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

**ONTARIO**

**SUPERIOR COURT OF JUSTICE**

**(COMMERCIAL LIST)**

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

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

Applicants

**SEVENTEENTH REPORT OF ERNST & YOUNG INC.**

**DATED JULY 23, 2010**

## INTRODUCTION

1. On March 11, 2009 (the "**Filing Date**"), Terrace Bay Pulp Inc. ("**Terrace Bay**" or the "**Applicant**") filed for and obtained protection from the Ontario Superior Court of Justice (the "**Court**") under the *Companies' Creditors Arrangement Act* (the "**CCAA**"). Pursuant to the Order made by this Honourable Court dated March 11, 2009 (the "**Initial Order**"), Ernst & Young Inc. ("**EYI**") was appointed as Monitor (the "**Monitor**") in this proceeding (the "**CCAA Proceeding**"). The Initial Order provided a period of time during which proceedings against the Applicant and its property were stayed (the "**Stay Period**"). The initial Stay Period expired on April 10, 2009, but has been extended from time to time, most recently by Order of this Honourable Court made on June 29, 2010. Absent a further extension, the Stay Period will expire on July 30, 2010.

2. On May 31, 2010, this Honourable Court made an Order, (the "**Creditors' Meeting Order**") authorizing and establishing the procedure for creditors of Terrace Bay with Affected Claims as defined in the Amended Plan (as defined below) (the "**Affected Claims**") to consider and vote on a Plan of Compromise and Arrangement (the "**Original Plan**", which term as used in this Seventeenth Report means the plan of compromise and arrangement attached to the Information Circular (as defined below)). Pursuant to the Creditors' Meeting Order, the meeting of creditors in the Unsecured Class (as defined below) to vote on the Original Plan was to be held on June 21, 2010 (the "**Creditors'

**Meeting**"). The Creditors' Meeting Order also provided a process to be followed to adjourn the Creditors' Meeting and for the filing of amendments to the Original Plan.

3. As reported in the thirteenth report of the Monitor to this Honourable Court dated June 17, 2010 (the "**Thirteenth Report**"), pursuant to the Creditors' Meeting Order, notice of the Creditors' Meeting, the information circular to which the Original Plan was appended (the "**Information Circular**") and a proxy form (a "**Proxy**") (collectively the "**Information Package**") were served on "**Eligible Voting Creditors**", as defined in the Creditors' Meeting Order, being all Affected Creditors holding a Proven Unsecured Claim or a Disputed Claim (each as defined in the Original Plan).

4. The twelfth report of the Monitor to this Honourable Court dated May 24, 2010 (the "**Twelfth Report**") and the Thirteenth Report reviewed the principal terms of the Original Plan.

5. As reported in the fourteenth report of the Monitor to this Honourable Court dated June 23, 2010 (the "**Fourteenth Report**"), the Creditors' Meeting was adjourned by the Monitor to the same location and time on June 28, 2010. As also reported in the Fourteenth Report, notice of the adjournment of the Creditors' Meeting was provided to the Service List (as defined in the Creditors' Meeting Order) (the "**Service List**") and posted on the Monitor's website, in accordance with the Creditors' Meeting Order. A representative of Terrace Bay also attended at the Valhalla Inn on June 21, 2010 to advise any creditor in attendance of the adjournment of the Creditors' Meeting to 2:00 p.m. on June 28, 2010.

6. As reported in the fifteenth report of the Monitor to this Honourable Court dated June 27, 2010 (the "**Fifteenth Report**"), the Original Plan has been amended twice. The first amended plan is dated June 24, 2010 (the "**First Amended and Restated Plan**"). The second amended plan is dated June 25, 2010 (the "**Second Amended and Restated Plan**"). Copies of the First Amended and Restated Plan and the Second Amended and Restated Plan, respectively, were served on the Service List and provided by e-mail to all persons who had by then provided a proxy to the Monitor (the "**Proxy Holders**"), other

than six creditors, having claims totalling approximately $9,264.[1] **Reference in this Seventeenth Report to the "Amended Plan" shall mean the Original Plan as amended on June 24, 2010 and June 25, 2010.**

7. As reported in the sixteenth report of the Monitor dated July 6, 2010 (the "**Sixteenth Report**"), the Creditors' Meeting for the Unsecured Class (as defined in the Amended Plan (the "**Unsecured Class**")) to consider and vote on a resolution to approve the Amended Plan (the "**Plan Resolution**") was held on June 28, 2010, and was conducted in accordance with the Creditors' Meeting Order. The Plan Resolution was duly adopted by the Required Majority[2] of creditors in the Unsecured Class, and as such, the Amended Plan has been approved by the Unsecured Class.

8. As reported in the Sixteenth Report, the Amended Plan amended the First Amended and Restated Plan by, among other things, including amendments to reflect an agreement with the Township of Terrace Bay (the "**Township**") in relation to outstanding realty taxes, including the amendment of the Original Plan to include a new class of Affected Creditors, the "Township Class", comprised of the Township, as well as other corresponding amendments.

9. On June 29, 2010, this Honourable Court made an Order (the "**June 29 Amending Order**"), which, among other things, amended the Creditors' Meeting Order to establish the procedure for the voting of the Township Class on the Amended Plan.

10. As reported in the Sixteenth Report, the meeting of the Township Class (as defined in the Amended Plan) (the "**Township Meeting**") was held on June 30, 2010 in accordance with the provisions of the Creditors' Meeting Order and the June 29 Amending Order, and the resolution approving the Amended Plan was duly adopted by the Required Majority in the Township Class and, as such, the Amended Plan has been approved by the Township Class.

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[1] The Monitor made several attempts to contact these six Proxy Holders by telephone to obtain a facsimile number or email address, but they did not respond.

[2] Under section 6 of the CCAA, a majority in number representing two-thirds in value of the class of creditors, present and voting either in person or by proxy is the majority required to approve of a plan of compromise or arrangement (the "**Required Majority**").

11. The June 29 Amending Order also amended the Creditors' Meeting Order to provide that the Monitor file a report within five business days of the Creditors' Meeting reporting on the results of the votes cast at the Creditors' Meeting and the acceptance of the Amended Plan by the required majorities of creditors in the Unsecured Class and by the Township Class.

12. In addition, the June 29 Amending Order fixed the date of the hearing of the Applicant's motion for approval of an order sanctioning the Amended Plan (the "**Sanction Hearing**") to be July 13, 2010, or such other date as may be fixed by the Commercial List.

**PURPOSE**

13. The purpose of this seventeenth report of the Monitor (the "**Seventeenth Report**") is to supplement the Twelfth Report, the Thirteenth Report, the Fourteenth Report, the Fifteenth Report and the Sixteenth Report and update this Honourable Court and creditors in relation to the activities of Terrace Bay and the Monitor since the Sixteenth Report relating to the following:

    (a) the results of the Creditor's Meeting and the Township Meeting and the voting at the Creditor's Meeting by Affiliated Creditors (as defined below);

    (b) the status of certain settlements and agreements being negotiated by Terrace Bay with certain of its key creditors and stakeholders that are conditions to the implementation of the Amended Plan (the **"Plan Conditions"**);

    (c) to advise this Honourable Court and creditors in relation to the conclusions and recommendations of the Monitor with respect to the approval and sanctioning by this Honourable Court of the Amended Plan at the Sanction Hearing;

    (d) the ongoing activities of the Monitor and the Applicant in relation to the claims process (the "**Claims Process**") authorized by the Order of the Honourable Court dated December 18, 2009 as subsequently amended (the "**Claims Process Order**");

    (e) the receipts and disbursements for the period from June 20, 2010 to July 18, 2010;

    (f) the revised cash forecast for the period ending September 5, 2010; and

(g) the motion by the Applicant that is also being brought on July 27, 2010 at the Sanction Hearing for an Order, among other things, extending the Stay Period to August 31, 2010 (the "**Stay Extension Motion**") as well as authorizing and empowering the Monitor to act as an escrow agent, for the purposes described below.

## TERMS OF REFERENCE

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

15. All references to monetary amounts in this Seventeenth Report are in Canadian dollars unless otherwise noted.

16. Capitalized terms not defined in this Seventeenth Report are as defined in the Second Amended and Restated Plan.

17. Copies of this Report and the other materials in respect to this CCAA Proceeding may be obtained from the Monitor's website at www.ey.com/ca/terracebay.

## RESULTS OF CREDITORS' MEETING AND THE TOWNSHIP MEETING

### I. Creditors' Meeting and voting by Affiliated Creditors

18. As reported in the Sixteenth Report, the Creditors' Meeting for the Unsecured Class to consider and vote upon the Plan Resolution was held on June 28, 2010 and was conducted in accordance with the Creditors' Meeting Order.

19. As reported in the Sixteenth Report, 98.2% of the number of Eligible Voting Creditors present and voting, in person or by proxy, representing 96.7% in value of the Proven Unsecured Claims and Disputed Claims held by Eligible Voting Creditors, voted to approve the Plan Resolution. All of the Disputed Claims were voted to approve the Plan Resolution. As a result, the Plan Resolution can be said to have been duly adopted by the Required Majority of creditors in the Unsecured Class, whether or not the votes in relation to Disputed Claims were taken into account. As such, the Amended Plan was approved by the Unsecured Class.

20. As reported in the Sixteenth Report, at the Creditor's Meeting, the Monitor had separately tabulated the votes of creditors at the Creditors' Meeting holding Proven Unsecured Claims and Disputed Claims that the Monitor understood at the time of the Creditors' Meeting were entities affiliated with the Applicant. At the time of the filing of the Sixteenth Report, the Monitor understood that there were eight such creditors (the "**Affiliated Creditors**"), having claims totalling $18,756,522.98, that fell into this category (the **"Affiliated Unsecured Claims**").

21. The Monitor now understands that there were fourteen Affiliated Creditors that voted in favour of the Amended Plan at the Creditors' Meeting and that these Affiliated Creditors held Affiliated Unsecured Claims totalling $19,647,712.99. These six additional Affiliated Unsecured Claims totalled $891,190.01, with $749,287.64 of that amount attributable to the claim of a single Affiliated Creditor.

22. Four Affiliated Creditors, rather than the three that were reported in the Sixteenth Report, held Affiliated Unsecured Claims totalling $2,363,195.70 that were also Disputed Claims (the "**Disputed Affiliated Claims**") at the time of the Creditors' Meeting. These four Disputed Affiliated Claims had been included in the nine Disputed Claims totalling

$7,565,698.80 that were reported on in the results of the vote described in paragraphs 23-26 of the Sixteenth Report. The remaining five Affiliated Creditors held Affiliated Unsecured Claims that were not Disputed Claims (the "**Undisputed Affiliated Unsecured Claims**") which totalled $17,284,517.29.

23. Based on the revised count of the votes cast by the Affiliated Creditors at the Creditors' Meeting, a vote on the Plan Resolution that is tabulated without regard to votes cast by either the holders of Disputed Claims (including the Disputed Affiliated Claims) or Undisputed Affiliated Unsecured Claims, has the following results:

| | **Unsecured Class (excluding Disputed Claims and Undisputed Affiliated Unsecured Claims)** | |
|---|---|---|
| | Number of Eligible Voting Creditors holding Proven Unsecured Claims | Value of Claims of Eligible Voting Creditors holding Proven Unsecured Claims |
| For | 146 | $8,815,158.25 |
| Against | 3 | $1,150,261.54 |
| TOTAL | 149 | $9,965,419.79 |

24. Based on the above revised results, 97.9% of the number of Eligible Voting Creditors, excluding creditors holding Disputed Claims (including Disputed Affiliated Claims) and Undisputed Affiliated Unsecured Claims, present and voting, in person or by proxy, representing 88.5% in value, voted to approve the Plan Resolution, rather than the 88.6% reported in the Sixteenth Report.

25. As reported in the Sixteenth Report, one of these Affiliated Creditors is Buchanan Forest Products Limited ("**BFPL**"). BFPL is bankrupt and a receiver has been privately appointed over certain of its property and assets (the "**Buchanan Receiver**"). There is an agreement (the "**BFPL Agreement**") in place between the Buchanan Receiver and Lucky Star Holdings Inc. ("**Lucky Star**") pursuant to which the unsecured claim of BFPL against the Applicant in the amount of $15,843,234.50 (the "**BFPL Claim**") is being assigned by the Buchanan Receiver to Lucky Star as of the Effective Date as part of the consideration flowing to Lucky Star under the BFPL Agreement. A Proxy was delivered by the Buchanan Receiver to the Monitor and the BFPL Claim was voted in favour of the

Plan Resolution. For this reason the BFPL Claim was reflected as an Affiliated Unsecured Claim in the Sixteenth Report.

26. Pursuant to an escrow agreement (the "**BFPL Escrow Agreement**") entered into in connection with the BFPL Agreement, the Monitor has agreed to act as an escrow agent in relation to the consideration to be paid to the BFPL Receiver under the provisions of the BFPL Agreement. The BFPL Agreement facilitated the approval of the Amended Plan by creditors and facilitates the implementation of the Amended Plan. The Monitor is requesting, as part of the relief sought at the Sanction hearing, that it be authorized and empowered, *nunc pro tunc*, to act as escrow agent, under, or in relation to any escrow arrangements it has, or may agree to, including under the BFPL Escrow Agreement.

27. As reported above, in addition to the BFPL Claim, thirteen other Affiliated Creditors voted in favour of the Amended Plan. These thirteen claims, not including the BFPL Claim, totalled \$3,804,478.49. All of these claims are Proven Unsecured Claims, other than the four Disputed Affiliated Claims. One of the Disputed Affiliated Claims is a Claim (a "**CLA Claim**") made under the Ontario *Construction Lien Act* (the "**CLA**"), and the Notice of Dispute (as defined in the Claims Process Order) ("**Dispute**") for this claim has now been withdrawn. The other three Disputed Affiliated Claims asserted are claims made under the Ontario *Forestry Workers Lien for Wages Act* (the "**FWLWA Claims**"). The Monitor understands from the Applicant that a majority of the FWLWA Claims (not including the three Disputed Affiliated Claims which are FWLWA Claims), will be resolved as part of the fibre supply agreement that is being entered into between the Applicant and others.

28. As described in the Sixteenth Report, the Plan Resolution for the Unsecured Class was duly adopted by the Required Majority of creditors in the Unsecured Class, whether or not Affiliated Unsecured Claims were included. Accordingly, it is the view of the Monitor that the Plan is fair and reasonable and should be approved by the Court as:

    (a) all of the Affiliated Creditors having Affiliated Unsecured Claims that voted in favour of the Amended Plan received the same treatment under the Amended Plan as other members of the Unsecured Class;

(b) the separate tabulation by the Monitor of the voting by Affiliated Creditors indicates that creditors with Proven Unsecured Claims who were not Affiliated Creditors voted overwhelmingly in favour of the Plan Resolution;

(c) the Monitor has reported to creditors in the Sixteenth Report regarding the voting of the BFPL Claim, and the votes cast at the meeting by the Affiliated Creditors and, to the knowledge of the Monitor, no creditor has raised any issue with the voting by the Affiliated Creditors in favour of the Plan Resolution;

(d) the Monitor has reported in the Fifteenth Report regarding agreements reached between the Applicant and the holders of claims asserted under the CLA, resulting in those creditors voting in favour of the Amended Plan; and

(e) the Monitor is not aware of any allegations of bad faith made in relation to the voting by any of the Affiliated Creditors in the Unsecured Class in favour of the Plan Resolution.

## II. Township Meeting

29. As also reported in the Sixteenth Report, the Township Meeting to consider and vote on a resolution to approve the Amended Plan was held on June 30, 2010, and was conducted in accordance with the June 29 Amending Order.

30. Prior to the commencement of the Township Meeting, the Township delivered a proxy to the Monitor pursuant to which it voted in favour of the Amended Plan. The resolution approving the Amended Plan was duly adopted by the Required Majority in the Township Class and, as such, the Amended Plan was approved by the Township Class.

31. As required by the provisions of paragraph 36 of the Creditors' Meeting Order, as amended by the June 29 Amending Order, on July 6, 2010 the Monitor served the Sixteenth Report on the Service List, posted the Sixteenth Report on the Monitor's website and filed the Sixteenth Report with this Honourable Court. The Sixteenth Report advised the creditors and this Honourable Court that:

(a) the Amended Plan had been accepted by the Required Majority of the Unsecured Class;

(b) that the Amended Plan had been accepted by the Required Majority in the Township Class; and

(c) that the votes cast by Eligible Voting Creditors with Disputed Claims at the Creditors' Meeting did not affect the result of the vote.

**UPDATE ON THE CLAIMS PROCESS**

32. As described in the Thirteenth Report, the Claims Process implemented by the Claims Process Order is described in greater detail in the ninth report of the Monitor dated December 15, 2009 (the "**Ninth Report**"). The Claims Process Order called for the filing of a Proof of Claim:

(a) for any Claim which arose prior to March 11, 2009 (each, a "**Pre-Filing Claim**"); and

(b) for any Claim arising as a result of, or in connection with, the repudiation, termination or restructuring by Terrace Bay of any contract, lease or other agreement after March 11, 2009 (each, a "**Restructuring Claim**").

33. Pursuant to the Claims Process Order, unionized and non-unionized employees were not required to file a Proof of Claim in respect of any Claim that they might have in their capacity as an employee, as any such Claim falls within the definition of an "**Excluded Claim**" in the Claims Process Order. Certain employees nonetheless filed a Proof of Claim in relation to a Claim that is an Excluded Claim pursuant to the Claims Process Order. These employees have been sent a Notice of Revision or Disallowance (a "**Disallowance Notice**") by the Monitor as the Claims Process did not require them to file a Proof of Claim. Other Excluded Claims are identified in the Twelfth Report, the Fifteenth Report and in the Amended Plan.

34. Pursuant to the Claims Process Order, creditors having Pre-Filing Claims or Restructuring Claims who failed to file a Proof of Claim by the applicable Bar Date are forever barred, estopped and extinguished from asserting or enforcing a Pre-Filing Claim or a Restructuring Claim. Notwithstanding this, the Claims Process Order also provides that any Affected Creditor who did not dispute the nature or amount of their Affected Claim as listed in a Claim Amount Notice that was provided to such Affected Creditor (a

"**Claim Amount Notice Creditor**") was not required to file a Proof of Claim. If a Claim Amount Notice Creditor did not dispute the Claim Amount Notice, then the amount of such Affected Creditor's Claim, as provided in the Claim Amount Notice, was ordered to be that creditor's Proven Unsecured Claim for voting and/or distribution purposes.

35. Three contracts were repudiated by Terrace Bay following the date of the Initial Order, and Claims Packages were sent to the counter-party(ies) to each such contract. Two of the counter-parties to these contracts filed proofs of claim with respect to their Restructuring Claims and a Disallowance Notice was sent by the Monitor to these creditors. Only one of these two creditors has filed a Dispute with the Monitor alleging a claim for constructive trust and that such claim is a post-filing, secured claim.

36. As at July 23, 2010 there remain ten Claims in the Claims Process for which a Dispute was filed and these Claims total $7,189,140.62 (the "**Remaining Disputed Claims**"). Terrace Bay has advised the Monitor that four of the Remaining Disputed Claims that are FWLWA Claims, including three Claims that are Affiliated Disputed Claims, have been resolved, or will be resolved. Formal withdrawals of the Affiliated Disputed Claims will be provided to the Monitor shortly.

37. In addition, Terrace Bay has advised the Monitor that the three Remaining Disputed Claims which are CLA Claims have been settled and each Dispute filed relating to these three Remaining Disputed Claims will be withdrawn prior to the Effective Date. Accordingly, Terrace Bay has advised the Monitor that these seven Remaining Disputed Claims totaling $2,471,430.58 (the "**Settled Disputed Claims**") will not need to be resolved or determined by a claims officer or the Court under the provisions of the Claims Process Order.

38. As a result, if these Settled Disputed Claims are excluded, there are three Remaining Disputed Claims totaling $4,717,710.04 that may need to be resolved or determined under the provisions of the Claims Process Order, with $4,327,860.74 of that amount attributable to the Remaining Disputed Claim of a single creditor.

39. As at July 23, 2010 the Proven Unsecured Claims determined in the Claims Process total $32,428,890.45.

**STATUS OF THE DISCUSSIONS WITH STAKEHOLDERS REGARDING PLAN CONDITIONS**

40. As previously reported in the Twelfth Report, the Thirteenth Report, the Fourteenth Report and the Fifteenth Report, and as described in the Information Circular, the implementation of the Amended Plan is conditional upon the fulfillment of the Plan Conditions, in addition to its approval by the Required Majority of Affected Creditors in each Class and this Honourable Court.

41. The following summarizes, as of the date of this Seventeenth Report, the status of the significant Plan Conditions previously reported on in the Fourteenth Report:

(a) **ABL Loan Agreement** – *Terrace Bay shall have entered into the ABL Loan Agreement, with all conditions precedent under such agreement having been satisfied or waived (subject only to completion of the transaction contemplated under the Plan).*

On July 2, 2010, Terrace Bay executed a term sheet for an operating facility post implementation ("**ABL Credit Facility**"), which term sheet provides that the facility is subject to due diligence, final credit approval and definitive documentation. Due diligence is in its final stages and during this time, the definitive documentation is being negotiated between Terrace Bay and the ABL lender.

(b) **Province Loan** – *Terrace Bay shall have entered into a loan agreement with the Province (the "**Province Loan Agreement**"), with all conditions precedent under such agreement having been satisfied or waived (subject only to completion of the transaction contemplated under the Plan).*

Terrace Bay has advised the Monitor that it is currently engaged in negotiations with the Province with respect to the form of the Province Loan Agreement and related documents. The Province requires that the ABL Credit Facility be in place as a condition of the Province's loan.

(c) **Stumpage Agreement** – *the Stumpage Agreement shall have been entered into with the Province with all conditions precedent under such agreement having* *been satisfied or waived (subject only to completion of the transaction contemplated under the Plan).*

As of the date of this Seventeenth Report, a form of draft Stumpage Agreement is being negotiated. Terrace Bay has advised the Monitor that Terrace Bay has resolved key issues relating to the Stumpage Agreement with the Province, in particular, issues regarding the allocation of amounts payable thereunder.

(d) **Fibre Purchase Agreement** – *Terrace Bay shall have entered into an agreement for the purchase of fibre located at its premises and elsewhere on terms and conditions satisfactory to Terrace Bay, with all conditions precedent under such agreement having been satisfied or waived (subject only to the completion of the transaction contemplated under the Plan).*

Terrace Bay is negotiating an agreement to purchase fibre located at its premises and elsewhere, which agreement will resolve a majority of the FWLWA Claims, which are Disputed Claims.

(e) **Province Fibre Commitment** – *Terrace Bay shall have obtained a commitment from the Province with respect to the supply of fibre on terms and conditions satisfactory to it.*

Terrace Bay has advised the Monitor that Terrace Bay and the Province have resolved outstanding matters with respect to the long-term supply of fibre. Remaining issues with the Province will be finalized prior to the Effective Date, assuming Plan sanction by the Court. Progress is being made in this regard.

(f) **Township Agreement** – *Terrace Bay shall have entered into the Township Agreement and all conditions precedent to be completed under such agreement shall have been satisfied or waived, subject only to the completion of the transactions contemplated under the Plan.*

As noted in the Fifteenth Report, the Township has entered into the Township Agreement subject to the Township receiving the approval of the town council at a meeting that was scheduled for Tuesday, June 29, 2010 (the "**Council**

**Meeting**"). The Monitor has been advised by Terrace Bay that the Township Agreement was approved at the Council Meeting and that the Township will execute the Township Agreement upon the granting of the Order approving the Amended Plan at the Sanction Hearing. As noted above, the Township Class voted in favour of the Amended Plan at the Township Meeting, in accordance with the terms of the Township Agreement.

(g) **Construction Lien Claims** – *Terrace Bay shall have entered into agreements with the claimants who had asserted claims under the CLA or taken other steps satisfactory to Terrace Bay to resolve such claims.*

The Monitor is advised by the Applicant that this condition has been satisfied, subject to certain registrations being discharged from title and receipt by the Monitor of confirmations of the withdrawal of the Disputes filed in respect of certain of these CLA Claims, which are to be provided by no later than the Effective Date; and

(h) **Payment under Section 3.3(i) of the Amended Plan** – *a condition that there shall be no impediment to the payment of the Lucky Star Claim on the Effective Date.*

The payment has been delivered into escrow with the Monitor and will be released to the Buchanan Receiver on Plan implementation pursuant to the terms of the BFPL Escrow Agreement.

42. Terrace Bay continues to work toward the satisfaction of the conditions referenced in subparagraphs (a) to (g) above, and is making progress towards their fulfillment.

**ADJOURNMENT OF SANCTION HEARING**

43. As reported in the Fifteenth Report of the Monitor, the Applicant obtained the June 29 Amending Order which, among other things, fixed the Sanction Hearing date of July 13, 2010.

44. As a result of certain outstanding conditions with respect to the implementation of the Plan, on July 13, 2010, the Applicant obtained the endorsement of Mr. Justice Morawetz,

adjourning the Sanction Hearing to July 27, 2010. The adjournment provided the Applicant with an opportunity to make more progress towards fulfilling the Plan Conditions prior to the date of the Sanction Hearing, and, in particular to advance negotiations with the Province. The Monitor supported the request for the adjournment of the Sanction Hearing to July 27, 2010.

## CONCLUSIONS AND RECOMMENDATIONS OF THE MONITOR ON SANCTION HEARING

45. The Monitor supports the Applicant's motion for an order sanctioning the Amended Plan and is of the view that approval of the Amended Plan by the Court is in the best interests of the Applicant's stakeholders for the following reasons:

(a) the Monitor believes that the Applicant has acted and continues to act in good faith and with due diligence;

(b) to the best of the Monitor's knowledge, the Monitor is not aware of any instances where the Applicant has not complied with the Orders granted by this Honourable Court during the CCAA Proceeding, and is not aware of any instances where the Applicant has taken, or has purported to have taken, any action that is not authorized by the CCAA;

(c) the terms of the Amended Plan are fair and reasonable in the circumstances;

(d) the Applicant should emerge from the CCAA Proceeding as a restructured and recapitalized company operating as a going concern;

(e) the Amended Plan maximizes the prospects for a recovery for Affected Creditors and provides attendant benefits for the Applicant's employees, suppliers, the Township of Terrace Bay and surrounding communities; and

(f) the Monitor continues to believe, as previously reported in the Thirteenth Report, that if the Amended Plan is not sanctioned by the Court, the most likely alternative would be a forced liquidation of the assets of the Applicant. In such a situation, the Monitor believes there would be minimal, if any, recovery for the Affected Creditors and, accordingly, the Amended Plan provides a more favourable result for the Affected Creditors.

46. Accordingly, the Monitor recommends that the Court sanction the Amended Plan which was approved by the Required Majority in each of the Unsecured Class and the Township Class and authorize the Applicant to proceed with the restructuring transactions and the implementation of the Amended Plan.

**RECEIPTS AND DISBURSEMENTS THROUGH JULY 18, 2010**

47. Attached as Appendix A to this Seventeenth Report is a summary of Terrace Bay's actual receipts and disbursements from June 20, 2010 to July 18, 2010 (the "**Reporting Period**"). Cash on hand at July 18, 2010 is approximately $7,048,000 exclusive of a $2,400,000 funded reserve for certain charges created under the Initial Order.

48. Details of the receipts and disbursements, and the variance analysis against the Applicant's cash flow forecast submitted in the Fourteenth Report (the "**Forecast**"), are attached as Appendix A to this Seventeenth Report. Receipts were higher than the Forecast by approximately $54,000. Disbursements were approximately $83,000 lower than the Forecast representing the $200,000 deposit paid to the ABL lender, offset mainly by lower costs of operations.

**STAY EXTENSION MOTION AND REVISED CASH FLOW FORECAST**

49. Attached as Appendix B to this Seventeenth Report is an updated cash flow forecast for the period ending September 5, 2010 (the "**Revised Forecast**") prepared by Terrace Bay, with the assistance of the Monitor. The Revised Forecast includes increased spending for long lead-time items including fuels and process chemicals and the ramping up of staffing to support the restart of the mill in late August.

50. The closing cash balance at September 5, 2010 is forecast to be approximately $1,348,000. In addition, Terrace Bay maintains a funded reserve for the CCAA Charges of $2,400,000. The Revised Forecast indicates that Terrace Bay should have adequate liquidity to fund its operations through August 31, 2010.

51. Terrace Bay is of the view that extending the Stay Period will afford it with the time necessary to resolve the Plan Conditions required to be satisfied by the Applicant for the Amended Plan to be implemented. The Monitor concurs that additional time is required

for such purposes and has been advised by Terrace Bay that it expects to resolve the Plan Conditions and implement the Plan by August 31, 2010.

## RECOMMENDATIONS OF THE MONITOR ON STAY EXTENSION MOTION

52. The Monitor approves of the following orders being made, if this Honourable Court sees fit:

(a) an order authorizing the extension of the Stay Period until August 31, 2010;

(b) an order approving of the Sixteenth Report and the Seventeenth Report and the conduct and activities of the Monitor and its legal counsel as reported on in such reports;

(c) an order authorizing, and empowering the Monitor to act as an escrow agent; and

(d) for such further and other order as this Court may deem just.

All of which is respectfully submitted this 23rd day of July, 2010.

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

Per:

Alex Morrison
Senior Vice President

# Appendix A

**Terrace Bay Pulp Inc.**
**CCAA Cash Flows**
**4 Week Period Ending July 18, 2010**
**(CDN$000s)**

| Week Ended | Actual Total | Forecast [1] Total | Variance Total |
|---|---|---|---|
| **Receipts** | | | |
| Other receipts | 1,930 | 1,876 | 54 |
| Total receipts | 1,930 | 1,876 | 54 |
| **Disbursements** | | | |
| Freight & sales agent | - | - | - |
| Salaries & wages | (91) | (90) | (1) |
| Operations | (9) | (120) | 111 |
| Payroll withholdings | (40) | (50) | 10 |
| Benefits & pension | (35) | (30) | (5) |
| Bank service charges | 4 | - | 4 |
| WSIB | (3) | (5) | 2 |
| Utilities & fuel | (43) | (75) | 32 |
| Insurance | (208) | (208) | (0) |
| Restructuring costs | (270) | (200) | (70) |
| Total disbursements | (695) | (778) | 83 |
| **Cash Flow** | **1,234** | **1,098** | **136** |
| Bank balance, opening | 5,814 | 5,814 | - |
| Cash flow | 1,234 | 1,098 | 136 |
| **Bank balance, closing** | **7,048** | **6,912** | **136** |
| Funded Reserve account for CCAA charges | 2,400 | 2,400 | - |

[1] From the Monitor's 14th Report

# Appendix B

**Terrace Bay Pulp Inc.**
**CCAA Cash Flows (Revised)**
**(CDN$000s)**

| **Week Ended** | **25-Jul-10** | **1-Aug-10** | **8-Aug-10** | **15-Aug-10** | **22-Aug-10** | **29-Aug-10** | **5-Sep-10** | **Total** |
|---|---|---|---|---|---|---|---|---|
| **Receipts** | | | | | | | | |
| Customer receipts | - | - | - | - | - | - | - | - |
| GST | - | - | - | - | - | - | - | - |
| Other receipts | - | - | - | - | - | - | - | - |
| Total receipts | - | - | - | - | - | - | - | - |
| **Disbursements** | | | | | | | | |
| Freight & sales agent | - | - | - | - | - | - | - | - |
| Salaries & wages | (45) | (12) | (45) | (131) | (45) | | (45) | (323) |
| Operations | (406) | (58) | (30) | (799) | (30) | (30) | (30) | (1,383) |
| Payroll withholdings | - | (25) | - | (25) | | (25) | | (75) |
| Benefits & pension | - | - | - | - | (20) | (256) | (30) | (306) |
| WSIB | - | (5) | (18) | - | - | - | (18) | (41) |
| Vacation pay | - | - | - | - | - | - | - | - |
| Utilities & fuel | (1,130) | (293) | (293) | (293) | (25) | | (25) | (2,059) |
| Insurance | - | (208) | - | - | - | - | (208) | (416) |
| Interest payments to secured creditors | - | - | - | - | - | - | - | - |
| Principal payments to secured creditors | - | - | - | - | - | - | - | - |
| Restructuring costs | (650) | (100) | (50) | (147) | (50) | (50) | (50) | (1,097) |
| Funding of reserve for CCAA charges | | | | | | | | |
| Total disbursements | (2,231) | (701) | (436) | (1,395) | (170) | (361) | (406) | (5,700) |
| **Cash Flow** | **(2,231)** | **(701)** | **(436)** | **(1,395)** | **(170)** | **(361)** | **(406)** | **(5,700)** |
| Bank balance, opening | 7,048 | 4,817 | 4,116 | 3,680 | 2,285 | 2,115 | 1,754 | 7,048 |
| Cash flow | (2,231) | (701) | (436) | (1,395) | (170) | (361) | (406) | (5,700) |
| Bank balance, closing | 4,817 | 4,116 | 3,680 | 2,285 | 2,115 | 1,754 | 1,348 | 1,348 |
| Funded Reserve account for CCAA charges | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 |

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

Applicants

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

***ONTARIO***
**SUPERIOR COURT OF JUSTICE**
**COMMERCIAL LIST**

Proceeding commenced at TORONTO

**SEVENTEENTH REPORT OF ERNST & YOUNG INC.**

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