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

ONTARIO

SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

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

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

NINTH REPORT OF ERNST & YOUNG INC.

DATED DECEMBER 15, 2009

INTRODUCTION

1. On March 11, 2009 (the "**Filing Date**"), 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 this proceeding (the "**CCAA Proceeding**"). The Initial Order provided a period of time during which proceedings against the Applicant and its property were stayed (the "**Stay Period**"). The initial Stay Period expired on April 10, 2009, but has been extended from time to time, most recently to February 26, 2010 pursuant to the Order of this Honourable Court made on November 20, 2009.

PURPOSE

2. The purpose of this ninth report of the Monitor (the "**Ninth Report**") is to provide information to this Honourable Court related to the following:

   (a) the Applicant's request for an Order (the "**Claims Process Order**") establishing and approving of a process (the "**Claims Process**") whereby Terrace Bay will call for the filing of claims by its creditors to determine such claims for voting and distribution purposes in connection with any plan of compromise or arrangement to be presented by Terrace Bay (the "**Plan**") at a future date; and

(b) the proposed Claims Process.

3. Capitalized terms not defined in this Ninth Report, are as defined in the Claims Process Order. A copy of this Report and the materials relating to the Applicant's motion relating to the Claims Process Order can be downloaded from the Monitor's website at **www.ey.com/ca/terracebay**.

4. As reported in the Monitor's eighth report dated November 19, 2009 (the "**Eighth Report**"), Terrace Bay has recently reached an agreement with the Province of Ontario on a term sheet outlining the basis on which the Province is prepared to extend a term loan in the amount of $25 million to Terrace Bay. As a result, Terrace Bay is beginning the process of arranging exit financing and the formulation of a Plan that will permit it to proceed with its restructuring.

5. The Claims Process proposed is meant to determine the nature and the amount of the Pre-Filing Claims and Restructuring Claims (each as defined below) of creditors of the Applicant in order to facilitate the process of voting and effecting distributions under a Plan.

6. The Applicant proposes that the Claims Process proceed at this time in order to facilitate its ability to emerge from the protection of the CCAA at the earliest possible date.

TERMS OF REFERENCE

7. In preparing this Ninth 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 Ninth Report. Some of the information referred to in this Ninth 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 Ninth 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.

8. References to the singular herein include the plural, the plural includes the singular, and any gender includes the other gender.

SUMMARY OF THE CLAIMS PROCESS

9. Under the Claims Process Order, creditors having claims that are Pre-Filing Claims or Restructuring Claims, each as defined below ("**Creditors**"), will be subject to the Claims Process.

10. A "**Claim**" is defined in the Claims Process Order to mean:

> any right or claim of any Person that may be asserted or made in whole or in part against the Applicant, whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, including without limitation, by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement (oral or written), by reason of any breach of duty (including, without limitation, any legal, statutory, equitable or fiduciary duty) or by reason of any right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown, by guarantee, surety or

otherwise, and whether or not any right or claim is executory or anticipatory in nature including, without limitation, any right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action whether existing at present or commenced in the future, including, without limiting the foregoing, any right or claim by a non-unionized employee of the Applicant; and any Tax Claim, provided however, that a "Claim" shall not include an Excluded Claim.

11. An "**Excluded Claim**" is defined in the Claims Process Order to mean (i) any Claim secured by the Administration Charge and the Directors' Charge (as each of the foregoing terms is defined in the Initial Order); (ii) any Claim with respect to goods and/or services provided to the Applicant on or after the Filing Date; (iii) that portion of a Claim arising from a cause of action for which the Applicant is covered by insurance, but only to the extent of such coverage; (iv) any Claim by a current or former unionized employee of the Applicant; and (v) any Claim by Lucky Star Holdings Inc.

12. A "**Pre-Filing Claim**" is defined in the Claims Process Order to mean any Claim (i) based in whole or in part on facts which existed prior to the Filing Date , (ii) related to a time period prior to the Filing Date or (iii) would have been a claim provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* (Canada) had the Applicant become bankrupt on the Filing Date. A Creditor entitled to claim for interest under its applicable agreement with the Applicant may claim for interest that has accrued on its Pre-Filing Claim as of the Filing Date, but no claim for interest shall be allowed for interest accruing after that date.

13. A "**Restructuring Claim**" is defined in the Claims Process Order to mean any Claim arising as a result of the restructuring, termination, disclaimer or repudiation by the Applicant of any contract, lease, employment agreement, or other arrangement or agreements of any nature whatsoever, whether oral or written, and any amending agreement related thereto on or after the Filing Date and whether such restructuring, termination, disclaimer or repudiation took place or takes place before or after the date of

the Claims Process Order. For greater certainty, a Restructuring Claim may include a claim by a non-unionized employee of the Applicant.

14. The Claims Process contemplates a negative confirmation of certain Pre-Filing Claims against the Applicant. Pursuant to the Claims Process, if provided by the Applicant, the Monitor is to include in a Claims Package (as defined below) a notice setting out the Applicant's determination of the nature and amount of a Creditor's Pre-Filing Claim (a "**Claim Amount Notice**"). Pursuant to paragraph 7 of the Claims Process Order, any Creditor who receives a Claim Amount Notice and who does not dispute the nature or amount of the Pre-Filing Claim as set forth in the Claim Amount Notice is not required to file a proof of claim form (a "**Proof of Claim**") by the Claims Bar Date. If a Creditor who receives a Claim Amount Notice does not file a Proof of Claim by the Claims Bar Date, then such Creditor's Pre-Filing Claim, as set out in the Claim Amount Notice, shall be that Creditor's Proven Claim (as defined in the Claims Process Order) for voting and/or distribution purposes under the Plan. Any Creditor who disputes the characterization of its claim as set forth in a Claim Amount Notice may file a Proof of Claim by the Claims Bar Date.

Claims Bar Date

15. Creditors seeking to assert a Pre-Filing Claim, other than those who receive a Claim Amount Notice, which is not disputed, are required to file a Proof of Claim before 5:00 p.m. (Eastern Time) on February 8, 2010 (the "**Claims Bar Date**").

16. Creditors seeking to assert a Restructuring Claim are required to file a Proof of Claim, in the form of Schedule "C" to the Claims Process Order, by the later of (a) the Claims Bar Date, and (b) 5:00 p.m. (Eastern Time) on the day that is 15 days after the date the notice of repudiation or disclaimer (the "**Notice of Repudiation or Disclaimer**") is issued (the **"Restructuring Claims Bar Date")**.

17. The proposed form of instruction letter that shall form part of the package (the "**Claims Package**") to be sent to "**Known Creditors**" (as defined in the Claims Process Order) is attached as Schedule "B" to the Claims Process Order (the "**Instruction Letter**").

18. A Creditor who fails to file a Proof of Claim in respect of a Pre-Filing Claim (other than a Creditor who receives a Claim Amount Notice) on or before the Claims Bar Date shall:

    (a) be forever barred, estopped and enjoined from asserting or enforcing any Pre-Filing Claim (or filing a Proof of Claim with respect to such Pre-Filing Claim) against the Applicant and such Pre-Filing Claim shall be forever extinguished;

    (b) not be permitted to vote on the Plan or participate in any distribution in these proceedings on account of such Pre-Filing Claim; and

    (c) not be entitled to receive further notice in these proceedings.

19. A Creditor who fails to file a Proof of Claim in respect of a Restructuring Claim on or before the Restructuring Claims Bar Date shall:

    (a) be forever barred, estopped and enjoined from asserting or enforcing any Restructuring Claim (or filing a Proof of Claim with respect to such Restructuring Claim) against the Applicant and such Restructuring Claim shall be forever extinguished;

    (b) not be permitted to vote on the Plan or participate in any distribution in these proceedings on account of such Restructuring Claim; and

    (c) not be entitled to receive further notice in these proceedings.

20. The Applicant will return to the Court to approve of a claims process relating to claims of unionized employees, if required, at a future point in time.

21. The Monitor is of the view that the proposed Claims Bar Date and Restructuring Claims Bar Date are reasonable, as they should provide sufficient time for persons wishing to do so to submit a Proof of Claim.

Notice of Claims Process

22. The Monitor shall cause Known Creditors to be sent a Claims Package, including an Instruction Letter, by regular prepaid mail, facsimile transmission or email on or before December 31, 2009 (the "**Mailing Date**"). If same is provided to the Monitor by the

Applicant prior to the Mailing Date (as defined in the Claims Process Order), a Claim Amount Notice shall be included in a Claims Package.

23. The Monitor shall cause the Claims Package to be sent to each creditor with a Restructuring Claim by regular prepaid mail, facsimile transmission or email on the later of (i) December 31, 2009, or (ii) within five Business Days of the Monitor's receipt of the Notice of Repudiation or Disclaimer from the Applicant.

24. The Monitor shall cause a newspaper notice, substantially in the form of the Newspaper Notice attached as Schedule "F" to the Claims Process Order (the "**Newspaper Notice**"), to be published in the Globe and Mail (National Edition) and the Thunder Bay Chronicle Journal, on or prior to December 29, 2009, and to be published in the Terrace Bay/Schreiber News, on or before January 12, 2010.

25. On or before December 23, 2009, the Monitor will post a copy of the Claims Process Order, a blank Proof of Claim and the Instruction Letter on its Monitor's website at www.ey.com/ca/terracebay to permit any interested Creditor to download these materials at their convenience.

26. The Monitor shall cause a Claims Package to be sent to any Person requesting such material as soon as practicable by ordinary regular prepaid mail, facsimile transmission or email.

27. The Monitor is of the view that the mailing of the Claims Packages as aforesaid, the publication of the Newspaper Notice and the posting on its website of the Claims Process Order, a blank Proof of Claim and the Instruction Letter will provide potential creditors with sufficient notice of the Claims Process.

Submission and Review of Claims

28. The Monitor will supervise the receipt and collection of the Proofs of Claim that are filed in the Claims Process. In consultation with Terrace Bay, the Monitor will review and examine each Proof of Claim filed by the Claims Bar Date or the Restructuring Claims Bar Date.

29. The Monitor, in consultation with Terrace Bay, may attempt to consensually resolve with the applicable Creditor the nature and amount of any Pre-Filing Claim or Restructuring Claim in respect of which a Proof of Claim is filed, prior to accepting, revising or disallowing any such claim for voting and/or distribution purposes under the Plan.

30. If the Monitor, in consultation with Terrace Bay, accepts a Pre-Filing Claim or Restructuring Claim in respect of which a Proof of Claim is filed for voting and distribution purposes under the Plan, then such claim will be a proven claim for voting and/or distribution purposes under the Plan.

31. If the Monitor, in consultation with Terrace Bay, determines to revise or disallow a Pre-Filing Claim or Restructuring Claim in respect of which a Proof of Claim is filed for voting and/or distribution purposes under the Plan, the Monitor shall send a notice of revision or disallowance (the "**Notice of Revision or Disallowance**") to the Creditor. A copy of the proposed form of Notice of Revision or Disallowance is attached as Schedule "D" to the Claims Process Order.

Dispute of Claims by Creditors

32. Affected Creditors who intend to dispute the amount of their Claim as set out in the Notice of Revision or Disallowance sent to such Creditor must deliver a notice of dispute, substantially in the form of the notice attached as Schedule "E" to the Claims Process Order (the "**Notice of Dispute**"), by registered mail, personal delivery, courier, e-mail (in PDF format) or facsimile transmission by 5:00 p.m. (Eastern Time) on the date that is fourteen days after the date of the Notice of Revision or Disallowance (the "**Dispute Deadline**").

33. Any Creditor who fails to deliver a Notice of Dispute by the Dispute Deadline shall be deemed to accept the nature and the amount of its Pre-Filing Claim or Restructuring Claim as revised, disallowed or set out in the Notice of Revision or Disallowance and such Pre-Filing Claim or Restructuring Claim, as revised, disallowed or set out in the Notice of Revision or Disallowance shall constitute a Proven Claim for voting and/or distribution purposes under the Plan.

Resolution of Disputed Claims

34. Upon receipt of a Notice of Dispute, the Monitor is permitted, in consultation with the Applicant, to (i) attempt to consensually resolve the nature and amount of the Pre-Filing Claim or Restructuring Claim with the Creditor for voting and/or distribution purposes, (ii) deliver a Dispute Package (as defined in the Claims Process Order) to a claims officer appointed in accordance with the Claims Process Order (the "**Claims Officer**"), or (iii) bring a motion before the Court in these proceedings for a determination of the nature and/or amount of the Pre-Filing Claim or Restructuring Claim for voting and/or distribution purposes under the Plan.

35. If the Monitor and the Creditor consensually resolve the nature and amount of the Pre-Filing Claim or Restructuring Claim, the Monitor may accept a revised Pre-Filing Claim or Restructuring Claim, and such revised Pre-Filing Claim or Restructuring Claim will constitute a Proven Claim for voting and/or distribution purposes under the Plan.

36. If a Dispute Package is delivered to the Claims Officer, the Monitor shall schedule, and cause to be conducted before the Claims Officer a hearing to determine the nature and/or amount of the Pre-Filing Claim or Restructuring Claim for voting and/or distribution purposes under the Plan, and the Claims Officer shall as soon as practicable after the hearing notify the Applicant, the Monitor and the Creditor of his or her determination.

37. The Monitor, the Applicant or the Creditor may, within fourteen (14) days of receipt of notification of the Claims Officer's determination, appeal such determination to the Court by serving on the other party and filing with the Court a notice of motion in accordance with the Ontario Rules of Civil Procedure, failing which the Claims Officer's determination shall be deemed to be final and binding on the Applicant and the Creditor and shall constitute a Proven Claim for voting and/or distribution purposes under the Plan.

38. The Monitor believes that the period of time to file a notice of motion to appeal the determination of a Claims Officer is reasonable as, given the time allowed in earlier stages of the Claims Process, Creditors should have performed a careful and complete

evaluation of their Claim prior to submitting a Proof of Claim or a Notice of Dispute of Claim and therefore should be in a position to respond within the time period established.

MONITOR'S RECOMMENDATION

39. The Monitor believes it appropriate for a claims process to be undertaken at this time in order to afford the Applicant a reasonable opportunity to review and assess potential claims so as to be in a position to facilitate its restructuring and proceed with a meeting of creditors to vote on a Plan.

40. The Monitor respectfully recommends to this Honourable Court that:

    (a) the proposed Claims Process be approved;

    (b) the Claims Process Order be approved; and

    (c) the appointment of a Claims Officer by the Applicant, should it consider it necessary or desirable to do so, be approved; and

All of which is respectfully submitted this 15th day of December, 2009.

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

Per:

Alex Morrison
Senior Vice President