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.

THIRD REPORT OF ERNST & YOUNG INC.

DATED JUNE 15, 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 (the "**Stay**") 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**").

2. On April 6, 2009 the Monitor filed its first Report (the "**First Report**") and on May 25, 2009 the Monitor filed its Second Report (the **"Second Report"**) with this Honourable Court. 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 third report of the Monitor (the "**Third Report**") is to update this Honourable Court in relation to the activities of Terrace Bay and the Monitor since the Monitor's previous reports, including:

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

   (b) the receipts and disbursements from May 18, 2009, through June 7, 2009;

   (c) the anticipated repayment in full of Terrace Bay's first secured lender, Nexcap Finance Corporation ("**Nexcap**"), and the contemplated commencement of repayments to Lucky Star Holdings Inc. ("Lucky Star"), Terrace Bay's second secured creditor;

   (d) the revised cash flow forecast;

   (e) certain statutory claims that have been asserted and related matters;

   (f) a proposed services agreement with Buchanan Sales Inc. ("**BSI**"); and

   (g) a proposed extension of the Stay.

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. 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.

7. 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's current inventory totals approximately 13,000 tons.

8. 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.

9. In addition to keeping the mill heated and selling inventory, employees at the mill have also maintained a pump house that supplied the Town with drinking water. Terrace Bay has advised the Monitor that, effective May 1, 2009, the Town has been operating its own, independent water pumping station and, as such, is no longer reliant on Terrace Bay's facility as a source of drinking water. At the time this proceeding was commenced, Terrace Bay was the dominant source of employment for residents of the Town and another nearby community, Schreiber, Ontario.

10. Buchanan Forest Products Ltd. ("**Buchanan**") is an affiliated company of Terrace Bay. Terrace Bay traditionally purchased a significant portion of its pulp logs and bush chips from Buchanan. Subsequent to the date of the Initial Order, a secured creditor of Buchanan, The Toronto-Dominion Bank, appointed Deloitte & Touche Inc. as the receiver of the property and assets of Buchanan (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 find a capital source to refinance Terrace Bay's activities. An update on the activities of Terrace Bay with regard to these items is included in this Third Report.

TERMS OF REFERENCE

12. In preparing this Third 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 Third Report. Some of the information referred to in this Third 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 Third 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. As summarized in the application materials filed by the Applicant in support of the Initial Order, and in the First Report and the Second Report, the Applicant had three objectives (the "**Restructuring Process**"), with respect to the re-starting of the mill. These included:

(a) the commencement of a process to seek out proposals for the refinancing of the business;

(b) the development of a plan to restructure the business to ensure continued mill viability; and

(c) the commencement of a marketing process to sell the mill as a going concern.

14. Since March 11, 2009, Terrace Bay has been engaged in activities to accomplish one or more facets of the Restructuring Process. These activities have included, among other things, updating Terrace Bay's financial projections to reflect the current status of the mill and working with the Monitor to develop information materials to send to potential financiers and/or purchasers that may be interested in supporting Terrace Bay with a view to re-starting operations at the mill.

15. Paragraph 35 of the Initial Order authorized the Monitor and Terrace Bay to conduct a process for the solicitation of offers for a financing or sale of the Property (as defined in the Initial Order) and to take such steps as are necessary to carry out the Solicitation Process in accordance with the following timetable, with such modifications, amendments or extensions of time as the Monitor and Terrace Bay deemed appropriate:

(a) preparation of a Confidential Information Memorandum (a "**CIM**") and identification of potential purchasers by March 23, 2009;

(b) dissemination of the CIM to interested parties on execution of confidentiality agreements by April 6, 2009; and

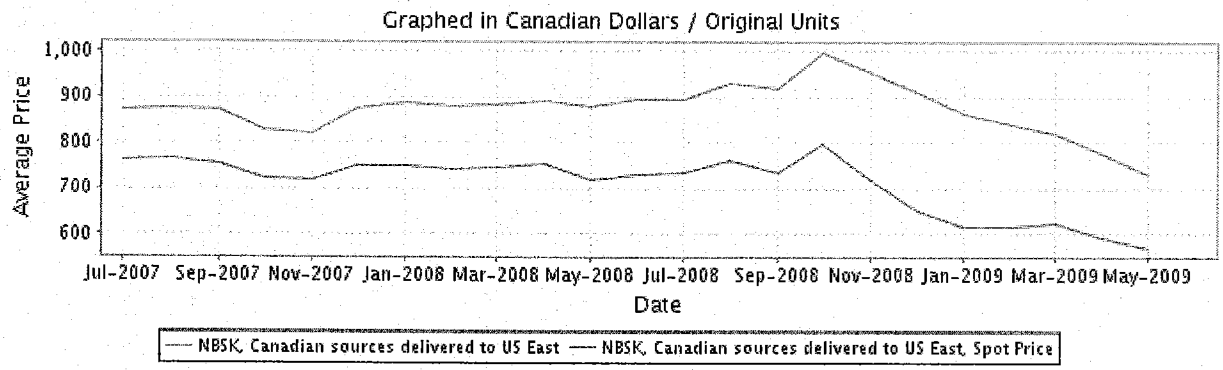
(c) receipt of expressions of interest by April 24, 2009.

16. Paragraph 36 of the Initial Order permits the Applicant and the Monitor to apply to this Honourable Court for advice and direction with respect to the Solicitation Process.

17. As the Monitor previously reported to this Honourable Court in the First Report, the CIM has been updated. As of the date of this Third Report, the Monitor has contacted approximately 60 parties regarding the opportunity to either provide financing to or purchase the business of Terrace Bay. A number of these parties have executed confidentiality agreements and received a copy of the CIM.

18. The Monitor has had discussions with many of these parties. As reported in the Second Report, however, the current state of the forestry sector, in general, and the pulp market, in particular, remains very challenged. Over the past twelve months, both the demand for

and the price of pulp have declined rapidly. Today, they remain at depressed levels. In addition to the challenging market conditions for pulp, Canadian producers have been further impacted by the recent rapid rise of the Canadian dollar, as most pulp is sold to the end customers in the U.S. market.



Source: RISI

As a result of these factors, a number of major North American integrated forestry firms have filed for CCAA and/or Chapter 11 protection in recent months, while many other firms have dramatically curtailed manufacturing of pulp, newsprint and timber. Due to these market conditions, the interest of parties in pursuing further due diligence at this time is limited. There are a limited number of parties with whom the Monitor continues to have discussions, but it is not clear whether these parties will have interest in pursuing a transaction at the current time.

19. As reported in the Second Report, the Monitor has also communicated with parties who are potential financiers. One lender has been identified that might be prepared to proceed, provided that additional long term financing also be arranged. Due to the uncertainty over the timing of the improvement in economic conditions, generally, and the pulp and broader forestry industry, in particular, a source of additional long term financing from traditional sources has not yet been identified.

20. The Monitor will continue to correspond with interested parties, but anticipates that this process will take additional time given the economic conditions prevalent in world pulp markets.

21. There have been recent reports that the federal government may announce funding support for the pulp and paper industry in the future. If an aid package is made available, Terrace Bay will assess whether or not there is an opportunity to access such funding to assist with its efforts to restart the mill.

22. Management of Terrace Bay is of the view that the mill is viable and financeable in more normalized and stable market conditions. Management also believes that an immediate liquidation of the mill would not be the best method of achieving value and, accordingly, it is not in the best interests of stakeholders to immediately proceed to liquidation without fully exploring other options. It is not clear, however, when market conditions will stabilize.

23. Terrace Bay is considering other alternatives to maximize stakeholder value, including the continued idling of the facility pending an improvement in the pulp markets. In a worst case scenario, it also recognizes that it may be necessary to proceed with the liquidation of the mill. Due to the ramifications for the community of Terrace Bay and the related forest product industry in Northern Ontario, as well as the impact a permanent closure of the mill would have on employees, suppliers and others, Terrace Bay believes that it is a responsible course of action for it to focus additional efforts on attempting to identify a solution that would preserve Terrace Bay as viable economic entity.

24. Terrace Bay intends to use the summer to continue with the Restructuring Process, while at the same time exploring the alternative scenarios of an indefinite idling of the plant, as well as a liquidation of its operations, in the event that the Restructuring Process is unsuccessful. The Monitor hopes to be in a position to report further to the Court on the progress of Terrace Bay in this regard, and any developments in relation to the Solicitation Process, before the end of the summer.

25. In the interim, Terrace Bay has advised the Monitor that it intends to continue to collect accounts receivable and sell finished pulp inventory to generate proceeds that can be used to retire its existing secured debt and maintain its minimized activities while the mill is idled.

RECEIPTS AND DISBURSEMENTS THROUGH JUNE 7, 2009

26. Attached as **Appendix "A"** to this Third Report is a summary of Terrace Bay's actual receipts and disbursements from May 18, 2009 to June 7, 2009 (the "**Reporting Period**"). Current cash on hand is approximately $8,796,000, including $7,075,000 relating to insurance proceeds reported on in the Second Report.

STATUS OF NEXCAP REPAYMENTS AND CONTEMPLATED COMMENCEMENT OF REPAYMENTS TO LUCKY STAR

27. Nexcap's principal balance outstanding at the commencement of this CCAA proceeding was $25 million. As set out in Appendix A, since the commencement of the CCAA proceedings, Terrace Bay has paid $23 million in principal and $338,000 in interest to Nexcap. Terrace Bay projects that it will fully repay the principal amount owing to Nexcap in June, 2009.

28. The Monitor advised this Court in its Second Report that it did not appear that Nexcap held valid 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**"). 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 is reflected in the cash flow reports that have been filed with this Honourable Court, total receipts to June 7, 2009 were approximately $33,756,000, excluding the Insurance Proceeds (as defined below), and were $40,831,000, if the Insurance Proceeds are included. During this same period, total disbursements to June 7, 2009, excluding payments to Nexcap, were approximately $9,151,000, resulting in there being total net proceeds, excluding payments to Nexcap, of approximately $31,680,000. As such, sufficient net proceeds have been realized, other than in relation to the disposition of the Quebec Inventory, even following payment of all disbursements, out of which payment of the entire secured amount owing to Nexcap could be made by Terrace Bay.

29. As reported in the Second Report, on or about May 4, 2009, Terrace Bay received the sum of $7,075,000, representing the proceeds from an insurance settlement with respect to a turbine owned by Terrace Bay that had been destroyed (the "**Insurance Proceeds**"). As also set out in the Second Report, the Monitor has been holding the Insurance Proceeds in trust pending a determination, if required, as to whom, as between Nexcap and Lucky Star, has a prior entitlement to the Insurance Proceeds. In that it is anticipated that the Nexcap secured indebtedness will be repaid this month, the Monitor understands that Lucky Star no longer has an objection to the Insurance Proceeds being released by the Monitor to Terrace Bay and that Terrace Bay will be seeking an order on this motion to permit their release from trust and paid to Terrace Bay.

30. Once the Nexcap indebtedness, inclusive of principal, interest and other amounts, if any (the "**Nexcap Indebtedness**") has been fully repaid and its security is discharged, Terrace Bay desires to commence repayment of the indebtedness that it owes to Lucky Star. Lucky Star is owed the principal sum of $14 million (the "**Lucky Star Indebtedness**").

31. In the Second Report, the Monitor reported on the review of the security registered by Nexcap in the United States that it had obtained. United States' counsel that prepared the report on security for the Monitor that was attached as Appendix "C" to the Second Report indicated that the appropriate jurisdiction for creditors of Terrace Bay, being a non-United States debtor without a residence, place of business or having its chief executive office in the United States, to file a financing statement under Article 9 of the Uniform Commercial Code (the "**UCC**") in relation to personal property in the form of inventory, was in the District of Columbia. Attached as Appendix "**B**" is a copy of the UCC search report provided by U.S. counsel, current as of March 11, 2009. As of that date, the only security interest registered was by Nexcap.

32. The records of Terrace Bay indicate that, as at June 7, 2009, approximately 10,397 tons of pulp inventory having a value, based on current prices, of approximately $5,199,000, was situated in warehouse locations in the United States (the "**U.S. Inventory**"). As of that same date, approximately 2,480 tons of pulp inventory having a value, based on

current prices, of approximately $1,240,000, was situated in Ontario. Terrace Bay's records reflect that it has outstanding accounts receivable as at June 7, 2009 of approximately $14,039,000, in addition to real property and other assets located in Ontario.

33. Terrace Bay wishes to commence repayment of the Lucky Star Indebtedness upon payment in full of the Nexcap Indebtedness. In conjunction with the motion to extend the Stay, Terrace Bay is seeking authorization from this Honourable Court to pay an amount of up to $7,000,000 to Lucky Star, which amount is to be paid from the Insurance Proceeds. Following this payment, the Monitor has been advised that Terrace Bay will continue to accrue receipts as provided for in the Revised Forecast (defined below) and will build up and maintain sufficient reserves to secure the charges created under the Initial Order in this proceeding (the "**CCAA Charges**"), to continue with the Restructuring Process and to maintain operations as contemplated by this Third Report throughout the extended Stay Period. Terrace Bay has advised the Monitor that it will seek a further order from this Honourable Court prior to making any additional payments to Lucky Star in relation to the Lucky Star Indebtedness.

REVISED CASH FORECAST

34. Attached as **Appendix "C"** is an updated cash flow forecast for the period ending on the week of October 4, 2009 (the "**Revised Forecast**"). The Revised Forecast reflects the payment in full of the indebtedness of Terrace Bay to Nexcap and the payment of $7,000,000 to Lucky Star during the forecast period. To more accurately reflect current market conditions, the Revised Forecast reflects an exchange rate of US$1.00=CDN$1.10 versus the rate of US$1.00=CDN$1.25 in prior forecasts. The closing cash balance at October 4, 2009 is estimated to be approximately $9,608,000, indicating sufficient liquidity to maintain operations for the duration of the Stay extension proposed. In addition to this cash balance, the Revised Forecast provides for a reserve in the amount of $3,250,000 from and following the week ending June 28, 2009 in relation to the CCAA Charges.

STATUTORY CLAIMS

35. 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 Buchanan. Terrace Bay has been named as a defendant in some, but not all of the FWLWA Actions.

36. In the Second Report, the Monitor reported that, as of May 19, 2009, it was aware of approximately 20 Claims of Lien being asserted pursuant the FWLWA in respect of which 16 Statements of Claim had been received by the Monitor. Since the Second Report, the Monitor has received one additional Claim of Lien pursuant to the FWLWA and has received four additional Statements of Claim issued in respect of Claims of Lien previously asserted.

37. On June 9, 2009, the Buchanan Receiver served motion materials in relation to the FWLWA Action. The motions of the Buchanan Receiver were heard by the Superior Court of Justice in Thunder Bay (the "**Thunder Bay Court**") on Thursday, June 11, 2009 (the "**Motions**"). In the Motions, the Buchanan Receiver requested the following relief in relation to the FWLWA Actions:

   (a) providing directions from the Court regarding the scheduling of a single hearing in all of the FWLWA Actions for the resolution of common issues concerning the validity and priority of liens claimed by the FWLWA claimants against logs and timber of Buchanan;

   (b) adding Buchanan, as represented by the Buchanan Receiver, as a defendant to any of the FWLWA Actions where Buchanan has not already been named as a defendant; and

   (c) that no default or enforcement proceedings be taken against any defendant to any of the FWLWA Actions with respect to the logs and timber of Buchanan pending the hearing described above.

38. The Monitor has been advised that, at the hearing of the Motions before Madam Justice Pierce, counsel for Terrace Bay advised the Thunder Bay Court that, while Terrace Bay does not object to the orders being sought by the Buchanan Receiver in respect of logs and timber that is owned by Buchanan, it takes the position that any relief granted should be without prejudice to the rights of Terrace Bay to assert any claims against the logs and wood chips situated upon its property for, among other things, charges related to processing, storage, security and other services and value provided. Justice Pierce has reserved her decision on the inclusion of the language requested by Terrace Bay.

39. The Monitor also reported in the Second Report that, as of May 19, 2009, it was aware of five claims for Lien under the *Construction Lien Act* (Ontario) (the "**CLA**") that had been registered against real property owned by Terrace Bay. Since the Second Report the Monitor has not received any additional Claims for Lien under the CLA, but the Monitor has received three Statements of Claim issued in respect of the Claims for Lien registered under the CLA.

TEMPORARY SERVICES AGREEMENT WITH BUCHANAN SALES INC. ("BSI")

40. BSI is an affiliate of Terrace Bay.

41. The Monitor understands that, since the commencement of this CCAA proceeding, employees of BSI, who also perform executive positions at Terrace Bay, have continued to perform functions that have been central to the Restructuring Process and the ongoing activities of Terrace Bay, with the understanding that BSI would be reimbursed by Terrace Bay for such services. BSI, while an affiliate of Terrace Bay, has had no economic interest in Terrace Bay or other motivation to continue to make available the services of its employees, unless reasonable compensation arrangements exist. While the parties thus far have been operating under a verbal agreement, it is now proposed that this arrangement be formalized. Accordingly, Terrace Bay, is seeking the approval of this Honourable Court to enter into a temporary services agreement, substantially in the form of the agreement that is attached as **Appendix "D"** to this Third Report (the "**Temporary Services Agreement**").

MONITOR'S RECOMMENDATION

42. The Monitor understands that a motion is being brought by Terrace Bay to extend the Stay and for other relief. It is the Monitor's belief that Terrace Bay continues to act in good faith and with due diligence. Accordingly, the Monitor supports the following orders being made by this Honourable Court:

    (a) an order authorizing Terrace Bay to commence repayments to Lucky Star in respect of the Lucky Star Indebtedness upon payment in full of the Nexcap Indebtedness, up to a maximum principal amount of $7,000,000;

    (b) an order authorizing the release of the Insurance Proceeds currently held in trust by the Monitor to Terrace Bay;

    (c) an order authorizing and directing Terrace Bay to enter into the Temporary Services Agreement with BSI;

    (d) an order authorizing the extension of the stay until September 30, 2009; and

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

All of which is respectfully submitted this 15th day of June, 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

Terrace Bay Pulp Inc.
CCAA Cash Flows
3 Week Period Ending June 7, 2009
(CDN$000s)

	Actual				Total From Commencement of CCAA Filing to June 7, 2009
Week Ended	**24-May-09**	**31-May-09**	**07-Jun-09**	**Total**	
Receipts					
Customer receipts	3,766	3,215	2,665	9,647	30,504
GST	-	-	-	-	-
Other receipts	4	(45)	52	11	3,252
Total receipts	**3,770**	**3,171**	**2,717**	**9,658**	**33,756**
Disbursements					
Freight & sales agent	(163)	(100)	(133)	(395)	(2,570)
Salaries & wages	-	(45)	(27)	(72)	(653)
Operations	(22)	(23)	(17)	(62)	(259)
Payroll withholdings	(7)	(23)	(6)	(37)	(785)
Benefits & pension	-	(75)	-	(75)	(434)
Bank service charges	(0)	(0)	0	(0)	1
WSIB	-	(21)	-	(21)	(27)
Vacation pay	-	-	(458)	(458)	(1,218)
Utilities & fuel	-	-	(8)	(8)	(2,347)
Insurance	-	-	(188)	(188)	(563)
Interest payments to secured creditors	-	-	(56)	(56)	(338)
Principal payments to secured creditors	(3,000)	(2,000)	(2,000)	(7,000)	(23,000)
Foreign exchange translation	(236)	(351)	(452)	(1,039)	(1,593)
Restructuring costs	(35)	(48)	(15)	(98)	(296)
Total disbursements	**(3,464)**	**(2,686)**	**(3,360)**	**(9,510)**	**(34,082)**
Cash Flow	**306**	**485**	**(643)**	**148**	**(327)**
Bank balance, opening	1,573	1,879	2,364	1,573	2,048
Cash flow	306	485	(643)	148	(327)
Bank balance, closing	**1,879**	**2,364**	**1,721**	**1,721**	**1,721**
Amount held by Monitor	**7,075**	**7,075**	**7,075**	**7,075**	**7,075**
Nexcap loan, opening	9,000	6,000	4,000	9,000	25,000
Payments to Nexcap	(3,000)	(2,000)	(2,000)	(7,000)	(23,000)
Nexcap loan, closing	**6,000**	**4,000**	**2,000**	**2,000**	**2,000**

Appendix B

CORPORATION SERVICE COMPANY
www.cscglobal.com

CSC- New York
Suite 3100
1133 Avenue of the Americas
New York, NY 10036
212-299-5600
212-299-5656 (Fax)

Matter# 012979-004
Project Id :
Additional Reference : KELLEY CORNISH

Order# 934336-1
Order Date 03/24/2009

Subject :	**TERRACE BAY PULP INC.**
Jurisdiction :	**DC-RECORDER OF DEEDS**
Request for :	**UCC Debtor Search**
Result :	Records found

File Type :	Original
File Number :	2007102150
File Date :	08/03/2007
Current Secured Party of Record :	NEXCAP FINANCE CORPORATION

Ordered by TIM CARNEY at PAUL WEISS RIFKIND WHARTON & GARRISON LLP

Thank you for using CSC. For real-time 24 hour access to the status of any order placed with CSC, access our website at www.cscglobal.com.

If you have any questions concerning this order or CSCGlobal, please feel free to contact us.

Jeffrey Boyle
jeboyle@cscinfo.com

[redacted]

LT1-5-2007102150-1

LT2-0-0-1

Doc# 2007102150 Fees:$46.50
08/03/2007 11:47AM Pages 1
Filed & Recorded in Official Records of
WASH DC RECORDER OF DEEDS LARRY TODD

SURCHARGE	$	8.50
UCCRECORD	$	40.00

UCC FINANCING STATEMENT

FOLLOW INSTRUCTIONS (front and back) CAREFULLY

A. NAME & PHONE OF CONTACT AT FILER [optional]

B. SEND ACKNOWLEDGMENT TO: (Name and Address)

Corporation Service Company
1090 Vermont Ave., NW #430
Washington, DC 20005

THE ABOVE SPACE IS FOR FILING OFFICE USE ONLY

1. DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (1a or 1b) - do not abbreviate or combine names

1a. ORGANIZATION'S NAME: Terrace Bay Pulp Inc.

OR 1b. INDIVIDUAL'S LAST NAME | FIRST NAME | MIDDLE NAME | SUFFIX

1c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY
21 Mill Road	Terrace Bay	ON	P0T 2W0	CAN

1d. SEE INSTRUCTIONS	ADD'L INFO RE ORGANIZATION DEBTOR	1e. TYPE OF ORGANIZATION	1f. JURISDICTION OF ORGANIZATION	1g. ORGANIZATIONAL ID #, if any
		CORP	ONTARIO	2192997 ☐ NONE

2. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (2a or 2b) - do not abbreviate or combine names

2a. ORGANIZATION'S NAME

OR 2b. INDIVIDUAL'S LAST NAME | FIRST NAME | MIDDLE NAME | SUFFIX

2c. MAILING ADDRESS | CITY | STATE | POSTAL CODE | COUNTRY

2d. SEE INSTRUCTIONS | ADD'L INFO RE ORGANIZATION DEBTOR | 2e. TYPE OF ORGANIZATION | 2f. JURISDICTION OF ORGANIZATION | 2g. ORGANIZATIONAL ID #, if any ☐ NONE

3. SECURED PARTY'S NAME (or NAME of TOTAL ASSIGNEE of ASSIGNOR S/P) - insert only one secured party name (3a or 3b)

3a. ORGANIZATION'S NAME: Nexcap Finance Corporation

OR 3b. INDIVIDUAL'S LAST NAME | FIRST NAME | MIDDLE NAME | SUFFIX

3c. MAILING ADDRESS	CITY	STATE	POSTAL CODE	COUNTRY
5420 North Service Rd., Ste. 504	Burlington	ON	L7L 6V7	CAN

4. This FINANCING STATEMENT covers the following collateral:

All assets of the Debtor.

5. ALTERNATIVE DESIGNATION [if applicable]: ☐ LESSEE/LESSOR ☐ CONSIGNEE/CONSIGNOR ☐ BAILEE/BAILOR ☐ SELLER/BUYER ☐ AG. LIEN ☐ NON-UCC FILING

6. ☐ This FINANCING STATEMENT is to be filed [for record] (or recorded) in the REAL ESTATE RECORDS. Attach Addendum [if applicable] 7. Check to REQUEST SEARCH REPORT(S) on Debtor(s) [ADDITIONAL FEE] [optional] ☐ All Debtors ☐ Debtor 1 ☐ Debtor 2

8. OPTIONAL FILER REFERENCE DATA

DC-Recorder Of Deeds

037893-1

FILING OFFICE COPY — UCC FINANCING STATEMENT (FORM UCC1) (REV. 05/22/02)

Corporation Service Company
2711 Centerville Rd. Ste. 400
Wilmington, DE 19808

Appendix C

Terrace Bay Pulp Inc.
CCAA Cash Flows (Revised)
To Period Ending October 4, 2009
(CDN$000s)

Week Ended	14-Jun-09	21-Jun-09	28-Jun-09	05-Jul-09	12-Jul-09	19-Jul-09	26-Jul-09	02-Aug-09	09-Aug-09	16-Aug-09	23-Aug-09	30-Aug-09	06-Sep-09	13-Sep-09	20-Sep-09	27-Sep-09	04-Oct-09
Receipts																	
Customer receipts	2,188	2,188	2,188	2,188	2,188	2,188	2,083	2,083	2,083	2,083	247	-	-	-	-	-	-
GST	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other receipts	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total receipts	2,188	2,188	2,188	2,188	2,188	2,188	2,083	2,083	2,083	2,083	247	-	-	-	-	-	-
Disbursements																	
Freight & sales agent	(333)	(333)	(333)	(226)	-	-	-	-	-	-	-	-	-	-	-	-	-
Salaries & wages	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-	(122)	-
Operations	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)	(25)
Payroll withholdings	(65)	(215)	(65)	-	(65)	-	(280)	-	(65)	-	(65)	-	(65)	-	(65)	-	(65)
Benefits & pension	(50)	-	-	(50)	(50)	-	-	(50)	(50)	-	-	-	(50)	-	-	-	(50)
WSIB	-	-	-	(12)	-	-	-	(12)	-	-	-	-	(12)	-	-	-	(12)
Vacation pay	-	-	-	-	(304)	-	-	-	-	-	-	-	-	-	-	-	(350)
Utilities & fuel	(80)	(80)	(380)	(80)	(80)	(80)	(380)	(80)	(80)	(80)	(380)	(80)	(80)	(80)	(80)	(80)	(80)
Insurance	-	-	-	(188)	-	-	-	(188)	-	-	-	-	(188)	-	-	-	(188)
Interest payments to secured creditors	-	-	-	(36)	-	-	-	-	-	-	-	-	-	-	-	-	-
Principal payments to secured creditors	-	(2,000)	(7,000)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Restructuring costs	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(100)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)
Funding of reserve for CCAA charges	-	-	(3,250)														
Total disbursements	(603)	(2,825)	(11,103)	(789)	(574)	(277)	(735)	(527)	(320)	(277)	(520)	(277)	(470)	(277)	(220)	(277)	(820)
Cash Flow	**1,585**	**(637)**	**(8,915)**	**1,399**	**1,614**	**1,911**	**1,348**	**1,556**	**1,763**	**1,806**	**(273)**	**(277)**	**(470)**	**(277)**	**(220)**	**(277)**	**(820)**
Bank balance, opening	8,796	10,381	9,744	829	2,228	3,841	5,752	7,099	8,655	10,417	12,223	11,949	11,672	11,202	10,925	10,705	10,428
Cash flow	1,585	(637)	(8,915)	1,399	1,614	1,911	1,348	1,556	1,763	1,806	(273)	(277)	(470)	(277)	(220)	(277)	(820)
Bank balance, closing[1]	10,381	9,744	829	2,228	3,841	5,752	7,099	8,655	10,417	12,223	11,949	11,672	11,202	10,925	10,705	10,428	9,608
Funded Reserve account for CCAA charges	-	-	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250	3,250
Accounts receivable, opening	14,039	13,934	13,829	13,724	12,952	10,764	8,577	6,494	4,412	2,329	247	-	-	-	-	-	-
Sales	2,083	2,083	2,083	1,415	-	-	-	-	-	-	-	-	-	-	-	-	-
Collections of accounts receivable	(2,188)	(2,188)	(2,188)	(2,188)	(2,188)	(2,188)	(2,083)	(2,083)	(2,083)	(2,083)	(247)	-	-	-	-	-	-
Accounts receivable, closing	13,934	13,829	13,724	12,952	10,764	8,577	6,494	4,412	2,329	247	-	-	-	-	-	-	-
Inventory tons (admt)	9,378	5,878	2,378														
Inventory value ($000s)	4,689	2,939	1,189														

1-It is contemplated that sufficient proceeds will exist to permit Terrace Bay to make payments to its secured creditors during the forecast period from its bank balance on hand, providing that sufficient reserves are maintained in relation to any potential priority claims that may exist, including pursuant to the Initial Order in the CCAA proceeding.

Appendix D

TEMPORARY SERVICES AGREEMENT

THIS AGREEMENT made as of the _____ day of June, 2009.

BETWEEN: **Terrace Bay Pulp Inc., a company governed by the laws of Ontario ("TBPI")**

-and-

Buchanan Sales Inc., a company governed by the laws of Ontario ("Buchanan")

WHEREAS:

A. Pursuant to an Order of the Ontario Superior Court of Justice (Commercial List)(the "CCAA Court") dated March 11, 2009, TBPI filed for and obtained protection under the *Companies' Creditors Arrangement Act* (the "CCAA Proceedings") and Ernst & Young Inc. ("EYI") was appointed as the Monitor of TBPI (the "Monitor");

B. TBPI and Buchanan have an oral agreement whereby since on or about March 11, 2009 TBPI has engaged employees of Buchanan for the provisions of certain temporary services during the CCAA Proceedings;

NOW THEREFORE in consideration of payment of the sum of $2.00 by TBPI to Buchanan and the mutual covenants in this agreement and other good and valuable consideration, the receipt and sufficiency of which are acknowledged, TBPI and Buchanan (hereinafter collectively referred to as the "Parties") agree that:

1.0 **<u>Services</u>**

1.1 **Services.** Buchanan will provide to TBPI the following temporary services to be performed by the individuals set out in Schedule "A" at the rates set out in Schedule "A":

(a) to cooperate with and assist TBPI and the Monitor in realizing on the TBPI Assets and the restructuring of TBPI in the CCAA Proceedings; and

(b) any and other services as may be agreed upon by the Parties from time to time during the course of the CCAA Proceedings.

1.1.1 It is acknowledged by TBPI that Buchanan will also be rendering assistance to Nexcap Finance Corporation ("Nexcap"), Lucky Star Holdings Inc. ("Lucky Star") in the realization of security held by them over the TBPI Assets and that employees of Buchanan providing services to TBPI will be involved in providing such assistance as well. Buchanan shall immediately advise TBPI in the event that in providing services to TBPI, Nexcap and/or Lucky Star a situation arises in which the employees of Buchanan providing the services hereunder are in a position of a conflict of interest, and the parties shall, acting reasonably, work to resolve the issue.

1.2 **Payment of Fees.** Buchanan shall invoice TBPI, with a copy to the Monitor, on a bi-weekly basis for the services provided pursuant to Section 1.1 which shall be inclusive of any and all sales, goods and services, excise, value added or similar taxes of any kind, remittances and assessments, whether of federal or other jurisdictional level. Such invoices shall detail descriptions of activities performed by employees of Buchanan by date and/or by number of hours expended by such employees in respect of such activities. Subject to first obtaining the approval of the Monitor, TBPI shall pay Buchanan the invoiced amount within 14 days of receipt of the invoice. It is expressly understood that such fees shall constitute the entire obligation of TBPI. For greater certainty, TBPI and the Monitor shall not be liable in respect of any entitlements or obligations in relation to the employees or contractors of Buchanan assigned by Buchanan to provide services pursuant to this Agreement, including, but not limited to, any salary/wages, commissions or other remuneration, overtime pay, vacation time off and vacation pay, holiday pay, bonus payments, termination and severance pay, medical or healthcare benefits or plans, pension plan contributions and/or statutory remittances or obligations of any nature or kind including, without limitation, pursuant to any federal, provincial or other legislation.

2.0 **Term and Termination**

2.1 **Term.** This agreement is effective as of March 11, 2009 until either party terminates this Agreement in accordance with section 2.2 below, unless terminated earlier by order of the CCAA Court and is subject to the issuance and entering of an order of the CCAA Court approving this Agreement.

2.2 **Termination.** Either party may terminate this Agreement, in its sole discretion, at any time, upon written notice to the other party, without any further payment, and without further liability, save and except any payments that are owed for services performed to the date of termination. Both parties will cooperate with each other to provide advance notice, where possible, of any changes in the need for services and/or the ability to provide such services (as the case may be). If possible, both parties will seek to provide at least one week advance notice of their intent to terminate the agreement.

3.0 **Representations and Warranties**

3.1 **Representation and Warranties of Buchanan.** Buchanan represents and warrants to the Receiver as follows:

(a) *Organization and Qualification.* Buchanan is a valid and existing Corporation under the *Ontario Business Corporations Act* and has full power and authority to own its property, hire employees and contractors, and conduct its businesses as currently owned and conducted.

(b) *Compliance with Applicable Laws.* Buchanan represents and warrants that in providing the services pursuant to this Agreement, it is in compliance with all applicable laws, including, but not limited to, any and all employment and labour laws that may apply to its employees.

(c) *OHSA and Workplace Safety and Insurance Compliance.* Without limiting the generality of the foregoing, Buchanan confirms that it is in compliance with the *Occupational Health and Safety Act* and the *Workplace Safety and Insurance Act*, and that it is solely responsible for any workplace safety and insurance coverage that may be applicable to any of its employees in the provision of services pursuant to this Agreement. Buchanan confirms that all workplace safety and insurance premiums and assessments for its employees have been paid up to the date of this Agreement, and undertakes to continue to make such payments as required.

(d) *Relationship.* The parties hereto expressly acknowledge and agree that Buchanan shall render the services hereunder as an independent contractor to TBPI and that any persons performing the obligations of Buchanan are not and shall not be construed to be employees or contractors of TBPI and/or the Monitor. Buchanan acknowledges and agrees that TBPI and the Monitor are not agreeing to employ or contract with any person other than Buchanan pursuant to this Agreement. Neither Buchanan, nor any of its employees or contractors, shall have any right to any employee benefit, entitlement or advantage from TBPI and/or the Monitor arising from the performance of the services being rendered by Buchanan to TBPI. Buchanan shall be responsible for supervision of all employees and contractors it assigns in satisfaction of its agreement to provide services to TBPI pursuant to this Agreement, including, without limitation, sole authority to discipline such employees and contractors, and to terminate the employment or engagement of any such persons. TBPI shall not supervise such employees, nor shall it have any authority to discipline and/or terminate the employment of such employees. In the event that TBPI is not satisfied with the services provided by Buchanan, or any aspect of such services, TBPI shall have the right to raise such issues with Buchanan and the parties will, acting reasonably, work together to resolve such issues. For greater certainty, nothing in this Agreement shall be construed as creating an employment relationship between the employees of Buchanan and TBPI and/or the Monitor.

(e) *Employee Acknowledgment.* Prior to assigning an employee or contractor to provide services pursuant to this Agreement, Buchanan shall require the employee or contractor to execute, and shall deliver an executed copy to TBPI of, a written "Acknowledgment and Agreement" that provides as follows:

> "I represent and acknowledge that I am an employee (independent contractor) of Buchanan Sales Inc. ("Buchanan"). Buchanan has agreed to provide certain temporary services to Terrace Bay Pulp Inc. pursuant to a Temporary Services Agreement dated as of June •, 2009 between Buchanan and Terrace Bay Pulp Inc. (the "TSA").

To induce Buchanan to assign or engage me to provide services to Buchanan so that it may comply with its obligations under the TSA, I acknowledge and agree that, in relation to any services that I perform for Buchanan relating to the TSA (the "Services"), I shall not commence, file or register any claim, action or other proceeding whatsoever that alleges, or otherwise assert, that:

(a) Ernst & Young Inc., in its capacity as Monitor of Terrace Bay Pulp Inc. (the "Monitor"), or in any other capacity, is an employer or a related, joint and/or successor employer of Terrace Bay Pulp Inc. and/or Buchanan Sales Inc.; or

(b) Terrace Bay Pulp Inc. is an employer or a related, joint and/or successor employer of Buchanan Sales Inc.,

pursuant to any employment and labour legislation, including but not limited to the *Employment Standards Act, 2000*, the *Labour Relations Act*, and the *Pension Benefits Act.*; or (b) directly contracting with me.

I agree that a copy of this Acknowledgment and Agreement will be provided to the Monitor and Terrace Bay Pulp Inc. and may be raised as an estoppel and relied upon as a full defence to any claim that I may make or assert against the Monitor, Terrace Bay Pulp Inc. and any of their respective directors, officers, partners, employees, agents or legal representatives, in the event that any such a claim, action or other proceeding is commenced or asserted, whether directly or indirectly, by me or on behalf of me.

I acknowledge that I have been given the opportunity to consult with legal counsel before signing this Acknowledgment and Agreement and that I have agreed to execute this Acknowledgment and Agreement with the full knowledge and understanding that any rights that I may have in relation to any services that I may render in relation to the TSA, whether or not for the direct or indirect benefit of Terrace Bay Pulp Inc., shall be only against Buchanan and not against the Monitor, Terrace Bay Pulp Inc. or any of their respective directors, officers, partners, employees, agents or legal representatives."

(f) *Indemnification by Buchanan.* Buchanan shall indemnify, and save harmless TBPI and the Monitor, and their respective directors, officers, employees, agents and other representatives, from and against any and all losses, claims, demands, debts, actions, causes of action, damages, penalties, interest, costs or expenses (excluding legal fees and disbursements) or liability of any kind whatsoever resulting from:

i. the negligent or wilful acts or omissions of Buchanan or its employees arising in connection with this Agreement;

ii. any and all breaches by Buchanan or its employees and/or agents of any representations, warranties, covenants, terms or conditions of this Agreement;

iii. any employee wages, vacation pay, income tax, Canada Pension Plan, Employment Insurance, Workplace Safety and Insurance Act and Employer Health Tax deductions and remittances and any other statutory payments in respect of an employee of Buchanan to the extent that such payments are not remitted or paid by Buchanan; and

iv. Buchanan's provision of pension contributions to an employee pension plan for any employee that is assigned to provide services pursuant to this Agreement,

all with respect to services provided under this Agreement.

4.0 General

4.1 Assignment. This agreement shall not be assignable by either party except as may be agreed upon in writing by the parties not to be unreasonably withheld.

4.2 Binding Effect. This agreement shall be binding upon and shall enure to the benefit of and be enforceable by the parties hereto and their respective successors.

4.3 Governing Law. This agreement shall be governed by and construed in accordance with the laws of Ontario (excluding any conflict of laws rule or principle that might refer such construction to the laws of another jurisdiction). Each party hereto irrevocably submits to the non-exclusion jurisdiction of the courts of Ontario with respect to any matter arising hereunder or related hereto.

4.4 Counterparts. This agreement may be signed in any number of counterparts (by facsimile or otherwise), each of which shall be deemed to be an original and all of which, when taken together, shall be deemed to constitute one and the same instrument. It shall not be necessary in making proof of this agreement to produce more than one counterpart. Executed copies of this Agreement may be delivered electronically in pdf format and, if so delivered, shall be deemed to be an original.

IN WITNESS WHEREOF, TBPI and Buchanan have executed this Agreement under seal as of the day and year first above written.

TERRACE BAY PULP INC.

Per: ______________________________
Title

I have authority to bind the corporation

BUCHANAN SALES INC.

Per: ________________________________

Title

I have authority to bind the corporation

Schedule "A"

Rates of Pay

Russ York - $100/hour

Taras Sawloa - $75/hour