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

SIXTEENTH REPORT OF ERNST & YOUNG INC. DATED JULY 6, 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 to consider and vote on a Plan of Compromise and Arrangement (the **"Original Plan**", which term as used in this Sixteenth 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 (the "**First Amended and Restated Plan**") is dated June 24, 2010. The second amended plan (the "**Second Amended and Restated Plan**"), is dated June 25, 2010. 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 Sixteenth Report to the "Amended Plan" shall mean the Original Plan as amended on June 24, 2010 and June 25, 2010.**

7. The Second Amended and Restated 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.

8. 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. Pursuant to the June 29 Amending Order, the meeting of the Township Class (the "**Township Meeting**") was scheduled for 2:00 p.m. on June 30, 2010 at the offices of Ernst & Young Inc., with the Monitor to preside as the Chair and to decide all matters relating to the rules and procedures at, and the conduct of, the Township Meeting. The Township was permitted to vote by proxy at the Township Meeting.

9. 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. In addition, the June 29 Amending Order extended the time for parties wishing to oppose the motion to sanction the Amended Plan, as a result of which such parties must now do so no later than seven business days' following the date of the Creditors' Meeting and fixed the date of the hearing of the sanction motion (the "**Sanction Hearing**") to be July 13, 2010, or such other date as may be fixed by the Commercial List.

---

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.

PURPOSE

10. The primary purpose of this sixteenth report of the Monitor (the "**Sixteenth Report**") is to report on the results of the Creditors' Meeting held on June 28, 2010 and the Township Meeting held on June 30, 2010.

TERMS OF REFERENCE

11. In preparing this Sixteenth 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 Sixteenth Report. Some of the information referred to in this Sixteenth 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 Sixteenth 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.

12. All references to monetary amounts in this Sixteenth Report are in Canadian dollars unless otherwise noted.

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

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

CREDITORS' MEETING FOR THE UNSECURED CLASS

15. The Creditors' Meeting for the Unsecured Class (as defined in the Amended Plan) to consider and vote on a resolution to approve the Amended Plan (the "**Plan Resolution**") was held on June 28, 2010, commencing at 2:16 p.m. at the Valhalla Inn in Thunder Bay, and was conducted in accordance with the Creditors' Meeting Order.

16. Mr. Alex Morrison, a representative of the Monitor, acted as Chairman (the "**Chairman**") of the Creditors' Meeting.

17. Ms. Sheryl Seigel, of Lang Michener LLP, counsel for the Monitor, acted as Secretary and took minutes of the discussions held and decisions made at the Creditors' Meeting.

18. Prior to commencing the Creditors' Meeting, the Chairman confirmed that the quorum required by the Creditors' Meeting Order was present, in person or by proxy, and, as such, the Creditors' Meeting was duly constituted in accordance with the provisions of the Creditors' Meeting Order.

19. In attendance, in person and by proxy, at the Creditors' Meeting were a total of 168 Eligible Voting Creditors, having total claims as follows:

	Unsecured Class (including Disputed Claims)	
	Number of Eligible Voting Creditors	Value of Claims of Eligible Voting Creditors
All Eligible Voting Creditors Present at the Creditors' Meeting, in person or by proxy, including those holding Disputed Claims	168	$34,815,635.99

20. The voting by the Eligible Voting Creditors, including those holding Disputed Claims, at the Creditors' Meeting on the Plan Resolution was as follows:

	Unsecured Class	
	Number of Eligible Voting Creditors	Value of Claims of Eligible Voting Creditors
For	165	$33,665,374.34
Against	3	$1,150,261.65

21. Based on the above results, 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.

22. The three Eligible Voting Creditors voting against the Plan Resolution held claims with a total value of $1,150,261.65, with $1,145,275.72 of that amount attributable to the claim of a single creditor.

23. In accordance with the Creditors' Meeting Order the Monitor also separately tabulated the votes of Eligible Voting Creditors with Disputed Claims. The Chairman reported at the meeting that ten Disputed Claims with a total value of $7,565,698.80 (including the Disputed Affiliated Claims as defined below) were voted in the Unsecured Class. It was subsequently confirmed that there were nine Disputed Claims with a total value of $7,565,698.80. All of the Disputed Claims (including the Disputed Affiliated Claims as defined below) were voted to approve the Plan Resolution.

24. If the claims of Eligible Voting Creditors holding Disputed Claims (including Disputed Affiliated Claims as defined below) are not included for voting purposes, then the result of the vote on the Plan Resolution would be as follows:

	Unsecured Class (excluding Disputed Claims)	
	Number of Eligible Voting Creditors holding Proven Unsecured Claims	Value of Claims of Eligible Voting Creditors holding Proven Unsecured Claims
For	156	$26,099,675.54
Against	3	$1,150,261.65
TOTAL	159	$27,249,937.19

25. Based on the above results, 98.1% of the number of Eligible Voting Creditors holding only Proven Unsecured Claims present and voting, in person or by proxy, representing 95.8% in value of the Proven Unsecured Claims held by Proven Unsecured Creditors voted to approve the Plan Resolution.

26. The Plan Resolution was therefore duly adopted by the required majorities[2] of creditors in the Unsecured Class, whether or not the votes in relation to Disputed Claims (including Disputed Affiliated Claims as defined below) are taken into account in tabulating votes in favour of the Plan Resolution.

27. The Monitor also has separately tabulated the votes of creditors holding Proven Unsecured Claims and Disputed Claims that the Monitor understands are entities affiliated with the Applicant. In total, there were eight such creditors (the "**Affiliated Creditors**"), having claims totalling $18,756,522.98, that fall into this category (the "**Affiliated Unsecured Claims**")[3]. Three of the Affiliated Creditors hold Affiliated

---

[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**").

[3] One of such 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 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. A Proxy was delivered by the Buchanan Receiver to the Monitor. For this reason, the BFPL Claim is included in this Sixteenth Report as an Affiliated Unsecured Claim.

Unsecured Claims totalling $1,613,908.06 that are also Disputed Claims (the "**Disputed Affiliated Claims**"). These three Disputed Affiliated Claims have 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 above. The remaining five Affiliated Creditors hold Affiliated Unsecured Claims that are not Disputed Claims (the "**Undisputed Affiliated Unsecured Claims**") which total $17,142,614.92.

28. If the vote on the Plan Resolution is tabulated without regard to votes cast by either the holders of Disputed Claims (including the Disputed Affiliated Claims) or Undisputed Affiliated Unsecured Claims, the result would be as follows:

	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	151	$8,957,060.62
Against	3	$1,150,261.54
TOTAL	154	$10,107,322.16

29. Based on the above results, 98.1% 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 88.6% in value, voted to approve the Plan Resolution.

30. As reflected by the foregoing, the Plan Resolution can be said to have been duly adopted by the Required Majority of creditors in the Unsecured Class, whether or not Disputed Claims and Undisputed Affiliated Unsecured Claims are included. As such, the Amended Plan has been approved by the Unsecured Class.

31. The Eligible Voting Creditors did not vote on any other matters at the Creditors' Meeting that were not related to the administration of the Creditors' Meeting (other than to terminate the Creditors' Meeting following the Chairman's report on the results of the vote on the Plan Resolution).

MEETING OF THE TOWNSHIP CLASS

32. The Township Meeting to consider and vote on a resolution to approve the Second Amended and Restated Plan was held at 2:00 p.m. on June 30, 2010 at the offices of Ernst & Young Inc. in Toronto, and was conducted in accordance with the June 29 Amending Order.

33. Mr. Alex Morrison, a representative of the Monitor, acted as chairman of the Township Meeting. 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. Mr. Morrison recorded the vote by the Township in favour of the Amended Plan and, there being no further business, terminated the Township Meeting.

34. 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.

CONCLUSIONS OF THE MONITOR

35. The Monitor in this Sixteenth Report, in compliance with paragraph 36 of the Creditors' Meeting Order as amended by the June 29 Amending Order, has reported to creditors and this Honourable Court: (a) on votes cast at the Creditors' Meeting and the Township Meeting, including the votes cast by Eligible Voting Creditors with Disputed Claims, and (b) that the Amended Plan has been accepted by the Required Majority of Affected Creditors and the Township.

All of which is respectfully submitted this 6th 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

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

SIXTEENTH REPORT OF
ERNST & YOUNG INC.

LANG MICHENER LLP
Lawyers – Patent & Trade Mark Agents
Brookfield Place, P.O. Box 747
181 Bay Street, Suite 2500
Toronto, ON M5J 2T7

Sheryl E. Seigel (LSUC No. 21850H)
Tel: 416-307-4063
Fax: 416-365-1719
E-mail: sseigel@langmichener.ca

Alex A. Ilchenko (LSUC No. 33944Q)
Tel: 416-307-4116
Fax: 416-304-3880
E-mail: ailchenko@langmichener.ca

Solicitors for the Monitor