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.

FOURTH REPORT OF ERNST & YOUNG INC.

DATED SEPTEMBER 1, 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**"). On April 8, 2009, this Honourable Court ordered that the Stay Period be extended to June 30, 2009 (the "**April 8 Order**") and on June 19, 2009, (the **"June 19 Order")** ordered that the Stay Period be extended to September 30, 2009.

2. The Monitor filed with this Honourable Court its first Report (the "**First Report**") on April 6, 2009, its Second Report (the **"Second Report")** on May 25, 2009, and its Third Report (the "**Third Report**") on June 15, 2009. A copy of all Monitor reports that are filed and all Court Orders issued and motion material filed in these CCAA proceedings are posted on the Monitor's website at www.ey.com/ca/terracebay.

PURPOSE

3. The purpose of this fourth report of the Monitor (the "**Fourth Report**" or this "**Report**") is to update this Honourable Court on:

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

   (b) certain statutory claims that have been asserted;

   (c) the resolution of a dispute in relation to certain fees being claimed by Nexcap (the "**Nexcap Fees**") and the release of a certain reserve in the amount of $200,000, being held by the Monitor pursuant to the June 19 Order, as a result of such resolution;

   (d) the anticipated additional repayment of $6,000,000 by Terrace Bay to Lucky Star Holdings Inc. ("**Lucky Star**"); and

   (e) a proposed forestry management agreement between Terrace Bay and GreenForest Management Inc. ("**GMI**").

BACKGROUND

4. 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.

5. In 2006, Terrace Bay purchased the Terrace Bay pulp mill operations and other assets from its former owner, Neenah Paper Company of Canada.

6. Terrace Bay is wholly owned by Lucky Star.

7. Prior to commencing this CCAA proceeding and due to the current difficulties in the global pulp and paper market, Terrace Bay had 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.

8. Activity at the mill site is currently limited. The primary activity of Terrace Bay at the current time 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 the mill site and at various warehouses located throughout North America. Terrace Bay has now sold all such saleable inventory.

9. The other activities of Terrace Bay relate to the preservation of the mill and related machinery and equipment and the maintenance of its water pump house. 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.

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

11. In the materials supporting Terrace Bay's initial application, Terrace Bay indicated that, while the mill was shut down, it would be undertaking a process to either find a buyer for the mill or to secure a capital source to refinance Terrace Bay's activities. A brief update on the activities of Terrace Bay with regard to these items is included in this Fourth Report.

TERMS OF REFERENCE

12. In preparing this Fourth Report, EYI 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. 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 Fourth Report. Some of the information referred to in this Fourth 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 Fourth 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

13. Terrace Bay and the Monitor have continued to review alternatives and maintain discussions with parties that have expressed an interest in financing the restart of Terrace Bay's operations. While discussions continue, no arrangements have been concluded.

14. The Monitor will more fully report on the status of the restructuring process prior to the expiration of the Stay Period.

STATUS OF NEXCAP REPAYMENTS AND COMTEMPLATED ADDITIONAL REPAYMENT TO LUCKY STAR

15. Nexcap's principal balance outstanding at the commencement of this CCAA proceeding was $25,000,000. Since the commencement of the CCAA proceedings, Terrace Bay has paid $24,000,000 in principal and approximately $414,000 in interest to Nexcap. Terrace Bay projects that it will fully repay the principal amount owing to Nexcap shortly following the end of August 2009, coincident with the discharge of Nexcap's security.

16. The June 19 Order directed an amount of $200,000 to be held by the Monitor in reserve in relation to the claimed Nexcap Fees, being certain additional fees being claimed by Nexcap, which were disputed by Terrace Bay. Nexcap and Terrace Bay have now

reached agreement regarding the Nexcap Fees. As such, The Monitor is advised that Terrace Bay intends to proceed with the payment of the agreed upon amount and all other amounts outstanding to Nexcap, and also will be seeking an order for the release by the Monitor of the funds it has been holding in reserve in relation to the Nexcap Fees.

17. Terrace Bay has provided the Monitor with information verifying that it has received loans from Lucky Star in the aggregate amount of $14,000,000 (the "**Lucky Star Indebtedness**"). Pursuant to the June 19 Order, Terrace Bay repaid $7,000,000 of the Lucky Star Indebtedness. The Monitor understands that a further order from this Honourable Court is now being sought by Terrace Bay to make an additional repayment of $6,000,000 owing by Terrace Bay to Lucky Star.

18. As previously reported by the Monitor in the First Report, Lucky Star holds a debenture dated May 5, 2008, pursuant to which Terrace Bay agreed to pay the principal sum of $13,000,000 on demand (the "**Debenture**"). Pursuant to the Debenture, Terrace Bay has granted security interests and charges in favour of Lucky Star against the real and personal property of Terrace Bay. In consideration of a loan from Lucky Star to Terrace Bay of a sum stated to be $5,000,000, Lucky Star and Terrace Bay entered into a purchase money security agreement (the "**Security Agreement**"). Pursuant to the Security Agreement, Terrace Bay has granted a security interest to Lucky Star against a certain turbine and related assets as described in Schedule "A" to the Security Agreement (the "**Turbine Assets**"). The Security Agreement is stated to be a purchase money security agreement. The Turbine Assets have not been sold and remain subject to the security interests granted to Lucky Star.

19. The Monitor has previously reported to this Honourable Court that Lucky Star did not register any security in the Province of Quebec and that the security registrations of Nexcap made in the Province of Quebec did not appear to have resulted in Nexcap holding security against the assets of Terrace Bay situated in Quebec, which at the time of the CCAA filing consisted of certain moveable inventory (the "**Quebec Inventory**").

20. At the time of the CCAA filing and following, certain of the inventory of Terrace Bay was situated in the United States. The Monitor has requested advice from United States'

counsel, Paul, Weiss, Rifkin, Wharton & Garrison LLP ("**Paul Weiss**"), regarding the status of the security interests of Lucky Star in relation to inventory situated in the United States. In this regard, Lucky Star did not make any registrations under Article 9 of the United States Uniform Commercial Code (the "**UCC**") until July 1, 2009. Attached as **Appendix "A"** to this Report is a copy of the report of Paul Weiss to the Monitor dated July 28, 2009 (the "**Paul Weiss Report**"). Subject to the assumptions and qualifications in the Paul Weiss Report, Paul Weiss has advised the Monitor that no registrations under the UCC need to be made in the United States to perfect a security interest against inventory that has been properly perfected under Ontario law. In the First Report, the Monitor reported to this Court that this was the case.

21. The Monitor is advised by Terrace Bay that the market value of the Quebec Inventory was approximately $4,600,000 when these proceedings were commenced on March 11, 2009. In the period since March 11, 2009, and as reflected in **Appendix "B"** to this Report, total receipts to August 14, 2009 were approximately $57,237,000. During this same period, total disbursements, excluding payments to Nexcap and Lucky Star, were approximately $14,812,000, resulting in there being total net proceeds, excluding payments to Nexcap and Lucky Star, of approximately $42,425,000. As such, sufficient net proceeds have been realized, other than in relation to the proceeds realized from the disposition of the Quebec Inventory, even following payment of all disbursements, out of which payment of the entire secured amount owing to Nexcap of $25,000,000, and $13,000,000 of the amount due to Lucky Star could be made by Terrace Bay, including the additional payment of $6,000,000 that Terrace Bay now proposes to make to Lucky Star. Following this payment, Lucky Star will still be owed the principal sum of $1,000,000, which is secured against the Turbine Assets.

STATUTORY CLAIMS

22. As previously reported to this Honourable Court, the Monitor is aware that certain parties have commenced actions (collectively, the "**FWLWA Actions**") to assert lien rights under the Ontario *Forestry Workers Lien for Wages Act* (the "**FWLWA**") in relation to certain logs and/or wood chips that are located on property owned by Terrace Bay (the

"**Timber Assets**"). Some or all of the Timber Assets may be owned by BFPL. Terrace Bay has been named as a defendant in some, but not all of the FWLWA Actions.

23. In the Second Report and the Third Report, the Monitor reported on the status of the FWLWA Actions. On August 14, 2009, counsel for Terrace Bay wrote to the FWLWA claimants and the Buchanan Receiver, to advise them that, as Terrace Bay did not dispute that the Timber Assets are the property of BFPL, the claimants had no basis to pursue any claims against Terrace Bay. Counsel for Terrace Bay requested any parties seeking relief against Terrace Bay in the FWLWA Actions to advise him of this by August 21, 2009. Attached as **Appendix "C"** is a copy of the letter of counsel for Terrace Bay. As of August 31, 2009, the Monitor was advised that no response had been received by counsel for Terrace Bay to this letter.

FORESTRY MANAGEMENT AGREEMENT WITH GREENFOREST MANAGEMENT INC.

24. GMI is owned by a person related to the principals of Terrace Bay.

25. Terrace Bay is the holder of a Sustainable Forest Licence #542256 (the "**SFL**") in respect of the Kenogami Forest issued by the Ministry of Natural Resources. As the holder of the SFL, Terrace Bay has harvest rights in the Kenogami Forest which is one of the main sources of fibre for the Terrace Bay mill. The SFL is critical for the long term viability of the mill. Terrace Bay also has certain responsibilities, as the SFL holder, related to the management of the forestry resource. These include silviculture operations, forestry monitoring and reporting activities that are required for Terrace Bay to remain in compliance with government regulations and the Ontario *Crown Forest Sustainability Act* (the "**Forest Management Obligations**").

26. Prior to being placed in receivership, Terrace Bay outsourced most of the Forest Management Obligations to BFPL.

27. The Monitor understands that, since the commencement of this CCAA proceeding, and following the receivership of BFPL, the Forest Management Obligations have been performed by GMI.

28. The Monitor understands that Terrace Bay will be seeking the approval of this Honourable Court in relation to a forestry management agreement dated April 1, 2009 (the "**FMA**") that has been entered into between Terrace Bay and GMI. A copy of the FMA is attached as **Appendix "D"** to this Fourth Report.

29. The FMA appoints GMI as the manager of the Kenogami forest SFL to perform the Forest Management Obligations on behalf of Terrace Bay. The services provided by GMI under the FMA include forestry management and planning, silviculture and operational planning in addition to providing reports to Terrace Bay to permit it to document that the services required under the SFL are being performed. The initial contract term commences on April 1, 2009, and runs for twenty years, with annual renewals thereafter. The FMA can be terminated in the event of default by one of the parties, the surrender by Terrace Bay of the SFL or the termination, revocation, cancellation or suspension of the SFL for a period of greater than twelve months by the Ontario Ministry of Natural Resources. GMI is to be compensated on the basis of its costs incurred, plus an administration fee. As described in the FMA, budgets are to be agreed and established annually on the basis of the services to be rendered in the following year. For 2009, the budget has been established at approximately $549,000, with monthly invoicing totalling approximately $46,000 per month, exclusive of taxes. The FMA has been executed, but no payments have been made by Terrace Bay to GMI, pending Terrace Bay obtaining the approval of this Honourable Court to enter into the FMA.

30. Terrace Bay does not have the capacity to undertake the Forest Management Obligations. The Monitor is of the view that the economic provisions of the FMA are not unreasonable and represent an approximation of what Terrace Bay would be required to pay were it to contract with an arms length party. The Monitor understands that on September 8, 2009, the sum of approximately $288,027.16 will be owed by Terrace Bay to GMI under the FMA. Subject to the approval of the FMA by this Honourable Court, the Monitor considers it reasonable for Terrace Bay to make payment of such amount.

MONITOR'S RECOMMENDATION

31. As referenced in this Fourth Report, the Monitor considers that the following orders being sought by Terrace Bay are reasonable in the circumstances and supports the following orders being made by this Honourable Court:

(a) permitting Terrace Bay to make a further payment of the sum of $6,000,000 to Lucky Star in repayment of the principal amount outstanding under the Debenture;

(b) approving of the release by the Monitor to Terrace Bay of the sum of $200,000 it has been holding in reserve pursuant to the June 19 Order in relation to the Nexcap Fees and the payment by Terrace Bay to Nexcap of the amount it has agreed upon with Nexcap in final settlement of the Nexcap Fees;

(c) approving of the entry of Terrace Bay into the FMA with GMI *nunc pro tunc* as of April 1, 2009 and the payment of the sum of $288,027.16 by Terrace Bay pursuant to the FMA; and

(d) an order approving of the Fourth Report and the conduct and activities of the Monitor and its counsel as reported on therein.

All of which is respectfully submitted this 1st day of September, 2009.

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

Per:

Alex Morrison
Senior Vice President

Appendix A

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP
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July 28, 2009

MEMORANDUM

To Ernst & Young Inc.
Ernst & Young Tower
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Lang Michener LLP
181 Bay Street, Suite 2500
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From Claudia R. Tobler
Mark R. Laramie

Subject Terrace Bay Pulp Inc.

I. Overview

Ernst & Young Inc., in its capacity as monitor in the matter of Terrace Bay Pulp Inc., as a debtor in a proceeding under Canada's *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, has asked us to determine whether Lucky Star Holdings Inc. ("Lucky Star") properly perfected its security interest in certain assets of Terrace Bay Pulp Inc. ("Terrace Bay" or the "Debtor") located in the U.S. under applicable United States law. Specifically, we were asked to analyze whether under the United States Uniform Commercial Code Article 9 as revised (the "UCC" and Article 9 thereof, as revised, "Article 9"), Lucky Star would be perfected in inventory located in the United States assuming that Lucky Star were properly perfected under the laws of Ontario, Canada. While the answer is not free from doubt, subject to the assumptions and

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qualifications contained herein, if Lucky Star is properly perfected under applicable Canadian law, including by way of a central filing in the jurisdiction of the Debtor's location, Lucky Star is perfected in Terrace Bay's inventory located in the United States under Article 9.

In reaching this conclusion, we assume, without expressing an independent view, that the governing loan documents and security agreement are enforceable under Canadian law, that all actions under Canadian law have been taken to give rise to an enforceable security interest in favor of Lucky Star, that such security interest would be recognized under applicable United States law, that the Debtor has rights in the collateral, that value has been given by Lucky Star, and that Lucky Star is properly perfected in the collateral located in the United States under applicable Canadian law. We further assume, without expressing an independent view, that the inventory at issue are "goods" within the meaning of the UCC, that Terrace Bay is a valid corporation, duly existing under the laws of Canada, and that its "chief executive office," as that term has been interpreted under the UCC, is in Ontario, Canada.[1] We do not express any view as to the scope of the grant of a security interest in the collateral, and whether it would, in fact, cover all personal property recognized under the UCC.

II. <u>Overview of Applicable Law</u>

Article 9 has been enacted in each state[2] and applies to transactions that create security interests in personal property by contract.[3] Section 9-301 of Article 9

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[1] *See* UCC § 9-307, official comment 2 ("'Chief executive office' means the place from which the debtor manages the main part of its business operations or other affairs.").

[2] *See* 9B Frederick H. Miller & Neil B. Cohen, *Hawkland U.C.C. Series* § 9-301:3 (2009); 4 James J. White & Robert S. Summers, *Uniform Commercial Code* § 31-16 (5th

determines the jurisdiction whose law governs the perfection of a security interest.[4] It provides:

> Except as otherwise provided in Section 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:
>
> > (a) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.
> >
> > (b) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.
> >
> > (c) Except as otherwise provided in paragraph (d), while negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:
> > (1) perfection of a security interest in the goods by filing a fixture filing;
> > (2) perfection of a security interest in timber to be cut; and
> > (3) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.
> >
> > (d) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.
> >
> > (e) When collateral is a cooperative interest, the law of this state governs perfection, the effect of perfection or nonperfection, and the priority of the security interest in such collateral.

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ed. 2002) (hereinafter "White & Summers"). For purposes of this memorandum, we rely upon the provisions of Article 9 as enacted in the State of New York.

[3] *See* UCC § 9-109(a).

[4] *See* UCC § 9-301.

Section 9-301(a) of Article 9 thus contains the general rule: the law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under Section 9-307 of Article 9.

Several exceptions exist to this general rule. It does not apply to goods covered by a certificate of title (*see* Section 9-303 of Article 9); deposit accounts (*see* Section 9-304 of Article 9); investment property (*see* Section 9-305 of Article 9); or letter-of-credit rights (*see* Section 9-306 of Article 9). The general rule – *i.e.,* that the law of the debtor's location determines perfection – also does not apply to: possessory security interests that the secured party has perfected by taking possession of the collateral (*see* Section 9-301(b) of Article 9);[5] security interests perfected by filing a fixture filing (*see* Section 9-301(c)(1)); security interests in timber to be cut (*see* Section 9-301(c)(2)); security interests in as-extracted collateral (*see* Section 9-301(d)); or security interests in a cooperative interest (*see* Section 9-301(e)).

Assuming that none of the exceptions to the general rule of Section 9-301 of Article 9 apply, the law of the jurisdiction of the debtor's location, as determined by Section 9-307 of Article 9, governs perfection of a nonpossessory security interest in goods. Section 9-307(b) of Article 9 states the general rules for determining a debtor's location: An individual debtor is deemed to be located at the individual's principal residence with respect to both personal and business assets. Any other debtor is deemed

[5] Section 9-301(b) applies to possessory security interests and provides that perfection is governed by the local law of the jurisdiction in which the collateral is located. *See* UCC § 9-301(b).

to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business.[6]

> Certain exceptions to this general rule exist. In particular, the rule
>
> applies only if a debtor's . . . chief executive office . . . is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.[7]

If no such law exists under foreign law, the debtor is deemed to be located in the District of Columbia.[8]

When read together, Sections 9-301 and 9-307 of Article 9 render foreign law applicable to international secured transactions but contingent on the substantive law of the foreign debtor's jurisdiction.[9] If the foreign legal system is equivalent to an Article 9 filing system with respect to perfecting nonpossessory security interests, Article 9-307(c) defers to foreign law.[10] If not, the debtor is deemed to be located in the

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[6] UCC § 9-307(b)(3). This rule applies to debtors organized under the laws of a non-United States jurisdiction. Hans Kuhn, *Multi-State and International Secured Transactions Under Revised Article 9 of the Uniform Commercial Code*, 40 Va. J. Int'l L. 1009, 1048-49 (2000) (hereinafter "Kuhn"). Companies incorporated or formed under United States state law (i.e., "registered organizations" within the meaning of Article 9) are deemed located in that state. UCC § 9-307(e); *see also* UCC § 9-307(f) (discussing location of entities formed under United States federal law).

[7] *See* UCC § 9-307(c).

[8] *Id.*

[9] Kuhn, *supra*, note 6, at 1049-50.

[10] *Id.*

District of Columbia and consequently, United States law (*i.e.*, Article 9) would govern perfection.[11]

Whether any particular non-U.S. jurisdiction's filing, recording, or registration system is equivalent to systems established under Article 9 remains an open question.[12] U.S. scholarly legal authority has generally concluded that Canada, in which most if not all of the provinces and territories except Quebec have enacted Personal Property Security Acts ("PPSAs") that are based on earlier versions of Article 9, has such a regime.[13] However, we have been unable to locate any United States case in which a court expressly reached this conclusion, and indeed, "reported cases involving foreign legal systems are rare."[14] For this reason, as we noted in our earlier memorandum,[15] although a Canadian secured party could argue that solely Canadian law governs perfection, we understand that many Canadian creditors file against a debtor concurrently in the District of Columbia as a matter of practice.

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[11] UCC § 9-307(c); Kuhn, *supra* note 6, at 1049-50.

[12] *See, e.g.*, Arnold S. Rosenberg, *Where to File Against Non-U.S. Debtors: Applying UCC § 9-307(c)[Rev] to Foreign Filing, Recording, and Registration Systems*, 39 UCC L.J. 2 Art. 1, 36 (2006) (hereinafter "Rosenberg").

[13] *See, e.g.*, *id.* ("Canadian law is based on an earlier version of Article 9 and therefore satisfies the Equivalence Test of § 9-307(c)"); Kuhn, *supra*, note 6, at 1053 ("[t]here is no doubt that [the Canadian common law jurisdictions'] legal regime satisfies the . . . test imposed by" UCC § 9-307(c)); Carl S. Bjerre, *International Project Finance Transactions: Selected Issues Under Revised Article 9*, 73 Am. Bankr. L.J. 261, 273-74 (1999) (hereinafter "Bjerre") (noting that Canada is one of the few jurisdictions that maintain a filing system for perfection). *See also* UCC § 9-307, official comment 3 ("A jurisdiction that has adopted this Article [9] or an earlier version of this Article" is a jurisdiction of the type described in section 9-307(c)).

[14] Kuhn, *supra* note 6, at 1016.

[15] *See* Memorandum to Ernst & Young Inc. from Claudia R. Tobler and Sarah Harnett dated April 1, 2009 re: Terrace Bay Pulp Inc.

III. Analysis

Although not free from doubt, applying Sections 9-301 and 9-307 of Article 9 to the present facts, we believe that Lucky Star would be perfected under Article 9 for U.S. law purposes. This assumes that Terrace Bay's inventory in the U.S. constitutes "goods" within the meaning of Article 9, and that none of the exceptions in Section 9-301[16] apply to the general principle that the law of the jurisdiction of the debtor's location governs perfection. Under these assumptions, Terrace Bay would be deemed located in Ontario and accordingly, Canadian law governs Lucky Star's perfection *unless* one were to conclude that Canadian law does not provide a system for perfecting nonpossessory security interests equivalent to Article 9.[17]

As noted above, the weight of U.S. secondary legal authority has concluded that Canadian law, specifically its Personal Property Security Act as enacted in various provinces, is equivalent to Article 9. Accordingly, Ontario's law governs Lucky Star's perfection. This would be true even in the absence of a UCC-1 filing in the

[16] In reaching this conclusion, we assume that Terrace Bay's inventory is not subject to a warehousing receipt. In this regard, we note an argument may exist that inventory subject to a warehouse receipt may be subject to perfection under the provisions of Article 9 governing certificates of title. *See* UCC 9-303. We believe that the better view of Article 9 is that even if Terrace Bay's inventory were subject to a warehouse receipt, Section 9-301(a) would still govern a secured party's perfection and that Section 9-303 relating to certificates of title would not apply. *See* UCC § 9-311(d). A full analysis of this question, however, exceeds the scope of this memorandum.

[17] *See* UCC § 9-307(c). The choice-of-law rules of Article 9 apply equally "to all debtors, foreign and domestic." UCC § 9-301, official comment 8. *See also* Kuhn, *supra* note 6, at 1016-17 ("In general, the Article 9 choice-of-law rules do not distinguish between multi-state and international transactions. With very few exceptions, both are governed by the same set of conflict rules."). "Under the general rules of [section 9-307], a non-U.S. debtor normally would be located in a foreign jurisdiction and, as a consequence, foreign law would govern perfection." UCC § 9-307, official comment 3.

District of Columbia, which would only be necessary under Article 9 if the PPSA does not satisfy Article 9-307(c).

While we do not opine on application of Canadian law, we note a possible issue that may exist under Sections 9-301 and 9-307 of Article 9 and the PPSA's choice of law principles. Since Section 9-301 of Article 9 refers to the local law of the debtor's location for purposes of determining perfection, an issue may exist if that local law itself incorporates a choice of law provision that would result in application of non-local law.[18] To avoid the untenable result of a seemingly endless "choice of law" loop,[19] while the UCC does not define the term "local law," the term is generally understood to refer to the substantive law of a jurisdiction without giving effect to that jurisdiction's choice-of-law rules.[20] Stated differently, the "local law" governing perfection should be "the law of the location of the debtor but only to the extent that it does not require application of a law other than that of the location of the debtor."[21] This law will direct "the set of mechanical steps, such as filing, that a jurisdiction requires . . . for the purpose of prevailing over a

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[18] *See, e.g.,* Rosenberg, *supra* note 12, at 35.

[19] *Id.* at 35-36 ("The primary issue that has arisen with respect to Canadian law on perfection is what may be referred to as the 'Canadian Loop.'...The choice of law provisions of the PPSAs provide that, as to goods, the law of the jurisdiction where the collateral is located governs validity, perfection, and the effect of perfection or nonperfection. If the collateral of a Canadian debtor is goods located in the U.S., Canadian law says to apply revised Article 9, yet revised §§ 9-301(1) and 9-307(c) say to apply Canadian law. ... The way out of the loop is to apply the law of the location of the debtor, but only to the extent that it does not require application of a law other than that of the location of the debtor.")

[20] *See* UCC § 9-301, official comment 3 ("In designating the jurisdiction whose law governs, this Article [9] directs the court to apply only the substantive ('local') law of a particular jurisdiction and not its choice-of-law rules.").

[21] Rosenberg, *supra* note 12, at 36.

subsequent lien creditor" – essentially determining which document should be filed in which place.[22] Thus, the practical effect of Section 9-301's reference to "local law" for purposes of determining perfection is that "the jurisdiction of the debtor's location is the proper place for filing a financing statement."[23] Applying these principles, the choice-of-law provisions contained in sections 5 and 7 of the Ontario PPSA, which we understand may result in application of United States law, should not determine Lucky Star's perfection and assuming that Lucky Star has complied with the central filing requirements of Ontario law, Lucky Star would be perfected under Article 9.[24] This result, however, is not free from doubt.

* * * * * * *

We are available to answer any questions you may have regarding the analysis above.

C.R.T.
M.R.L.

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[22] Bjerre, *supra* note 13, at 277. *See also* White & Summers, *supra* note 2, § 31-16.

[23] *See* Rosenberg, *supra* note 12, at 36. *See also* Tamara M. Buckwold, *The Conflict in Conflicts: Choice of Law in Canada – U.S. Secured Financing Transactions*, 21 Banking & Fin. L.R. 407, 438 (2006) ("The determination of the jurisdiction whose law governs perfection of a security interest is of cardinal importance, since it carries with it the requirement that a secured party who wishes to perfect a security interest by registration use the registry system of that jurisdiction."); Kuhn, *supra* note 6, at 1024 ("the jurisdiction of the debtor's location is the proper place for filing a financing statement").

[24] Rosenberg, *supra* note 12, at 36

Appendix B

Terrace Bay Pulp Inc.

Actual Cash Flow from Commencement of CCAA filing to August 14, 2009
($'000s)

Receipts	
Customer receipts	$46,861
Other receipts	10,376
Total receipts	**57,237**
Disbursements	
Freight & sales agent	(3,098)
Salaries & wages	(862)
Operations	(469)
Payroll withholdings	(1,397)
Benefits & pension	(554)
Bank service charges	4
WSIB	(45)
Vacation pay	(1,676)
Utilities & fuel	(2,353)
Insurance	(1,031)
Interest payments to secured creditors	(344)
Principal payments to secured creditors	(31,000)
Foreign exchange translation	(2,341)
Restructuring costs	(646)
Total disbursements	**(45,812)**
Cash Flow	**$11,425**
Bank balance, opening	$2,048
Cash flow	11,425
Bank balance, closing	**$13,473**
Amount held by Monitor in Trust	**$850**
Nexcap loan, opening	$25,000
Payments to Nexcap	(24,000)
Nexcap loan, closing	**$1,000**

Appendix C

Blakes

Blake, Cassels & Graydon LLP
Barristers & Solicitors
Patent & Trade-mark Agents
199 Bay Street
Suite 2800, Commerce Court West
Toronto ON M5L 1A9 Canada
Tel: 416-863-2400 Fax: 416-863-2653

Michael McGraw
Dir: 416-863-4247
michael.mcgraw@blakes.com

August 14, 2009

Reference: 71942/4

VIA E-MAIL

To: The Service List attached as Schedule "A"

Dear Counsel:

Re: In the Matter of Buchanan Forest Products Ltd. ("Buchanan") and the Proceedings Listed in Schedule "A" Hereto (Court File Nos.: Various)
Re: The Order of the Honourable Madam Justice Pierce dated June 11, 2009 (the "Order")
Re: Terrace Bay Pulp Inc. ("TBPI")

As you are aware, we are counsel to TBPI in the above matter. As you are also aware, TBPI is subject to proceedings pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA Proceedings").

By this letter, we hereby advise and confirm that TBPI will not be asserting any claims against the logs and timber of Buchanan which are the subject of the Common Hearing (as defined in the Order) and the lien claims and proceedings pursuant to the *Forestry Workers Lien For Wages Act* (Ontario) (the "Act") set out at Schedule "A" to the Order (the "Lien Proceedings").

Further, as TBPI and Buchanan have both acknowledged that the logs and timber which are the subject of the Lien Proceedings are the property of Buchanan, it is TBPI's position that notwithstanding the fact that TBPI is named as a defendant in certain of the Lien Proceedings, none of the plaintiffs in any of the Lien Proceedings have any basis, under the Act or otherwise, to assert any claims against TBPI. In any event, the seeking of any relief against TBPI is prohibited by the stay of proceedings in the CCAA Proceedings (the "Stay") and the Order further prohibits any default proceedings against TBPI as a defendant in the Lien Proceedings.

Accordingly, as TBPI has no interest in the property which is the subject of the Lien Proceedings, and in light of the Stay, TBPI does not intend to participate in the Common Hearing or the Lien Proceedings, including the filing of any materials. If your client intends to seek any relief against TBPI in the Lien Proceedings, at the Common Hearing or otherwise, please advise the undersigned as soon as possible, and in any event, no later that August 21, 2009, so that, if necessary, TBPI can respond.

Should you have any questions or require additional information, please do not hesitate to contact me.

Thank you for your consideration.

12317288.1

Yours very truly,

Michael McGraw

MQM:cdlu

c: Russell York, Terrace Bay Pulp Inc.
Taras Sawula, Terrace Bay Pulp Inc.
Pamela Huff, Blakes
Katherine McEachern, Blakes
Chris Burr, Blakes
John Illingworth, Illingworth & Illingworth
Sheryl Seigel, Lang Michener LLP

Schedule "A"

SERVICE LIST

Louis R. Filion
Louis Filion Professional Corporation
1101 Front Street/P.O. Box 1626
Hearst, ON P0L 1N0
Tel: 705-327-6333 Fax: 705-737-6334

Chantal M. Brochu and Derek D. Zulianello
Buset & Partners LLP
1121 Barton Street
Thunder Bay, ON P7B 5N3
Tel: 807-623-2500 Fax: 807-622-7808

J. Douglas Shanks
Cheadles LLP
Suite 2000, 715 Hewitson St.
Thunder Bay, ON P7B 6TB

Tel: 807-622-6821 Fax: 807-623-3892

Etienne G.D. Esquega
Erickson & Partners
Barristers and Solicitors
291 South Court Street
Thunder Bay, ON P7B 2Y1

Tel: 807-345-1213 Fax: 807-345-2526

James Garofalo
Petrone Hornak Garofalo Mauro
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76 North Algoma Street
Thunder Bay, ON P7A 4Z4

Tel: 807-344-9141 Fax: 807-345-8391

Walter C. Wieckowski
Law Office
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Tel: 807-345-6566 Fax: 807-345-9982

Terry L. Gilbart
Barrister & Solicitor
217 Van Norman Street
Hearst, ON P7A 4B6
Tel: 807-345-6538 Fax: 807-345-7141

N.A. Melchiorre
Weiler, Maloney, Nelson
Barristers & Solicitors
1001 William Street, Suite 201
Thunder Bay, ON P7B 6M1

Tel: 807-625-8883 Fax: 807-623-4947

Fred Myers and Hannah Arthurs
Goodmans LLP
250 Yonge Street
Suite 2400, Box 24
Toronto, ON M5B 2M6
Phone: 416 597-5923 Fax: 416 979-1234

Appendix D

MANAGEMENT CONTRACT

THIS MANAGEMENT CONTRACT is made this 1st day of April, 2009.

BETWEEN:

TERRACE BAY PULP INC.
(the "Company")

- and –

GREENFOREST MANAGEMENT INC.
("GreenForest")

RECITALS:

A. Terrace Bay Pulp Inc. (TBPI) operates a pulp mill in the Township of Terrace Bay Ontario, located in the District of Thunder Bay.

B. TBPI is the holder of a Sustainable Forest Licence #542256 issued by the Ministry of Natural Resources, in respect of an area known as the Kenogami Forest and accordingly has certain forest management obligations as set out in the said Licence.

C. GreenForest carries on business as a forest management services provider

D. TBPI wishes to retain the services of GreenForest to meet its SFL obligations on the Kenogami Forest and GreenForest is prepared to provide the foregoing, on the terms and conditions noted herein.

NOW THEREFORE this Agreement witnesses that, in consideration of the premises, and of the mutual promises given by each of the Parties to the other of them, and for other good and valuable consideration, the receipt of which is hereby acknowledged, the Parties agree as follows:

1. The Recitals are true and accurate, and form integral terms of this Agreement.

THE PARTIES AGREE AS FOLLOWS:

1. **DEFINITIONS**

1.1 In this Contract (which includes Schedule "A" hereto):

(a) "AWS" means a document, mainly in the form of text, tables and maps, showing the order and extent of all work of any nature to be carried out during one year consistent with a FMP.

(b) "Crown Stumpage Charges" means those costs invoiced to the Overlapping Licensees and the Company from the Ministry based on the volume of timber harvested from the Licence Area.

(c) "Eligible Silviculture Work" means Eligible Silviculture Work as defined in the Sustainable Forest Licence.

(d) "Forest" means the Kenogami Forest.

(e) "Forest Management Operations" means the operational aspects of conducting forest management to meet the objectives of the forest management plan including but not limited to forest audits for certification or other purposes, surveys for forest renewal, planning, information gathering, data management, logistics support, special project personnel, silviculture operations, monitoring, reporting, compliance or any other activity necessary to remain in compliance with government regulation.

(f) "Forestry Futures Trust" means the Forestry Futures Trust established by the Minister pursuant to the Crown Forest Sustainability Act.

(g) "FMP" means a forest management plan, plan amendment, or contingency plan, prepared in accordance with the Forest Management Planning Manual ("FMPM") or a plan deemed to be a forest management plan pursuant to Section 71 of the Crown Forest Sustainability Act.

(h) "FMPM" means the Forest Management Planning Manual (2004) which is a document that provides direction for all aspects of forest management planning for forest management plans scheduled for renewal after March 2007 for management units designated under the Crown Forest Sustainability Act in the Area of the Undertaking. It also provides direction for annual operations, monitoring, reporting and evaluation of forest management operations prepared under this manual and the Forest Management Planning Manual (1996) or any subsequent manuals that replace the 2004 version (i.e. FMPM 2009, which is presently in draft format).

(i) "Forest Renewal Charges" means those costs invoiced to the Overlapping Licensees and the Company from the Ministry based on the volume of timber harvested from the Licence Area to support forest renewal activities on the Forest pursuant to the Crown Forest Sustainability Act.

(j) "Forest Renewal Trust" means the Forest Renewal Trust established by the Minister pursuant to the Crown Forest Sustainability Act.

(k) "Licence Area" means the lands designated in Appendix A of the SFL.

(l) "Ministry" means the Ontario Ministry of Natural Resources.

(m) "Operating Area" means the specific geographical area which is or which has been designated by the Company as being available for harvest by a specific Overlapping Licensee in a specific Year.

(n) "Overlapping Licence" means a forest resource licence issued pursuant to section 38 of the Crown Forest Sustainability Act.

(o) "Overlapping Licence Agreement" means an agreement in compliance with section 38 of the Crown Forest Sustainability Act between the Company on the one hand, and an Overlapping Licencee on the other hand, in respect of an Overlapping Licence issued or to be issued by the Ministry on the SFL.

(p) "Overlapping Licencee" means the holder of an Overlapping Licence on the SFL other than the Company.

(q) "Services" means all of the services listed in Schedule "A" to this Contract.

(r) "SFL" means the sustainable forest license for the Kenogami Forest.

(s) "Silvicultural Contract" means a contract between GreenForest on the one hand, and a provider of Eligible Silviculture Work services on the other hand.

(t) "Year" means the period commencing April 1 of a calendar year and ending March 31 of the next ensuing calendar year.

2 APPOINTMENT OF MANAGEMENT CONTRACTOR

2.1 The Company hereby appoints GreenForest as forest manager for its Forest, to provide on a day-to-day basis the Services as specified in Schedule "A" of this Contract, and GreenForest accepts such appointment all on the terms and conditions herein contained.

3 PROVISION OF SERVICES

General

3.1 GreenForest shall provide the Services herein described in a manner consistent with prudent industry standards.

3.2 GreenForest shall perform all of its Services hereunder in such a manner as to ensure that with respect to the Services provided the terms and conditions of the SFL and are at all times complied with by the Company.

3.3 GreenForest may subcontract the supply of any Service, except Forest Management Planning services that are described in Schedule A, provided it continues to be liable hereunder for the provision thereof, and protects the confidentiality of any related information.

3.4 GreenForest shall report to and take direction from the General Manager of the Company with respect to its provision of the Services.

3.5 GreenForest shall provide the Services under its own name but shall always hold itself out as agent for the Company in doing so.

3.6 Except as provided by Section 8 herein, GreenForest may enter into contracts and exchange correspondence on behalf of the Company in carrying out the Services without prior approval from the Company.

3.7 In providing the Services, GreenForest shall comply with:

(a) all applicable laws, statutes, ordinances and requirements in regard to the same;

(b) all rules and regulations concerning safety and proper conduct of Forest Management Operations as may be established by the Company.

4 **STAFFING**

4.1 GreenForest shall provide sufficient resources to supervise and/or carry out the Services under this Contract. GreenForest shall oversee all Forest Management Operations on the Forest carried out pursuant to Schedule A of this Contract and the related terms and conditions of the SFL.

5 **DESCRIPTION OF SERVICES**

5.1 GreenForest shall provide in the areas of forest management planning, forest operations, silviculture operations, independent forest audits, compliance and certification monitoring, and other areas as described in Schedule "A".

5.2 GreenForest will provide any additional services required to meet the legal obligations of the SFL as identified from time to time by the Company. Any services not identified in Schedule A will come at an additional cost and will be negotiated between the Company and GreenForest prior to additional services being provided.

6 **FOREST RENEWAL TRUST**

6.1 GreenForest shall be designated as a signing authority on and administer on behalf of the Company the Forest Renewal Trust accounts for the Forest.

6.2 GreenForest shall provide the following Services relating to the administration of applications to the Forest Renewal Trust:

(a) Record all silvicultural expenses incurred by GreenForest and the Company, and their respective contractors or subcontractors, on the Forest;

(b) Provide the Company with a detailed accounting of eligible silviculture costs on a monthly basis for invoicing to the Forest Renewal Trust for Eligible Silvicultural Work;

(c) Invoice the Forest Renewal Trust on behalf of the Company for Eligible Silviculture Work;

(d) Participate in periodic audits of the Forest Renewal Trust account by the Renewal Trust Fund Trustee;

(e) Make recommendations each Year for determining the subsequent Year's Forest Renewal Charge, as described in the SFL and pursuant to Section 49 of the Crown Forest Sustainability Act.

6.3 GreenForest shall ensure that the Company is in compliance with all of its obligations necessary to fully participate in the Forest Renewal Trust.

6.4 By March 1 of each Year, GreenForest will inform the Company as to the status of the Forest Renewal Trust Fund for the Forest with respect to its financial obligations of meeting Minimum Balance, as defined in the SFL. It is the financial responsibility of the Company to ensure the Forest Renewal Trust Fund has sufficient funds to meet Minimum Balance as of March 31 of each Year.

7 FORESTRY FUTURES TRUST

7.1 GreenForest shall prepare applications to the Forestry Futures Trust for funding to perform activities on the Forest. Applications approved by the Company will be submitted to the Forest Futures Trust Committee by GreenForest on behalf of the Company.

7.2 GreenForest shall prepare work plans for such work, ensure such work is implemented, monitor such work, and report on such work.

7.3 GreenForest shall prepare interim and final project work reports for all Forestry Futures Trust projects conducted under this Contract. Project work reports approved by the Company will be submitted to the Forest Futures Trust Committee by GreenForest on behalf of the Company. For the sake of clarity, the Company shall remain responsible for payment of project work invoices, regardless of whether there is complete reimbursement out of the said Trust.

8 LIMITATIONS ON GREENFOREST'S POWERS

8.1 Notwithstanding anything herein to the contrary, GreenForest does not have authority to carry out the following matters without the prior consent of the Company:

(a) acquiring, leasing, selling or otherwise disposing of any asset or right of the Company;

(b) borrowing of funds on behalf of the Company;

(c) entering into contracts on behalf of the Company that are expressly prohibited by this Contract, or fall outside of the range of Services;

(d) entering into contracts of insurance;

(e) entering into a contract (other than an Overlapping License Agreement or Silvicultural Contract) on behalf of the Company that has a value of more than $100,000, or has a term which is longer than the term of this Contract as determined in Article 12 herein.

9 **NOTIFICATION OF BREACHES AND NONPERFORMANCE**

9.1 GreenForest shall, on a timely basis, notify the Company of any breach of or default under the SFL, or Overlapping Licence Agreement, or any other agreement, any applicable law, regulation, policy or guideline.

10 **MANAGEMENT CONTRACTOR'S REMUNERATION**

10.1 GreenForest shall invoice the Company monthly for all of its direct costs incurred plus an administration fee for the Services (plus GST or HST).

10.2 The Company has the right to require GreenForest to provide such further information as may be reasonably necessary to justify any amount on the invoice. The Company shall pay for the Services provided within 15 days of receipt of GreenForest's invoice or such further information, as the case may be. A charge of 1.25 percent of the unpaid bill will be added as a penalty on the first day of default and/or on the first day of each calendar month thereafter.

10.3 By November 30 of each Year the Company and GreenForest will meet to identify the Services required in the upcoming Year and finalize the budget for the Company's operations for the upcoming Year for incorporation into the AWS. Any dispute on the proposed costs of GreenForest will be handled through Article 16 herein.

11 **EMPLOYEES**

11.1 GreenForest shall, for all purposes, be an independent contractor and the employees of GreenForest shall be servants of GreenForest and not of the Company.

11.2 GreenForest shall ensure that its employees and sub-contractors comply with all safety regulations and rules pertaining to the safe performance of the Services to be undertaken pursuant to this Contract.

11.3 GreenForest and its sub-contractors shall comply with all laws respecting its employees and their employment applicable to the Services provided pursuant hereto.

12 **TERM AND TERMINATION**

12.1 The Term of this Contract shall be for an initial Term of twenty (20) years commencing April 1, 2009. The 20 year Term of this Contract shall be extended for an additional Year, unless and until either Party provides to the other of them a Notice of Termination of this Contract, before January 1st of any calendar year.

12.2 Either party may terminate this Contract in the event of a material default in performance hereunder by the other Party, if such default continues unremedied for more than six (6) months after written notice from the non-defaulting Party.

12.3 For the sake of clarity, the Parties acknowledge their intention to create a long-term relationship between them, terminable only as set out above. Any alleged breach of a provision of this Contract shall entitle a Party to a right to access the dispute resolution process as provided herein. Each of the Parties shall use their best efforts to resolve their disputes as expeditiously as possible, bearing in mind their commitment to a rolling 20 year Term of this Contract.

12.4 This Contract shall be terminated upon acceptance by the Ministry of a surrender of the SFL by TBPI or by any termination, revocation, or cancellation of the SFL, or suspension of the SFL for a period in excess of 12 months.

12.5 Upon expiration of the Term of this Contract, or upon any termination of this Contract, the Parties shall continue to be obligated with respect to all payments and to their respective obligations to the date of such expiration or termination, and the joint ownership and access rights with respect to the Forest Management Information shall terminate, all such rights thereafter being vested solely in the Company.

13 INDEMNITY

13.1 GreenForest shall indemnify the Company against any loss, damage (other than those damages referred to in Section 18.1 herein), liability or expense (including reasonable attorney's fees) suffered or incurred by the Company caused by GreenForest's gross negligence or willful misconduct in the performance of the Services.

13.2 The Company shall indemnify GreenForest against any loss, damage (other than those damages referred to in Section 18.1 herein), liability or expense (including reasonable attorney's fees) which GreenForest suffers or incurs as a result of providing any Service, unless such loss, damage, liability or expense is a result of GreenForest's negligence or willful misconduct.

13.3 The party claiming indemnity hereunder shall promptly notify the other party, with all reasonable particulars, of the basis for each claim for indemnity hereunder. The party claiming the indemnity shall take no action to prejudice the other party's right to contest the basis of any claim giving rise to the request for indemnity, and shall afford the party receiving the notice an opportunity within the 30 day period following receipt of such indemnity notice to decide whether and to what extent any claim giving rise to the request for indemnity shall be contested or compromised, including whether to retain counsel. Unless otherwise agreed, the cost of such contestation including legal fees shall be at the expense of the person receiving the claim for indemnity. The party claiming indemnity shall at all times fully cooperate with the other party to minimize any loss, damage, liability or expense for which indemnity is claimed hereunder. All reasonable expenses incurred by the party claiming indemnity in providing such cooperation are to be paid with 30 days after demand by the other party.

13.4 These indemnity provisions relate to losses, damages, liabilities, or expenses based on claims by third parties and do not derogate from or limit remedies either party may have against the other for breach of his contract.

14 CONFIDENTIALITY

14.1 GreenForest shall hold, and shall cause its employees to hold, all information in respect of the businesses of the Company and of the Overlapping Licencees received by it under this Contract in strict confidence, unless and to the extent that such information is intended to be disclosed by those parties pursuant to their respective agreements with the Company, is in the public domain, or is required to be disclosed by law or an order of a court of competent jurisdiction.

14.2 The Company shall hold, and cause its employees to hold, all information in respect of the business of GreenForest received by it under this Contract in strict confidence, unless and to the extent that such information is intended to be disclosed by GreenForest pursuant to its agreements with the Company, is in the public domain, or is required to be disclosed by law or an order of a court of competent jurisdiction. In addition, the Company shall ensure that it does not disclose or allow its employees to disclose the confidential information associated with the software program used by GreenForest in performance of its Services herein.

15 INSURANCE

15.1 The Company shall obtain, at its expense, and maintain during the entire period of this Contract, a general liability insurance policy in an amount of not less than $5,000,000 to protect GreenForest and the Company against any claim that may arise out of any act or omission of GreenForest or any employee or subcontractor of GreenForest in the performance of the Services under this Contract. Such policy shall name both the Company and GreenForest as insureds. The Company shall provide proof of such insurance within 30 days of the signing of this Contract, upon any change in that coverage including cancellation, and upon request by GreenForest.

16 DISPUTES

16.1 The Parties agree that any dispute which arises out of, or in connection with, this Contract, or in respect of any legal relationship associated or derived from this Contract (a "Dispute"), including but not limited to disputes specifically referenced above, shall be referred to and finally resolved by arbitration before a single Arbitrator.

16.2 Neither Party may commence arbitration proceedings with respect to a Dispute unless the Dispute has first been referred to a mediator (a "Mediator").

16.3 The Mediator shall be selected by mutual agreement of the Parties to the Dispute, and failing such mutual agreement, the Mediator shall be selected by the legal counsel for the Company.

16.4 All information provided by a Party to a Mediator shall be revealed on a strictly confidential basis, and shall not be divulged by the Mediator to the other Parties to the Dispute, except with the consent of the Party.

16.5 If the Mediator is unable to resolve the Dispute within 14 days of his/her appointment, or advises the Parties prior to that time that he or she is unable to resolve the Dispute, any Party to the Dispute may commence arbitration proceedings with respect to the Dispute by delivery to the other Parties to the Dispute a notice of arbitration in writing. The Mediator shall not act as Arbitrator. The selection, process and jurisdiction of the arbitrator shall be in accordance with the provisions of the *Arbitrations Act*.

16.6 The costs of the mediation shall be borne equally among the Parties to the Dispute. The costs of the arbitration shall be borne, in the first instance, equally by the Parties to the Dispute, but the Arbitrator shall have the discretion to fix costs of the arbitration in such manner as he/she determines is appropriate in the circumstances.

16.7 All decisions of the Arbitrator shall be binding upon the Parties thereto, and not subject to review by any court.

16.8 The Arbitrator shall sit as an Arbiter of first instance, and not by way of appeal.

17 **NOTICES**

17.1 Any demand, notice or other communication (hereinafter referred to as a "Communication") to be given in connection with this Agreement shall be given in writing and shall be given by personal delivery, by registered mail, by transmittal by facsimile or by E-mail.

To:

(a) The Company, at the following address:

Terrace Bay Pulp Inc.

Terrace Bay, Ontario P0T 1C0

Attention: Bob Bryson, General Manager
Telephone: (807) 825-9840
Fax: (807) 825-9805

(b) GreenForest, at the following address:

GreenForest Management Inc.
1980 John Street Road
Thunder Bay, Ontario P7B 0A3
c/o P.O. Box 22004, 470 Hodder Avenue
Thunder Bay, Ontario P7A 8A8

Attention: Bert Hennessey, R.P.F. – President
Telephone: (807) 343-6496
Email: bert@gfmiontario.ca

or to other such address, facsimile number, E-mail address or individual as may be designated by notice given by either Party to the other. Any Communication given by personal delivery shall be conclusively deemed to have been given on the day of actual delivery thereof and, if given by registered mail, on the fifth Business Day following the deposit thereof in the mail and, if given by fax or by E-mail, on the day of transmittal thereof. If the Party giving any Communication knows or ought reasonably to know of any difficulties with the postal system which might affect the delivery of mail, any such Communication shall not be mailed but shall be given by personal delivery or by facsimile.

18 FORCE MAJEURE

18.1 If the full or partial performance of this Contract by either party is delayed, interrupted or prevented by any material event that could reasonably be considered to be a force majeure by reason that it is beyond the reasonable control of the party affected, which reason will include, but not be limited to any substantial or material accident, fire, explosion, flood, embargo, war, riot, act of God, enemy action, blockade, any decision of any government, or subdivision or agency thereof, (but does not include the inability of any party to obtain financing or any other financial inability on the part of a party), such party shall not be held responsible for failure to perform during the period of and to the extent that such party is delayed by one or more of such causes, provided that performance of this contract shall be resumed as soon as practical after such disability is remedied and such party fully complies with the provisions of paragraph 18.2 herein.

18.2 A party that is prevented, interrupted or delayed from fully performing its obligations hereunder due to the occurrence of one or more of the causes mentioned in paragraph 18.1 above shall:

(a) forthwith after the occurrence of such cause give notice to the other party informing it of such cause and in so far as known, the probable duration and extent to which such party shall be unable to perform or be delayed in performing its obligations hereunder;

(b) take whatever action may be appropriate and or reasonable to mitigate the extent or duration of the interruption or delay, provided that this obligation does not require a party to resolve a labour dispute; and,

(c) give prompt notice to the other party when such cause or causes have been eliminated or remedied.

19 DAMAGES

19.1 Notwithstanding anything to the contrary herein contained, neither GreenForest nor the Company shall be liable to the other party for any consequential, indirect, incidental, special, punitive or exemplary damages that may arise out of the failure of the other party to perform any of its obligations hereunder.

20 **ENTIRE CONTRACT, MODIFICATION AND NON-WAIVER**

20.1 This contract constitutes the entire contract and understanding between GreenForest and the Company with respect to the subject matter of this Contract and supersedes any prior agreement and understanding concerning the subject matter hereof. This Contract may be amended only by written instrument executed by a duly authorized representative of GreenForest and the Company. The waiver of any default or breach hereunder by either GreenForest or the Company shall not operate as a waiver in respect of any other or subsequent default or breach.

21 **ASSIGNMENT**

21.1 This Contract may not be assigned by GreenForest or the Company in whole or in part except with the prior written consent of the other party.

21.2 Notwithstanding the provisions of s.21.1:

(a) Either Party may, without consent, assign any of its interests in and obligations under this Contract to an "affiliate" as defined in the Ontario Business Corporations Act, provided such affiliate agrees to be bound by all of the provisions hereof, and

(b) The Company acknowledges the right of GreenForest to subcontract some or all of its Services (save and except forest management planning), but it shall remain responsible to the Company for the due performance of such subcontracted Services.

22 **GOVERNING LAW, ENSUREMENT, TIME, ETC.**

22.1 This Contract shall be governed by and construed in accordance with the laws of the Province of Ontario and shall bind and ensure to the benefit of the parties hereto and their respective successors and permitted assigns. Time shall be of the essence.

23 **MISCELLANEOUS**

23.1 If GreenForest requires that any portion of the Services be performed by GreenForest at the Company's premises, the Company shall provide all appropriate computer hardware and standard operating software, office space, supplies, telephone and Internet access for the provision of such portion of the Services, at no additional cost to GreenForest.

23.2 GreenForest in all other respects shall, at its expense, provide for its own computer hardware, and standard operating software to facilitate the performance by GreenForest of the Services.

EXECUTED BY:

TERRACE BAY PULP INC.

By: ______________________________
Name: Bob Bryson
Officer: General Manager

GREENFOREST MANAGEMENT INC.

By: ______________________________
Name: Bert Hennessey
Officer: President

SCHEDULE "A"

To the Management Contract between:

TERRACE BAY PULP INC.

(the "Company")

And

GREENFOREST MANAGEMENT INC.

("GreenForest")

Dated April 1, 2009

Services Provided by GreenForest Management Inc.

Forest Management Planning

1. **Preparation and approval of Forest Management Plans (FMP), including:**
   a. Overall FMP project management, including management of Planning Team (Plan Author, Project Manager/Chair)
   b. Development of planning and base model inventories
   c. Development of Resource Stewardship Agreements
   d. Development of Aboriginal consultation approach
   e. Strategic model preparation and approval
   f. Long Term Management Direction preparation and approval, including addressing any required modifications
   g. Planning proposed operations:
      - Selection of areas of operations: development of Term 1, Term 2 and Contingency allocations
      - Preparation and selection of Renewal and Tending operations/areas (develop overall silviculture program and silvicultural ground rules)
      - Selection of Primary, Branch and Operational Road
      - Develop prescriptions for operations (AOC planning)
      - Verification of proposed and selected roads through aerial photos
      - Development of Use Management strategies for Primary, Branch and Operational roads.
      - Revenues and expenditures development
      - Spatial assessments
   h. Draft FMP submission
   i. Address draft FMP required alterations and submission of final FMP
   j. Conducting negotiations/discussions with relevant stakeholders (e.g. First Nations communities, tourist outfitters, trappers, etc.)
   k. Conduct regular reports to Local Citizens' Committee (LCC) and Planning Teams
   l. Make required presentations to the Ministry Regional Director
   m. Participate in Issue Resolution
   n. Meeting the specific Company FMPM obligations regarding the involvement of Aboriginal communities and consideration of their interests, in forest management planning
   o. Conducting required public and stakeholder consultation, including, but not limited to the preparation of information centres

p. Address any FMP changes resulting from Ministry of the Environment decisions on request for individual environmental assessments
q. Prepare and develop planned operations for the second five-year term (Phase II)
r. Conduct and submit, as required, any Contingency planning
s. Prepare and submit, as necessary, any amendments to the approved FMP

2. **Preparation and approval of Annual Work Schedules, including:**
   a. Draft AWS preparation and submission in accordance with Ministry requirements and address any required alterations, including planned harvest areas, discussions and review with Licensees, submission to Ministry, address required alterations, ensure approval, present to LCC.
   b. Final AWS submission and approval
   c. Review AWS with the District Manager, Licensees and the LCC
   d. Prepare and submit, as necessary, any revisions to the approved AWS

3. **Preparation to support the approval of Annual Reports (AR), including:**
   a. Annual Report Submission and Approval including: collection and confirmation/verification of data (spatial and numeric) for forest management activities (aerial photo acquisition), summarize operations, analysis as required, discussion/implementation of IFA Action Plan items, submission, and present to LCC.
   b. Revise and submit, as necessary, any alterations to the AR for final approval.

4. **Independent Forest Audits (IFA), including:**
   a. Preparation of Trend Analysis report
   b. Preparation and coordination of field audit activities and packages
   c. Attend all meetings related to the IFA (pre-meeting, opening meeting, draft Audit Report meeting, Final Audit report meeting)
   d. Meet with Auditors and the Ministry to review and comment on the Draft Audit report
   e. Prepare the IFA Action Plan and liaise with those involved
   f. Final IFA Action Plan submission and approval
   g. Prepare a Status Report for the Action Plan

5. **Certification, including:**
   a. Preparation of Trend Analysis report
   b. Prepare and review background information required for audits
   c. Attend all meetings related to the certification standard and certification audits

6. **Relate to Compliance, including:**
   a. Compliance planning associated with FMP and AWS as described by the FMPM.

<u>Silviculture</u>

1. **Silvicultural Activities**
   Program planning (AWS), budgeting, supervision, reporting (AR) and overall administration for the following activities:
   a. Tree Plant
   b. Seeding
   c. Stock Production
   d. Site Preparation (all types)
   e. Slash Management

f. Tending (all types)
g. Surveys (FTG, survival, etc.)
h. Support Programs (cone collection, SAP's, etc.)

2. **Silviculture Contract**
   a. Preparation
   b. Tender and award contracts
   c. Administration of contracts

3. **FRT Trust Account management**
   a. Invoice the Forest Renewal Trust Account
   b. Supporting any Forest Renewal Trust Account audits

4. **FMP development and support of associated components**
   a. SGRs,
   b. Silviculture Strategies,
   c. Modeling inputs related to silviculture program and costs,
   d. Program planning and forecasting (*programs as listed above*).

5. **Annual Work Schedule**
   a. Preparation and prescription development for all silviculture components, as listed above
   b. Preparation of Forest Operational Prescriptions

6. **Annual Report**
   a. Preparation for all silviculture components (*as listed above*),
   b. Review and updating of Forest Operational Prescriptions

7. **Forestry Futures project development and implementation.**
   a. Preparation and prescription development for all silviculture components, as listed above, related to the project
   b. Planning and development of the application
   c. Reporting and invoicing upon completion of milestones in the project
   d. Final report preparation

8. **Data management and GIS.**
   a. Ensure all data is managed in a organized system to allow for continued monitoring of effectiveness of the silvicultural prescriptions

<u>Operational Planning</u>

1. **Overlapping Licence Agreements**

   a. GreenForest will meet with the Company or its designate and Forest Resources Licences (FRLs) holders each year prior to the development of the Annual Work Schedule. The purpose of the meeting will be to coordinate where each Overlapping Licensee will be harvesting and calculate the area and associated volumes for each FRL-holder.

b. GreenForest will then prepare Licensee maps and the associated volumes and area calculations for each FRL-holder. The maps and associated agreements (provided by the Company or its designate) will be delivered for signature to the Company or its designate. Also, at that time, GreenForest will give its projected management costs to the SFL-holder or its representative.

2. Water-crossings

a. GreenForest will conduct all water-crossing calculations that are necessary for the development and submission of the Annual Work Schedules. GreenForest will provide these calculations to the Company or its designate for installation purposes.

b. The Company or its designate will be responsible for site inspections for all water-crossing installation and any required sediment control plans.

3. Aggregate Pits

a. GreenForest will require the location of any potential aggregate pits for inclusion in the AWS.

b. The Company or its designate will be responsible for applications of any potential aggregate pits and the required site inspections and reporting.

4. Roads Funding Agreements

a. GreenForest will provide the required forest management planning information for the preparation of the Roads Funding Agreements. The information will be delivered to the Company or its designate for inclusion in the Roads Funding Agreement.

Other

1. Open communication with the Company and updates on status of the Services.

2. Presentations to the officers or directors of the Company, as required.