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.

SUPPLEMENTAL NINTH REPORT OF ERNST & YOUNG INC. DATED DECEMBER 16, 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 supplement to the Ninth Report of the Monitor dated December 15, 2009 (the "**Supplemental Ninth Report**") is to provide information to this Honourable Court related to the following:

   (a) a forest management agreement between the Applicant and GreenForest Management Inc. ("**GMI**") and the payments proposed to be made by Terrace Bay to GMI pursuant to such agreement.

3. 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 website of EYI located at **www.ey.com/ca/terracebay**.

TERMS OF REFERENCE

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

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

FORESTRY MANAGEMENT AGREEMENT WITH GREENFOREST MANAGEMENT AGREEMENT

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

7. As reported in the Fourth Report of the Monitor to this Honourable Court, Terrace Bay is the holder of a Sustainable Forest Licence #542256 (the "**SFL**") issued by the Ministry of Natural Resources in respect of the Kenogami Forest. 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**").

8. Prior to being placed in receivership, Terrace Bay outsourced most of the Forest Management Obligations to Buchanan Forest Products Ltd. ("**BFPL**"). On or about March 17, 2009, Deloitte & Touche Inc. was privately appointed as the receiver of certain of the property and assets of BFPL. On October 22, 2009, a bankruptcy order was made against BFPL.

9. Terrace Bay has advised the Monitor that, since the commencement of this CCAA proceeding, and following the receivership of BFPL, the Forest Management Obligations have been performed by GMI.

10. 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 "**Original Management Contract**"), as amended on December 16, 2009. A copy of the amended and restated management contract between Terrace Bay and GMI (the "**Amended and Restated Management Contract**") is attached as Exhibit "F" to the affidavit of Russell York sworn December 16, 2009.

11. While the Original Management Contract was executed, the Monitor is advised by Terrace Bay that no payments have been made to GMI pursuant to that agreement, pending the approval of this Honourable Court. The Amended and Restated Management Contract amends the termination provisions of the Original Management Contract, including the addition of a 60-day notice period for termination of such agreement without cause during the duration of the CCAA Proceeding as well as a limitation on the damages arising from such a termination during the CCAA Proceeding.

12. The Amended and Restated Management Contract 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 Amended and Restated Management Contract include forestry management and planning, silviculture and operational planning and providing reports to Terrace Bay to permit it to document that the services required under the SFL are being performed.

13. The initial contract term under the Amended and Restated Management Contract commences on April 1, 2009, and runs for twenty years, with annual renewals thereafter. GMI is to be compensated on the basis of its costs incurred, plus an administration fee. As described in the Amended and Restated Management Contract, budgets are to be agreed and established annually on the basis of the services to be rendered in the following year. The Monitor is advised that for 2009, the budget was established at approximately $549,000, with monthly invoicing totalling approximately $46,000 per month, exclusive of taxes. While the Original Management Contract was executed, no payments have been made by Terrace Bay to GMI thereunder, pending Terrace Bay obtaining the approval of this Honourable Court to enter into the Amended and Restated Management Contract.

14. Pursuant to section 12.1.1 of the Amended and Restated Management Contract, during the period beginning April 1, 2009 until the date of termination of the CCAA Proceedings, the Amended and Restated Management Contract may be terminated without cause by Terrace Bay. Termination of the Amended and Restated Management Contract during the CCAA Proceeding shall be effective on the date that is 60 days after the date of delivery of a notice of termination by Terrace Bay (the "**Termination Date**"). In the event of such a termination during the CCAA Proceeding, the only liabilities of Terrace Bay to GMI shall be to pay an amount equivalent to the actual costs incurred by GMI prior to the Termination Date as a result of the provision of goods or services related to the performance of the Amended and Restated Management Contract by GMI prior to the Termination Date (the "**Costs**"), whether incurred on its own account or payable by GMI to third parties on the condition that GMI shall obtain approval of the Monitor and Terrace Bay prior to entering into any agreement or arrangement which

would cause GMI to incur an individual obligation in excess of $50,000. For clarity, the Costs shall not include any loss or damages (including any consequential, indirect, incidental, punitive or other damages), suffered or incurred by GMI arising from the breach, non-performance or early termination of any agreement between GMI and another party.

15. The Amended and Restated Management Contract also contains other termination provisions.

16. 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 Amended and Restated Management Contract 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.

17. The Monitor has been advised by Terrace Bay that, as of November 30, 2009, the sum of approximately $384,036 was owed by Terrace Bay to GMI under the Amended and Restated Management Contract, referable to the period commencing April 1, 2009. Subject to the approval of the Amended and Restated Management Contract by this Honourable Court, the Monitor considers it reasonable for Terrace Bay to make payment of such amount.

MONITOR'S RECOMMENDATION

18. The Monitor respectfully recommends to this Honourable Court that the entry into by Terrace Bay of the Amended and Restated Management Contract and the payment by Terrace Bay of the payments proposed to be made by Terrace Bay to GMI pursuant to the Amended and Restated Management Contract be approved.

All of which is respectfully submitted this 16th 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