder Bay, ON P7B 0A3 (ON Corp. #2101997)	**Lucky Star Holdings Inc.** 1120 Premier Way Thunder Bay, ON P7B 0A3	E, A, O, MV No fixed maturity date	Amount: 5000000 Security Agreement date May 5, 2008

Reference File No.	*Registration No.*	*Debtor*	*Secured Party*	*Collateral*	*General Collateral Description/Comments*
643202037 (4 years)	20080307 1003 6005 7224	Terrace Bay Pulp Inc. 21 Mill Road Terrace Bay, ON P0T 2W0	**National Leasing** Group Inc. L#2411960 1558 Willson Place Winnipeg, MB R3T 0Y4	E	All photocopiers of every nature or kind described in lease number 2411960 between the secured party, as lessor and the debtor as lessee, as amended from time to time, together with all attachments, accessories and substitutions.
637713234 (5 years)	20070730 1215 1862 0810 20070730 1306 1862 0820 (amendment – amend secured party address) 20070802 1006 1862 1087 (amendment – add collateral to registration) 20070803 0906 1862 1178 (Amendment – to substitute line 10 and if required to clarify financing change statement 20070802100618621087)	Terrace Bay Pulp Inc. 21 Mill Road Terrace Bay, ON P0T 2W0 (ON Corp. #002101997)	**Nexcap Finance Corporation** 5420 North Service Road, Suite 504 Burlington, ON L7N 6C7	I, E, A, O, MV No fixed maturity date	
634468275 (3 years)	20070418 1943 1531 9387	Terrace Bay Pulp Inc. 21 Mill Road Terrace Bay, ON P0T 2W0	**CitiCorp Vendor Finance, Ltd.** 123 Front Street West 16^{th} Fl Toronto, ON M5J 2M3	E, MV	Year: 2007 Make: Toyota Model: 7FGU25 V.I.N.: 84961 Year: 2007 Make: Toyota Model: 7FGU25 V.I.N.: 84969 Together with all parts, attachments, accessories, additions, repair parts and other equipment placed on or forming part of the goods described herein and any proceeds thereof and therefrom including, without limitation, all goods, securities, instruments, documents of title, chattel paper and intangibles (as defined in the Personal Property Security Act)

Reference File No.	*Registration No.*	*Debtor*	*Secured Party*	*Collateral*	*General Collateral Description/Comments*
631475865 (7 years)	20061215 1441 1616 1576	Terrace Bay Pulp Inc 1223 Amber Drive Thunder Bay, ON P7B 6M4	**Kinecor LP** 2200 52 Eme Avenue Lachine, QC H8T 2Y3	I	Consignment agreement, further to a consignment agreement between the seller Kinecor LP & the buyer Terrace Bay Pulp Inc, all goods consigned by the seller to the buyer, such as nut not restricted to, hydraulic and process equipment, bearings and power transmission (bearings, pillow block & components, packing, cam followers, gasets, etc)

SCHEDULE "C"

REAL PROPERTY SUBSEARCH SUMMARY

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
1	62456–0120	Terrace Bay Pulp Inc.	Crown Grant see PPA5365	Lucky Star Holdings Inc. – TY62886	n/a	n/a
2	62456–0122	Terrace Bay Pulp Inc.	Crown Grant see PPA5365	Lucky Star Holdings Inc. – TY62886	S/T LPA83730	Transfer Easement LPA83730 Plan Reference PAR301
3	62457–0432	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578
4	62457–0492	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	n/a
5	62457–0728	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	n/a
6	62457–0815	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R3613
7	62457–0954	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R3613
8	62457–0956	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R3613
9	62457–1000	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R5587
10	62457–1024	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R9343
11	62457–1025	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	n/a
12	62457–1026	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	n/a
13	62457–1033	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	n/a
14	62457–1034	Terrace Bay Pulp Inc.	Crown Grant see PPA5174, PPA5189	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R6668
15	62457–1041	Terrace Bay Pulp Inc.	Crown Grant see PPA5174, PPA5189	Lucky Star Holdings Inc. – TY62886	n/a	n/a
16	62457–1048	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	S/T LT235181	Plan Reference 55R6668 Transfer Easement LT235181
17	62457–1082	Terrace Bay Pulp Inc.	Planning Act Consent as in LT173634; Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 56R732 Notice LT174387

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
18	62457–1083	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	S/T LPA43496, LT210598	Transfer Easement LPA43496 Plan Reference 55R1257 Plan Reference 55R3595 Plan Reference 55R5375 Transfer Easement LT210598 Plan Reference 55R11103 LR's Order TY3308
19	62457–1091	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
20	62457–1096	Terrace Bay Pulp Inc.	Crown Grant see PPA5174	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Plan Reference 55R2142 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
21	62457–1105	Terrace Bay Pulp Inc.	Crown Grant see PPA5189	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Plan Reference 55R11640 Plan Reference 55R11735 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
22	62457–1116	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
23	62457–1117	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Notice LPA31804 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
24	62457–1118	Terrace Bay Pulp Inc.	Crown Grant see PPA5277	Lucky Star Holdings Inc. – TY62886	S/T LPA43496 partially released by LT152053	Order LPA32578 APL (General) LPA40453 Transfer Easement LPA43496 Release LT152053 Plan Reference 55R4505 APL (General) LT164282 Plan Reference 55R4825 Notice LT209729 Plan Reference 55R8154 Plan Reference 55R11544 Certificate F116935 LR's Order F137148 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.) Construction Lien TY79281 ($321,322 - Skyway Canada Limited)
25	62457–1119	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
26	62457–1120	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	S/T LPA43492, LPA43494, LPA43496, LT210598	Order LPA32578 APL (General) LPA40453 Transfer Easement LPA43492 Transfer Easement LPA43494 Transfer Easement LPA43496 Plan Reference 55R5375 Transfer Easement LT210598 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
27	62457–1121	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
28	62457–1206	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	S/T F65076, LPA49848, LT148632	Order LPA32578 Transfer Easement LPA49848 Plan Reference PAR576 Plan Reference 55R3612 Transfer Easement LT148631 Transfer Easement LT148632 Plan Reference 55R7495 Order LT233066 Plan Reference 55R10328 Transfer Easement F65076 LR's Order F137183 APL (General) TY238 LR's Order TY2293 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.) Plan Reference 55R12801 Construction Lien TY79281 ($321,322 - Skyway Canada Limited)
29	62457–1202	Terrace Bay Pulp Inc.	Crown Grant see PPA5365	Lucky Star Holdings Inc. – TY62886	S/T LPA83730	Transfer Easement LPA83730 Plan Reference PAR301 No Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
30	62458–0523	Terrace Bay Pulp Inc.	Crown Grant see PPA3368	Lucky Star Holdings Inc. – TY62886	S/T Right in LPA32803	Order LPA32578 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
31	62458–0533	Terrace Bay Pulp Inc.	Crown Grant see PPA5276	Lucky Star Holdings Inc. – TY62886	n/a	Order LPA32578 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
32	62458–0534	Terrace Bay Pulp Inc.	Crown Grant see PPA5289	Lucky Star Holdings Inc. – TY62886	n/a	APL (General) LPA40453 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
33	62458–0578	Terrace Bay Pulp Inc.	Crown Grant see PPA889	Lucky Star Holdings Inc. – TY62886	n/a	Plan Reference 55R11271 APL (General) TY32012 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
34	62458–0579	Terrace Bay Pulp Inc.	Crown Grant see PPA861	Lucky Star Holdings Inc. – TY62886	S/T LT201161	Plan Reference 55R5898 Transfer Easement LT201161 Plan Reference 55R11271 Transfer Easement F96840E LR's Order F137164 APL (General) TY32365 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
35	62458–0591	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886		Order LPA32578 Plan Reference 55R11271 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
36	62501–0002	Terrace Bay Pulp Inc.	n/a	Lucky Star Holdings Inc. – TY62886	n/a	Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)

No.	PIN No.	Owner	Property Remarks	Charges	Subject To	Other Registrations
37	62501–0003	Terrace Bay Pulp Inc.	Crown Grant see PPA5315	Lucky Star Holdings Inc. – TY62886	n/a	Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
38	62501–0090	Terrace Bay Pulp Inc.	Crown Grant see PPA5366	Lucky Star Holdings Inc. – TY62886	S/T LPA53820	Transfer Easement LPA53820 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)
39	62458–0314	Terrace Bay Pulp Inc.	Crown Grant see PPA861	Lucky Star Holdings Inc. – TY62886	S/T Ease ovr parts 2, 4, 5 & 7 on 55R11271 infavour of part 9 on 55R11271 as in F96838	Transfer Easement LT201161 Plan Reference 55R11271 APL (General) TY32012 Notice of Sec Interest TY49141 (Nexcap Finance Corporation) Notice of Sec Interest TY62887 (Lucky Star Holdings Inc.)

SCHEDULE "D"

ASSUMPTIONS AND QUALIFICATIONS

The Assumptions and Qualifications contained in this Schedule "D" form part of and should be read together with the preceding Report. References to "Documents" or a "Document" in this Schedule "D" shall mean the Security Agreement. Capitalized terms in Schedule "D" have the meanings set forth in the Report, unless otherwise defined. The views and opinions contained in the Report are subject to each of the Assumptions and Qualifications that follow.

ASSUMPTIONS

1. We have assumed the genuineness of all signatures, the identity and the necessary legal capacity at all times of all individuals, the authenticity of all documents and instruments submitted to us as originals, the conformity to originals and completeness of all documents and instruments submitted to us as photocopies thereof to the originals, the authenticity of the originals of such photocopies, that each of the Documents, including any dated "as of" a particular date, was executed on the date appearing on each such document and that none of such documents have been amended and that all relevant individuals had full legal capacity at all relevant times.

2. We have assumed that the Debtor was duly incorporated and validly subsisting at the time the Documents to which it is a party were executed by it and that the Debtor continues to be validly subsisting as of the date of this opinion.

3. We have assumed that the Profile Report dated March 18, 2009 received from the Ministry is conclusive evidence that the Debtor was incorporated under the OBCA at all material times and has not been dissolved under the OBCA.

4. We have assumed that, at the time of the execution of the Documents, the Debtor had the requisite power, capacity and authority to enter into, execute, deliver and perform its rights and obligations under each of the Documents and that each of the Documents was duly authorized, executed and delivered by the Debtor and that no provision of the articles of incorporation, charter documents or other documents by which the Debtor was incorporated or continued or any by-laws or any unanimous shareholders agreement was violated by the execution, delivery or performance of any of the Documents.

5. We have assumed that the Documents are governed by the laws of the Province of Ontario and that where the choice of law of a Document is the Province of Ontario, it will be given effect to in any legal proceeding, and that the principal place of business for the Debtor was, at all material times, Ontario.

6. We have assumed the validity and enforceability of the obligations purporting to be secured by each of the Documents, that valid consideration has been given by Nexcap to the Debtor in respect of which the security was granted, that the obligations secured have

not been repaid, or complied with, and remain outstanding, and that all conditions precedent contained in each of the Documents, if any, were satisfied or waived.

7. We have assumed that there are no agreements, facts or understandings, written or oral, (such as duress, mistake of fact, undue influence, unconscionability, oppressive conduct, misrepresentations or bad faith) or usage of trade or course of prior dealings between the parties affecting or concerning any of the Documents or the various principal obligations in respect of which the Documents were granted that were not apparent from our review of the Documents and that would or might affect the execution and delivery, validity, legality, binding effect or enforceability of any of the Documents, at law or in equity, or that would or might discharge, release, subordinate, surrender or assign any security interest granted to Nexcap or have provisions that are inconsistent with the provisions of the Documents.

8. We have assumed the identity and capacity of all individuals acting or purporting to act as public officials, the accuracy and completeness of the records maintained by offices of public record and of all representations, statements and other matters of fact set out or referred to in such searches and documents, the reliability of all search results obtained by electronic transmission, the accuracy of the results of any printed or computer search of offices of public record and that the applicable filings, registrations or recordings referred to in the searches conducted relate to the Documents and continue to be effective and unchanged as of the date of this opinion.

9. We have assumed the conduct of the parties to the Documents has complied with any requirement of good faith, fair dealing and conscionability, and that Nexcap, and any agent acting for Nexcap, in connection with the Documents, have acted in good faith and without notice of any defence against the enforcement of any rights created by, or adverse claim to, any property or security interest transferred, or created, as part of, the Documents.

10. We have assumed, for the purposes of any opinion relating to the validity, perfection or effect of perfection or non-perfection of any security interest in any personal property, that:

(a) the PPSA applies to such personal property and security interest;

(b) value has been given (within the meaning of Section 11(2) of the PPSA);

(c) Nexcap has not agreed to postpone the time for attachment of any of the security interests created by the Documents and that attachment, within the meaning of the PPSA, of the security interests constituted by the Documents, has occurred;

(d) such personal property does not constitute "consumer goods" as defined in the PPSA;

(e) this collateral comprises tangible personal property situated in the Province of Ontario; and

(f) the Debtor has rights in such personal property.

11. We have not undertaken any independent investigation to verify the correctness of any of the foregoing assumptions.

QUALIFICATIONS

1. The enforceability of the Documents and the rights and remedies set out therein or any judgment arising out of or in connection therewith may be limited by any applicable bankruptcy, insolvency, winding-up, reorganization, arrangement, moratorium, fraudulent preference, fraudulent conveyance, oppression or other laws affecting creditors' rights generally. We express no opinion as to whether the Documents could be attacked under any such legislation or in any manner, including:

   (a) the costs of and incidental to a proceeding to enforce a Document are in the discretion of an Ontario court of competent jurisdiction (the "**Court**"), and the Court may determine by whom and to what extent the costs shall be paid;

   (b) under the *Courts of Justice Act* (Ontario) interest after judgment may be limited to a rate which is less than a rate specified in any Document;

   (c) section 347 of the *Criminal Code* (Canada) prohibits the payment of "interest" at a "criminal rate" (as such terms are defined therein);

   (d) any action on any Document may be barred by the *Limitations Act* (Ontario) after the applicable limitation period has expired;

   (e) a judgment by the Court for the payment of an amount of money may only be awarded in Canadian currency and may be based on a rate of exchange in existence on a date other than the date of payment.

2. We express no opinion regarding the enforceability of any provision of the Documents which purports to provide that any portion thereof which is unenforceable may be severed without affecting the enforceability of the remaining provisions.

3. We express no opinion as to the legal or beneficial right, title or interest of the Debtor to any of the collateral subject to the Documents and such title has been assumed to the full extent necessary to express the opinions herein contained.

4. We express no opinion as to the ranking or priority of any security interest, lien, hypothec or security interest expressed to be created by or under the Documents. We note that the order of registration of a security interest under the PPSA is not absolutely indicative of priority. There are exceptions to priority by registration, not limited to, the case of

investment property, purchase money security interests, interests not governed by or subject to the PPSA and unregistered government claims.

5. We express no opinion regarding the creation, validity, enforceability, perfection or priority of any security interest, mortgage, charge, lien, hypothec or other interest in, or the enforceability of, the Documents insofar as it relates to any:

(a) real property, fixtures, claims or rights, or a lease of real property, or any interest in real property or right to payment that arises in connection with an interest in land;

(b) policy of insurance or contract of annuity;

(c) trade-mark, copyright, industrial design, patent, patent application, licence, approval, privilege, quota, franchise, permit or any other intellectual property, regulatory authorizations or other similar property which is not personal or movable property;

(d) consumer goods (as such item is defined in the PPSA);

(e) interest in a right to damages in tort or at law;

(f) debt owing to the Debtor by the Crown or any agent thereof;

(g) any property which is an interest in an unearned right to payment under a contract to a transferee who is to perform the transferor's obligations under the contract.

6. We express no opinion as to the enforceability of any provisions in any of the Documents, which:

(a) purport to directly or indirectly exclude unwritten variations, waivers or consents of, to or under the Documents or restrict their effect;

(b) provide for agreement at a later date;

(c) purport to restrict the access to, waive or purport to waive the benefit or protection of, any legal or equitable rights, remedies or defences, or principle of statutory protection based on public policy, including any rights to notices, including notices of enforcement,

(d) provide for obligations, rights or remedies which are inconsistent with any other provisions of the Documents or subject or subordinate to, or overridden by, other provisions in the Documents;

(e) provide for evidentiary standards as being conclusive and binding;

(f) purport to bind or affect, or confer a benefit upon, persons who are not parties to the Documents;

(g) purport to establish evidentiary standards, such as provisions stating that certain determinations, calculations, requests or certificates will be conclusive or binding; or

(h) appoint or constitute any person as attorney for the Debtor to execute any document or do any other act on behalf of the Debtor.

7. Each of the Documents may be subject to:

(a) the court's powers to stay proceedings and execution of judgments;

(b) applicable laws regarding limitation of actions;

(c) the court's discretion to decline to hear any action or give effect to any obligation if to do so would be contrary to public policy; and

(d) implied obligations of good faith, fair dealing and reasonableness in the performance of a contract;

8. Provisions providing for the recovery of fees and expenses may be restricted by a court to a reasonable amount and counsel fees may be subject to taxation.

9. No opinion is expressed concerning the applicability of any equitable right or remedy, nor concerning equitable limitations on, and defences against, the availability of remedies and equitable principles of application to proceedings at law or in equity.

10. No opinion is expressed as to the creation, validity, enforceability, attachment or perfection of any mortgage, charge, hypothec, security interest or other interests expressed to be created by or under any of the Documents with respect to any property of the Debtor or any proceeds of such property that are not identifiable or traceable.

11. No opinion is expressed as to the maintenance of perfection of any security interest created by any of the Documents.

12. Notwithstanding that, subject to attachment, registration under the PPSA will perfect a secured party's security interest in all forms of personal property to the extent that such statute applies to such personal property, only perfection by (i) possession by or on behalf of the secured party of chattel paper and instruments (including certain types of letters of credit and advances of credit and negotiable documents of title), and (ii) control by or on behalf of the secured party of Investment Property (within the meaning of the PPSA), is sufficient to defeat the interest of certain specified parties as provided for under the PPSA.

13. No opinion is expressed in this Report as to whether Nexcap has obtained "control", as defined in s.1(2) of the PPSA, over any form of collateral over which the provisions of the Ontario *Securities Transfer Act, 2006* ("**STA**") apply, or whether security interests in any personal property collateral have been perfected by Nexcap or any other person other than by registration in accordance with the provisions of the PPSA.

14. A security interest perfected by registration of a financing statement under the PPSA will only remain perfected by such registration until the expiry date shown in respect of that registration, unless renewed before that date by the filing of a financing change statement or Form 3C properly completed in the manner prescribed under the PPSA. Any change in corporate name of, or the adoption or change of a French form of the name of, or a transfer to any third party of any of its property subject to the security interests created in favour of the holder of any Document would require timely registration of a financing change statement properly completed in the manner prescribed under the PPSA to preserve the priority and perfection of the security interests therein.

15. Any security interest expressed to be created under any of the Documents in any collateral acquired by the Debtor after the execution and delivery of the relevant Document will not attach to such collateral (and will not be enforceable against third parties or perfected) until the Debtor acquires rights in such collateral.

16. The views expressed in this opinion unless otherwise noted are limited to the PPSA and therefore do not address (i) laws of jurisdictions other than the Province of Ontario; (ii) Ontario law, except for the PPSA; (iii) collateral of a type not subject to the PPSA, including the types of collateral enumerated under s.4 or the PPSA; or (iv) the creation or perfection of any security interest with respect to property for which, pursuant to applicable conflicts rules (including, without limitation, the conflicts rules of the PPSA) the validity, perfection and effect of perfection or non-perfection or enforcement are governed by the laws of a jurisdiction other than Ontario.

17. Any views expressed with respect to the personal property security held by Nexcap are based solely upon a review of the information provided to us by the Ministry. We express no opinion with respect to (i) any subordination or postponement agreements, or (ii) any unregistered or unperfected claims of third parties whether now existing or arising in the future, including legislative super-priority claims, liens, charges or trusts, which may, in the absence of any registration or other means of perfection, rank in priority to, or take precedence over, the security interests of Nexcap.

18. We express no opinion as to title to, rights in or the beneficial or equitable interest of the Debtor, Nexcap or any other person in any real property, personal property or lease of real or personal property.

19. With respect to the security interests in the Collateral created under the Documents:

    (a) acceleration, enforcement and realization under the Documents may be limited or conditioned by statutory conditions contained in the PPSA;

(b) a security interest in instruments, securities, chattel paper and negotiable documents of title may be perfected by registration, but will be defeated by certain claimants obtaining possession or control of such property in the circumstances described in the PPSA, STA or the *Bills of Exchange Act* (Canada), as applicable;

(c) a security interest in goods will be defeated by certain claimants to whom the Debtor sells, leases or encumbers those goods in the ordinary course of business, in the circumstances described in the PPSA;

(d) a security interest in motor vehicles sold outside of the ordinary course of business may be taken by the buyer free of any security interest, even if perfected by registration, unless the VIN is included in the PPSA registration (which, as noted above, Nexcap's registration did not include); and

(e) no opinion is expressed with respect to any security interest in collateral that is transformed in such a way that it is not identifiable or traceable or in any proceeds of collateral that are not identifiable or traceable.

20. A receiver or receiver and manager appointed pursuant to any Document may, for certain purposes, be treated by the Court as being the agent of Nexcap and not solely the agent of the Debtor (and Nexcap may not be deemed to be acting as the agent or attorney of the Debtor in making such appointment), notwithstanding any provision in any of the Documents to the contrary.

21. Provisions in any Document to the effect that Nexcap is not responsible to the Debtor for its own misconduct or negligence, or the misconduct or negligence of any agent, receiver or receiver and manager appointed by Nexcap, may be invalid.

22. The effectiveness of provisions of any Document which purport to relieve a person from a liability or duty otherwise owed may be limited by law, and provisions requiring indemnification or reimbursement may not be enforced by the Court to the extent they relate to the failure of such person to have performed such duty or liability.

23. The fixed and specific security interests expressed to be created by any Document may be ineffective in respect of any collateral not in existence on, or acquired by the Debtor, after the date of delivery of the Document, or not described with sufficient particularity therein, with the result that such collateral will be subject to a security interest which is not in the nature of a fixed and specific security.

24. No opinion is expressed in this opinion letter as to whether it may be necessary in connection with the enforcement of any Document for Nexcap, the Debtor or any other persons proposing to acquire, own or operate all or any part of the property secured thereunder, to give any notice or obtain or effect any licence, franchise, permit, consent, approval, registration or other authorization or exemption in connection therewith.

25. We have not conducted any searches in respect of any trade marks, trade names, industrial designs, patents, copyrights or other intellectual property interests and no opinion is expressed with respect to the validity or effectiveness of the security interests of Nexcap in relation to any such property. A security interest in (i) a trade mark, copyright, industrial design, patent, patent application, license or any goods purchased under any licence, (ii) an approval, privilege, quota, franchise, permit or lease, and (iii) an instrument, contract, account or agreement may not be perfected, valid, binding or enforceable because of the nature or terms of such property, or to the extent the nature or terms of such property or any statute or regulation require a consent, approval, acknowledgement, notice or other authorization or registration which has not been given or made.

26. Our opinions do not address any of the following matters:

    (a) any required registration, filing, recording or notice in respect of any fixtures, or goods that may become fixtures;

    (b) any required caution filing which may be required in certain circumstances where goods are intended to be brought or are brought into Ontario; or

    (c) any required registration, filing, recording or notice in respect of any real property rights or interests of any of the Documents.

27. No opinion is expressed in this opinion letter as to any of those matters, which we have assumed for the purposes of rendering the opinions expressed above. All opinions which expressly, or by necessity, relate to the validity and enforceability of each of the Documents may be subject to any of the foregoing matters and limitations.

Appendix B

APPENDIX B

Terrace Bay Pulp Inc.
Actual Cash Flows
March 11 to March 29, 2009
CDN$000s

	Actual				Forecast				Variance			
Week Ended	15-Mar-09	22-Mar-09	29-Mar-09	Total	15-Mar-09	22-Mar-09	29-Mar-09	Total	15-Mar-09	22-Mar-09	29-Mar-09	Total
Receipts												
Customer receipts	1,121	2,578	1,839	5,538	1,200	2,000	2,000	5,200	(79)	578	(161)	338
GST	-	-	-	-	-	-	100	100	-	-	(100)	(100)
Other receipts	65	-	-	65	-	-	-	-	65	-	-	65
Total receipts	1,186	2,578	1,839	5,603	1,200	2,000	2,100	5,300	(14)	578	(261)	303
Disbursements					-	-	-					
Freight & sales agent	-	(229)	(307)	(535)	(333)	(333)	(333)	(998)	333	104	26	462
Salaries & wages	(127)	-	(56)	(183)	(73)	-	(122)	(195)	(54)	-	66	12
Payroll withholdings	(0)	(70)	-	(71)	-	(65)	-	(65)	(0)	(5)	-	(6)
Benefits & pension	-	-	(153)	(153)	-	(200)	-	(200)	-	200	(153)	47
WSIB	-	-	(0)	(0)	-	-	-	-	-	-	(0)	(0)
Vacation pay	-	-	-	-	-	-	-	-	-	-	-	-
Utilities & fuel	-	-	-	-	(109)	(1,290)	-	(1,399)	109	1,290	-	1,399
Insurance	-	-	-	-	-	-	-	-	-	-	-	-
Interest payments to secured creditors	-	-	-	-	-	-	-	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-	-	-	-	-	-	-	-
Restructuring costs	-	-	(38)	(38)	(150)	(50)	(50)	(250)	150	50	12	212
Total disbursements	(127)	(299)	(553)	(980)	(665)	(1,938)	(505)	(3,107)	538	1,639	(49)	2,127
Cash Flow	1,059	2,279	1,286	4,624	535	63	1,596	2,193	524	2,217	(310)	2,431
Bank balance, opening	2,048	3,107	5,386	2,048	299	834	897	299	1,749	2,272	4,489	1,749
Cash flow	1,059	2,279	1,286	4,624	535	63	1,596	2,193	524	2,217	(310)	2,431
Bank balance, closing	3,107	5,386	6,672	6,672	834	897	2,492	2,492	2,272	4,489	4,179	4,179

Appendix C

APPENDIX C

Terrace Bay Pulp Inc.
CCAA Cash Flows (Revised)
14 Week Period Ending July 5, 2009
(CDN$000s)

Week Ended	05-Apr-09	12-Apr-09	19-Apr-09	26-Apr-09	03-May-09	10-May-09	17-May-09	24-May-09	31-May-09	07-Jun-09	14-Jun-09	21-Jun-09	28-Jun-09	05-Jul-09	Total
Receipts															
Customer receipts	2,250	1,604	2,000	1,889	2,108	2,030	2,751	2,188	2,188	2,188	2,188	2,188	2,188	2,188	29,944
GST	-	100	-	-	25	-	-	-	25	-	-	-	-	-	150
Other receipts	-	4,590		-	-	-	-	-	-	-	-	-	-	-	4,590
Total receipts	2,250	6,294	2,000	1,889	2,133	2,030	2,751	2,188	2,213	2,188	2,188	2,188	2,188	2,188	34,684
Disbursements															
Freight & sales agent	(294)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(333)	(4,617)
Salaries & wages	(73)	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	(927)
Operations	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(70)
Payroll withholdings	(74)	-	(278)	-	(65)	-	(280)	-	(65)	-	(65)	(215)	(65)	-	(1,107)
Benefits & pension	(103)	-	(200)	-	(50)	-	(50)	-	-	(50)	(50)	-	-	(50)	(553)
WSIB	-	-	-	-	(5)	-	-	-	-	(12)	-	-	-	(12)	(29)
Vacation pay	(304)	-	-	-	(304)	-	-	-	-	(304)	-	-	-	-	(912)
Utilities & fuel	-	(2,545)	(80)	(80)	(380)	(80)	(80)	(80)	(380)	(80)	(80)	(80)	(380)	(80)	(4,405)
Insurance	(188)	-	-	-	(188)	-	-	-	-	(188)	-	-	-	(188)	(752)
Interest payments to secured creditors		(150)	-	-	(138)	-	-	-	-	(90)	-	-	-	(36)	(414)
Principal payments to secured creditors	-	(4,500)	(3,500)	(1,000)	(1,000)	(1,000)	(1,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(1,000)	(25,000)
Restructuring costs	(10)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(660)
Total disbursements	(1,051)	(7,705)	(4,446)	(1,590)	(2,518)	(1,590)	(1,798)	(2,590)	(2,833)	(3,234)	(2,583)	(2,805)	(2,833)	(1,876)	(39,446)
Cash Flow	**1,199**	**(1,411)**	**(2,446)**	**299**	**(385)**	**440**	**953**	**(402)**	**(620)**	**(1,046)**	**(395)**	**(617)**	**(645)**	**312**	**(4,762)**
Bank balance, opening	6,672	7,871	6,461	4,015	4,314	3,930	4,370	5,323	4,921	4,301	3,255	2,860	2,243	1,598	6,672
Cash flow	1,199	(1,411)	(2,446)	299	(385)	440	953	(402)	(620)	(1,046)	(395)	(617)	(645)	312	(4,762)
Bank balance, closing	7,871	6,461	4,015	4,314	3,930	4,370	5,323	4,921	4,301	3,255	2,860	2,243	1,598	1,910	1,910
Nexcap loan, opening	25,000	25,000	20,500	17,000	16,000	15,000	14,000	13,000	11,000	9,000	7,000	5,000	3,000	1,000	25,000
Payments to Nexcap	-	(4,500)	(3,500)	(1,000)	(1,000)	(1,000)	(1,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(1,000)	(25,000)
Nexcap loan, closing	25,000	20,500	17,000	16,000	15,000	14,000	13,000	11,000	9,000	7,000	5,000	3,000	1,000	-	-
Accounts receivable, opening	15,431	15,211	16,357	16,545	16,843	16,923	17,081	16,518	16,518	16,518	16,518	16,518	16,518	16,518	15,431
Sales	2,030	2,751	2,188	2,188	2,188	2,188	2,188	2,188	2,188	2,188	2,188	2,188	2,188	2,188	31,030
Collections of accounts receivable	(2,250)	(1,604)	(2,000)	(1,889)	(2,108)	(2,030)	(2,751)	(2,188)	(2,188)	(2,188)	(2,188)	(2,188)	(2,188)	(2,188)	(29,944)
Accounts receivable, closing	15,211	16,357	16,545	16,843	16,923	17,081	16,518	16,518	16,518	16,518	16,518	16,518	16,518	16,518	16,518
Inventory tons (admt)	49,556	46,056	42,556	39,056	35,556	32,056	28,556	25,056	21,556	18,056	14,556	11,056	7,556	4,056	