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.**

# THIRTEENTH REPORT OF ERNST & YOUNG INC. DATED JUNE 17, 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 April 30, 2010. Absent a further extension, the Stay Period will expire on June 30, 2010.

## PURPOSE

2. The purpose of this thirteenth report of the Monitor (the "**Thirteenth Report**") is to update this Honourable Court in relation to the activities of Terrace Bay and the Monitor since the twelfth report of the Monitor dated May 24, 2010 (the "**Twelfth Report**"), to supplement the Twelfth Report and to report on the following:

(a) the plan of compromise and arrangement filed by Terrace Bay dated May 21, 2010, a copy of which is annexed as Appendix "A" to this Thirteenth Report (the "**Plan**") and matters supplemental to the Twelfth Report. The Twelfth Report should be read together with this Thirteenth Report;

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

(c) events since the filing of the Plan and the making by this Court of the Order (the "**Creditors' Meeting Order**") authorizing and establishing the procedure for Terrace Bay to consider and vote on the Plan. **Capitalized terms not otherwise defined in this Thirteenth Report shall have the definitions used in the Plan.**

**TERMS OF REFERENCE**

3. In preparing this Thirteenth 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 Thirteenth Report. Some of the information referred to in this Thirteenth 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 Thirteenth 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.

4. Unless otherwise noted, all references to dollar amounts in this Thirteenth Report are in Canadian currency.

**UPDATE ON THE CLAIMS PROCESS**

5. The Claims Process implemented by the Claims Process Order is described in the ninth report of the Monitor dated December 15, 2009 (the "**Ninth Report**"). Copies of the Ninth Report (and all prior reports of the Monitor) and the Claims Process Order (and all prior Orders of this Honourable Court in the CCAA Proceeding) are posted on the Monitor's website (www.ey.com/ca/terracebay).

6. The Claims Process Order called for the filing of a Proof of Claim (as defined in the Claims Process Order):

   (a) for Claims (as defined in the Claims Process Order) which arose prior to March 11, 2009 (each, a "**Pre-Filing Claim**"); and

   (b) for Claims (as defined in the Claims Process Order) 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**").

7. Pursuant to the Claims Process Order, unionized and non-unionized employees were not required to file a Proof of Claim (as defined in the Claims Process Order) 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 ("**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 and in the Plan.

8. Pursuant to the Claims Process Order, creditors having Pre-Filing Claims or Restructuring Claims who fail 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 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.

9. 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.

10. The Monitor has progressed substantially in its review of the Proofs of Claim filed to date in relation to the Claims Process Order. The Monitor has summarized, in Appendix "B" to this Thirteenth Report, the current status of the Claims filed, and all claims listed in Claim Amount Notices sent to Claim Amount Notice Creditors. Appendix "B" was prepared based on information known to the Monitor as at June 11, 2010 and contains the following information:

(a) the total number of Proofs of Claim received by the Monitor, including whether the Claims asserted were secured or unsecured and the face value of such claims, as received;[1]

(b) the dollar value of the Claims for which Claims Amount Notices were sent and in respect of which a Proof of Claim was not filed;

(c) the dollar value of the Claims that have not been disallowed or revised by the Monitor and which are not anticipated to be disputed; and

(d) the dollar value (based on the face amount of the Claim as asserted) of claims for which a Disallowance Notice has been sent by the Monitor following the review of the applicable Proof of Claim, including those claims for which the period to

[1] One claim in the amount of $379,655.00 that is listed in the Secured Claim column was filed as a claim for constructive trust, rather than as a secured claim.

file a Notice of Dispute (as defined in the Claims Process Order) has not elapsed, as well as the dollar value of claims received that are still under consideration by the Monitor.

11. The Claims Process will not be fully completed by the date of the Creditors' Meeting, with the result that the total number and quantum of all Proven Unsecured Claims will not be known. To the extent that a Notice of Dispute (as defined in the Claims Process Order) is received by the Monitor in response to a Disallowance Notice sent by the Monitor, it is very likely that the amount of such Disputed Claim for voting and/or distribution purposes will not have been finally determined as at the date of the Creditors' Meeting.

12. As reported in the Twelfth Report, the Creditors' Meeting Order therefore proposes a process to be followed in relation to Disputed Claims that have not been finally determined in accordance with the Claims Process Order prior to the Creditors' Meeting.

13. The Claims Process Order (as amended by the Creditors' Meeting Order) also includes a mechanism for the Monitor to agree to extend the Claims Bar Date or the Restructuring Claims Bar Date (each as defined in the Claims Process Order) if the Monitor is satisfied that a Person did not receive a Claims Package (as defined in the Claims Process Order) or notice of the Claims Process at least ten days prior to the relevant Bar Date. At the time of preparation of this Report, the Monitor has sent a Claims Package (as defined in the Claims Process Order) to one such party and such party has filed a Proof of Claim.

## ACTIONS TAKEN PURSUANT TO THE CREDITORS' MEETING ORDER

14. In accordance with the Creditors' Meeting Order, on June 4, 2010 the Monitor sent to each Eligible Voting Creditor (as defined in the Creditors' Meeting Order) an information package containing a copy of the Information Circular, the Notice of Creditors' Meeting and the form of proxy (collectively, the "**Information Package**").

15. A copy of the Information Package has also been posted on the Monitor's website (www.ey.com/ca/terracebay).

16. Pursuant to the Creditors' Meeting Order, the Newspaper Notice (as defined in the Creditors' Meeting Order) has been published in the Globe and Mail (National Edition), the Thunder Bay Chronicle – Journal and the Terrace Bay/Schreiber News.

**STATUS OF THE DISCUSSIONS WITH STAKEHOLDERS REGARDING THE PLAN AND CONDITIONS PRECEDENT TO THE IMPLEMENTATION OF THE PLAN**

17. **This Thirteenth Report provides information relating to the Plan that supplements the Twelfth Report. This Thirteenth Report should be read together with the Twelfth Report and the Information Circular. As noted above, capitalized terms referenced in this Thirteenth Report have the meanings set forth in the Plan, where not otherwise defined.**

18. The Applicant, with the assistance of the Monitor, has developed the Plan, which it believes is in the best interests of all of its stakeholders, including creditors, employees and the community in which the mill is the main source of economic activity. Terrace Bay has advised the Monitor that the Plan would permit it to be restructured and repositioned on a long-term basis as a viable business and a key component of the forest products industry in Ontario. This would, in turn, allow Terrace Bay to continue to support the Township of Terrace Bay and the Township of Schreiber, in addition to other forestry operations and communities throughout northern Ontario.

19. An overview of the Plan was provided in the Twelfth Report. In summary, the Plan provides that each of the Affected Unsecured Creditors will exchange its Proven Unsecured Claim for a pro rata share of a non-interest bearing subordinated secured promissory note issued by Terrace Bay (the "**Plan Note**"). The Plan Note will be in a principal amount ranging from \$10 to \$30 million, depending on the future income generated by Terrace Bay subsequent to exiting from this CCAA Proceeding.

20. Terrace Bay and the Monitor are continuing to engage in discussions with stakeholders, including significant unsecured creditors, in relation to the Plan. At this time, discussions are ongoing, with a view to gaining the support of key stakeholders required for the approval of the Plan.

21. The implementation of the Plan is conditional upon the fulfillment or waiver of several conditions, in addition to its approval by required majority of Affected Creditors and this Honourable Court. These conditions include, among other things, that:

(a) 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). As reported in the Tenth Report of the Monitor dated February 18, 2010, the Applicants had entered into a letter of intent with a funding provider on January 20, 2010 for an asset-based revolving operating facility. On June 10, 2010, however, the funding provider informed Terrace Bay that it was no longer willing to proceed with the credit facility. Terrace Bay is currently in discussions with an alternative funding provider, which it hopes will enable it to enter into an agreement that will provide it with sufficient operating funding (an "**Operating Loan**"). Should Terrace Bay not be able to secure an Operating Loan, it is unlikely that it will be able to satisfy the conditions of the Province Loan Agreement, nor be in a position to finance the restart of its mill operations;

(b) Terrace Bay shall have entered into a loan agreement with the Province of Ontario (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);

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

(d) 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 the Terrace Bay, with all conditions precedent under such agreement having been satisfied or waived (subject only to the completion of the transaction contemplated under this Plan); and

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

22. While Terrace Bay continues to work toward their fulfillment, as of the date of this Thirteenth Report the conditions referenced in subparagraphs 21(a) to (e) above have not as yet been satisfied, and it is not currently known when or if this will occur. As such conditions are material to its success, even if the Plan is approved by the requisite majority of Affected Creditors that are eligible to vote, the failure to fulfill one or more of such conditions could result in the Plan not being implemented. Terrace Bay has advised the Monitor that if the Plan is approved by the required majority of Affected Creditors, Terrace Bay will ask the Court to approve and sanction the Plan only when the issues which remain outstanding are resolved. If this requires a change in the current date for court approval and sanction, June 29, 2010, notice of the change of date of the sanction hearing will be provided to the Affected Creditors. The Monitor will provide a further update to creditors prior to the sanction hearing.

**UNION AGREEMENTS**

23. As referenced in the Information Circular, Terrace Bay has negotiated agreements with its unions, which have been ratified, that provide, among other things, for the settlement of obligations for severance and termination pay and allow for recall rights to be extended and recall to be offered to some employees who might otherwise lose their employment. The agreements will facilitate the resumption of operations of its mill and cap the amount payable for severance and termination pay claims. Finally, the agreements also cap certain benefit costs and significantly reduce exposure to long term pharmaceutical cost liabilities for certain employees. The Monitor is advised that these agreements require and Terrace Bay intends to bring a motion for approval by this Honourable Court of the union agreements prior to or at the same time as the hearing seeking the Sanction Order.

## MONITOR'S ANALYSIS OF THE PLAN AND ALTERNATIVES

### Implications of Failure to Implement the Plan

24. The Applicant is insolvent and the Applicant's operations have been idled since February 23, 2009. While a sale process has not been conducted for the entire business of Terrace Bay, without funding to restart the mill, a likely consequence of a failure to approve the Plan is a forced liquidation of the Applicant's property and assets. Under a forced liquidation, a realization from the property and assets of the Applicant will likely be materially less than the sum of the Affected Claims. Moreover, any amounts realized in a forced liquidation will most likely be eroded by environmental claims costs and charges, termination and severance pay amounts and the professional and other costs typically incurred in connection with such a process.

25. The Applicant, with the assistance of the Monitor, has developed the Plan, which it believes is in the best interests of all of its stakeholders, including creditors, employees and the community in which the mill is the main source of economic activity. Terrace Bay has advised the Monitor that the Plan would permit it to be restructured and repositioned on a long-term basis as a viable business and a key component of the forest products industry in Ontario.

26. In light of the available alternatives, it is the view of the management and director of the Applicant, which is concurred with by the Monitor, that the implementation of the Plan offers the best prospects for the continued viability of the business of the Applicant and that the Affected Creditors are being offered a significantly better prospect for a recovery under the Plan than they would receive in a forced liquidation. In the event of a forced liquidation of the Applicant's property and assets, subject to the assumptions and qualifications detailed in the Liquidation Analysis and in Section 5 and 6 of the Information Circular, the Monitor believes there would be minimal, if any, recovery for Affected Creditors.

**Illustrative Liquidation Recovery Analysis if the Plan is Not Implemented**

27. Attached as Appendix "C" to this Thirteenth Report is an illustrative estimated realization value liquidation analysis prepared by the Monitor (the "**Liquidation Analysis**") for inclusion in the Information Circular. The Liquidation Analysis is based on information provided by the Applicant. It reflects a range of recoveries to creditors based on certain estimates, and is subject to the assumptions and qualifications contained therein and in Section 5 of the Information Circular and the Risk Factors described in Section 6 of the Information Circular. As noted in the Liquidation Analysis, the estimates and assumptions used are subject to significant contingencies and uncertainties, some of which will take place in the future, with the result that the actual forced liquidation value of the Applicant's property and assets may be materially different than the amounts set out in the Liquidation Analysis. The Liquidation Analysis was attached as Schedule "C" to the Information Circular. The Monitor makes no representation or assurance that the values or recoveries in the Liquidation Analysis would be realized or could be achieved if the property and assets of the Applicant were liquidated.

28. The Monitor believes that if the Plan is not approved by the Affected Creditors, the most likely alternative will be the forced liquidation of the property and assets of the Applicant under the CCAA, the BIA or otherwise. In such circumstances, the prospect of a distribution to Affected Creditors would be uncertain as a result of priority claims, likely realization values and associated costs and expenses of realization. In addition, any liquidation process would be subject to considerable execution risk and cost.

29. Attached as Appendix "D" to this Thirteenth Report is an analysis in which the Monitor has estimated the range of recoveries for Affected Creditors pursuant to the Plan based upon a range of recoveries from \$10 million to \$30 million under the Plan Note (the "**Illustrative Recovery Analysis**"). The Illustrative Recovery Analysis is an illustrative estimate, which may vary from the actual results, with final recoveries for Affected Creditors being dependant, among other things, on the final determined amount of the Proven Unsecured Claims.

30. Subject to the assumptions and qualifications and risk factors described in the Liquidation Analysis and Sections 5 and 6 of the Information Circular, in the event that the Plan is not approved and a forced liquidation ensues, the Monitor anticipates that the Affected Creditors will receive minimal, if any, recovery on their Proven Unsecured Claims in a forced liquidation.

31. The Monitor believes that the Plan has the ability to produce a more favourable result for Affected Creditors than would a forced liquidation of the property and assets of the Applicant as there would be minimal, if any, distribution to the Affected Creditors in the event of a liquidation.

**CONCLUSION AND RECOMMENDATIONS OF THE MONITOR**

32. The Monitor believes that, if the CCAA Plan is not approved by the required majority of Affected Creditors, the most likely alternative would be a forced liquidation of the Applicant's assets and the distribution of the net proceeds from such a liquidation to the creditors in accordance with their respective priorities. In such a case, the prospects for any significant, or any, recovery for unsecured creditors appears to be remote.

33. The implementation of the Plan appears to offer the best prospects for the continued viability of the business of the Applicant. If the Applicant is able to restart its operations, the prospect for a recovery for Affected Creditors under the Plan Note would be maximized. There would also be attendant benefits for the employees of and suppliers to the Applicant, the Township of Terrace Bay and its surrounding communities.

34. In view of the foregoing, the Monitor recommends that Affected Creditors vote in favour of the resolution approving the Plan, but cautions that conditions material to the success of the Plan may not be fulfilled or waived, resulting in the Plan not being capable of being implemented, even if the requisite number of Affected Creditors vote in favour of the resolution.

All of which is respectfully submitted this 17th day of June 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

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.**

# PLAN OF COMPROMISE AND ARRANGEMENT OF TERRACE BAY PULP INC.

**May 21, 2010**

## TABLE OF CONTENTS

**TABLE OF CONTENTS**
(continued)

**Page**

**TABLE OF CONTENTS**
(continued)

**Page**

**PLAN OF COMPROMISE AND ARRANGEMENT OF TERRACE BAY PULP INC. PURSUANT TO THE *COMPANIES' CREDITORS ARRANGEMENT ACT* (CANADA)**

**DATED FOR REFERENCE MAY 21, 2010**

# ARTICLE 1
# DEFINITIONS AND INTERPRETATION

## 1.1 Definitions

In this Plan (including the Schedules hereto), unless otherwise stated or the context should otherwise require, the capitalized terms and phrases used but not defined herein have the following meanings:

"**ABL Loan Agreement**" means the loan agreement to be entered into by the Applicant for operating financing of up to $40 million on terms and conditions satisfactory to the Applicant;

"**Administration Charge**" means the Administration Charge granted under the Initial Order;

"**Affected Claim**" means all Claims other than Excluded Claims;

"**Affected Creditor**" means any Person who has a Pre-Filing Claim or Restructuring Claim against the Applicant, as more particularly set out in the Claims Process Order, and may include any transferee or assignee of an Affected Claim;

"**Applicable Law**" means, at any time, in respect of any Person, property, transaction, event or other matter, as applicable, all laws, rules, statutes, regulations, treaties, orders, judgments and decrees, and all official requests, directives, rules, guidelines, orders, policies, practices and other requirements of any Authorized Authority;

"**Applicant**" means Terrace Bay Pulp Inc.;

"**Authorized Authority**" means, in relation to any Person, transaction or event, any:

(a) federal, provincial, territorial, state, municipal or local governmental body (whether administrative, legislative, executive or otherwise), both domestic and foreign;

(b) agency, authority, commission, instrumentality, regulatory body, court, or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative powers or functions of or pertaining to government, including any Taxing Authority;

(c) court, arbitrator, commission or body exercising judicial, quasi-judicial, administrative or similar functions; or

(d) other body or entity created under the authority of or otherwise subject to the jurisdiction of any of the foregoing, including any stock or other securities exchange, in each case having jurisdiction over such Person, transaction or event;

**"Bar Date"** means the Claims Bar Date or the Restructuring Claims Bar Date;

**"BIA"** means the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3;

**"Buchanan Group"** means the Applicant, Great West Timber Limited, Northern Sawmills Inc., Dubreuil Forest Products Limited, Long Lake Forest Products Inc., MacKenzie Forest Products Inc., Buchanan Northern Hardwoods Inc., Atikokan Forest Products Inc., 686860 Ontario Limited, Lucky Star Holdings Inc.;

**"Business Day"** means, with respect to any action to be taken, any day, other than Saturday, Sunday or a statutory holiday, on which banks are generally open for business in Toronto, Ontario, Canada;

**"CCAA"** means the *Companies' Creditors Arrangement Act*, as applicable to the CCAA Proceedings, which for greater certainty does not include the amendments proclaimed into force on September 18, 2009;

**"CCAA Proceedings"** means the proceedings commenced by the Applicant in the Court under the CCAA;

**"Charges"** means the Administration Charge and the Directors' Charge;

**"Claim"** means any right or claim of any Person that may be asserted or made in whole or in part against the Applicant, whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, including without limitation, by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement (oral or written), by reason of any breach of duty (including, without limitation, any legal, statutory, equitable or fiduciary duty) or by reason of any right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown, by guarantee, surety or otherwise, and whether or not any right or claim is executory or anticipatory in nature including, without limitation, any right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action whether existing at present or commenced in the future, including, without limiting the foregoing, any Tax Claim, provided however, that a "Claim" shall not include an Excluded Claim;

**"Claim Amount Notice"** means the notice to Affected Creditors setting out Pre-Filing Claims delivered by the Applicant in accordance with the Claims Process Order;

**"Claims Bar Date"** means 5:00 p.m. (Eastern Time) on February 8, 2010, or such other date as may be ordered by the Court;

**"Claims Officer"** means any individual appointed by the Applicant, under such terms as are approved by the Monitor or further Order of the Court, to act as a claims officer for purposes of and in accordance with the Claims Process Order;

"**Claims Process Order**" means the Order granted by the Court dated December 18, 2009, as amended, restated or varied by subsequent Order of the Court;

"**Court**" means the Ontario Superior Court of Justice (Commercial List), or any Canadian court with appellate jurisdiction over the CCAA Proceedings;

"**Creditors' Meeting**" means the meeting of Affected Creditors called for the purposes of considering and voting in respect of this Plan, which has been set by the Creditors' Meeting Order to take place for the Unsecured Class at 10:00 a.m.(Eastern time) on June 21, 2010, and any postponements, adjournments or amendments thereof;

"**Creditors' Meeting Order**" means the Order of the Court made May 31, 2010 which, among other things, sets the date of the Creditors' Meeting and establishes meeting procedures for the Creditors' Meeting, as such Order may be amended or varied from time to time by subsequent Order of the Court;

"**Crown**" means Her Majesty in right of Canada or a province of Canada;

"**Crown Claims**" means Claims of the Crown, for all amounts that were outstanding at the Filing Date and are of a kind that could be subject to a demand under:

(a) subsection 224(1.2) of the ITA;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the ITA and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the ITA, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

  (i) has been withheld or deducted by a Person from a payment to another Person and is in respect of a tax similar in nature to the income tax imposed on individuals under the ITA, or

  (ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection;

"**Directors' Charge**" means the Directors' Charge granted under the Initial Order;

"**Disallowed Claim**" means a Disputed Claim (or any portion thereof) which has been finally disallowed in accordance with the Claims Process Order;

**"Disputed Claim"** means an Affected Claim or any portion thereof, which has not been allowed or accepted as proven by the Monitor, which is the subject of a Notice of Dispute, and which has not been resolved by the Claims Officer, if applicable, by agreement or by further Order of the Court. For greater certainty, once a Disputed Claim is finally determined, it shall become a Proven Unsecured Claim or Disallowed Claim;

**"Effective Date"** means a day as determined by the Applicant that is the Business Day as soon as reasonably practicable after all conditions precedent to implementation of this Plan set out in Section 8.2 have been satisfied or (to the extent legally permissible) waived and the Monitor has filed the Monitor's Certificate confirming the foregoing;

**"Excluded Claim"** has the meaning set forth in Section 3.3 of this Plan;

**"Filing Date"** means March 11, 2009, being the date of the Initial Order;

**"Information Circular"** means the information circular relating to this Plan, including any Schedules attached thereto, as it may be restated, supplemented or amended from time to time;

**"Initial Order"** means the Order granted by the Court in the CCAA Proceedings on March 11, 2009, as amended, restated, varied or extended from time to time by subsequent Orders of the Court;

**"ITA"** means the *Income Tax Act* (Canada), as amended;

**"Lien"** means any mortgage, charge, pledge, assignment by way of security, lien, hypothec, security interest, deemed trust or other encumbrance granted or arising pursuant to a written agreement or statute or otherwise created by law;

**"Monitor"** means Ernst & Young Inc., in its capacity as Court-appointed monitor of the Applicant in the CCAA Proceedings;

**"Monitor's Certificate"** has the meaning given to it in Section 8.3 of this Plan;

**"Note Indenture"** means the note indenture to be established in respect of the Plan Note;

**"Notice of Dispute"** means a notice delivered by an Affected Creditor who has received a Notice of Revision or Disallowance with respect to an Affected Claim disputing such Notice of Revision or Disallowance pursuant to the Claims Process Order or this Plan;

**"Notice of Revision or Disallowance"** means a notice delivered to an Affected Creditor pursuant to the Claims Process Order revising or rejecting such Affected Creditor's Pre-Filing Claim or Restructuring Claim in whole or in part;

**"Order"** means any order of the Court in the CCAA Proceedings;

**"Person"** shall be broadly interpreted and includes, without limitation, an individual, firm, partnership, joint venture, venture capital fund, limited liability company, unlimited liability company, association, trust, corporation, unincorporated association or organization, syndicate, committee, the government of a country or any political subdivision thereof, or any agency, board, tribunal, commission, bureau, instrumentality or department of such government or political subdivision, or any other entity, howsoever designated or constituted, including any Taxing Authority, and the trustees, executors, administrators, or other legal representatives of an individual, and, for greater certainty, shall include any Authorized Authority;

"**Plan**" means this Plan of Compromise and Arrangement, as it may be amended, restated, or supplemented from time to time in accordance with the provisions hereof;

"**Plan Note**" means the promissory note to be issued by the Applicant to the Trustee on the Effective Date in the principal amount of $30,000,000 with the terms and conditions set out in Schedule "B" hereto;

"**Pre-Filing Claim**" means any Claim (i) based in whole or in part on facts which existed prior to the Filing Date, (ii) related to a time period prior to the Filing Date or (iii) which would have been a claim provable in bankruptcy within the meaning of the BIA had the Applicant become bankrupt on the Filing Date. An Affected Creditor entitled to claim for interest under its applicable agreement with the Applicant may claim for interest that has accrued on its Pre-Filing Claim as of the Filing Date, but no claim for interest shall be allowed for interest accruing after that date;

"**Proof of Claim**" means a proof of claim, in substantially the form attached as Schedule "C" to the Claims Process Order, as submitted to the Monitor by an Affected Creditor in accordance with the Claims Process Order;

"**Pro Rata Share**" means, at any time, a proportionate share, so that the ratio of the consideration distributed on account of a Proven Unsecured Claim is the same as the ratio of the amount of that Proven Unsecured Claim to the amount of all Proven Unsecured Claims receiving such distribution;

"**Proven Unsecured Claim**" means the Affected Claim of an Affected Creditor, as finally determined in accordance with the Claims Process Order any other Order of the Court and/or this Plan;

"**Province**" means Her Majesty the Queen in Right of Ontario, as represented by the Minister of Northern Development, Mines and Forestry;

"**Province Loan Agreement**" means the loan agreement to be entered into by the Applicant and the Province for term financing of $25 million to assist in funding the restart of the Terrace Bay mill, on terms and conditions satisfactory to the Applicant;

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

"**Restructuring Claims Bar Date**" means the later of (i) the Claims Bar Date; and (ii) 5:00 p.m. (Eastern Time) on the day which is 15 days after the date of the notice of repudiation or disclaimer delivered in accordance with the Claims Process Order.

"**Sanction Order**" means an Order sanctioning this Plan and giving all necessary directions regarding its implementation, which shall include the provisions set forth in Section 8.1 of this Plan;

"**Stumpage Agreement**" means the agreement to be entered into between the Buchanan Group and the Province with respect to unpaid stumpage fees payable by the Buchanan Group on terms and conditions satisfactory to the Applicant;

"**Tax**" or "**Taxes**" means any and all amounts subject to a withholding or remitting obligation and any and all taxes, duties, fees, and other governmental charges, duties, impositions and liabilities of any kind whatsoever whether or not assessed by the Taxing Authorities (including any Claims by any of the Taxing Authorities), including all interest, penalties, fines, fees, other charges and additions with respect to such amount;

"**Tax Claim**" means any Claim against the Applicant for any Taxes in respect of any taxation year or period ending on or prior to the Filing Date, and in any case where a taxation year or period commences on or prior to the Filing Date, for any Taxes in respect of or attributable to the portion of the taxation period commencing prior to the Filing Date and up to and including the Filing Date. For greater certainty, a "Tax Claim" shall include, without limitation, any and all Claims of any Taxing Authority in respect of transfer pricing adjustments and any Canadian or non-resident Tax related thereto;

"**Taxing Authorities**" means Her Majesty the Queen, Her Majesty the Queen in right of Canada, Her Majesty the Queen in right of any province or territory of Canada, the Canada Revenue Agency, any similar revenue or taxing authority of each and every province or territory of Canada and any political subdivision thereof, and any Canadian or foreign governmental authority exercising taxing powers in administering and/or collecting Taxes;

"**Trustee**" means the trustee to be appointed by the Applicant under the Note Indenture;

"**Unsecured Claims**" means all Affected Claims that are Pre-Filing Claims or Restructuring Claims, including all Affected Claims secured by a Lien to the extent that the value of the property securing the Lien is less than the amount of the Lien;

"**Unsecured Class**" means the holders of Unsecured Claims.

### 1.2 Article and Section Reference

The terms "**this Plan**", "**hereof**", "**hereunder**", "**herein**", and similar expressions refer to this Plan, and not to any particular article, section, subsection, paragraph or clause of this Plan and include any variations, amendments, modifications or supplements hereto. In this Plan, a reference to an article, section, subsection, clause or paragraph shall, unless otherwise stated, refer to an article, section, subsection, paragraph or clause of this Plan.

### 1.3 Extended Meanings

In this Plan, where the context so requires, any word importing the singular number shall include the plural and vice versa, and any word or words importing gender shall include all genders.

### 1.4 Interpretation Not Affected by Headings

The division of this Plan into articles, sections, subsections, paragraphs and clauses and the insertion of a table of contents and headings are for convenience of reference and shall not affect the construction or interpretation of this Plan.

### 1.5 Inclusive Meaning

As used in this Plan, the words "**include**", "**includes**", "**including**" or similar words of inclusion mean, in any case, those words as modified by the words "**without limitation**" and "**including without limitation**"; so that references to included matters shall be regarded as illustrative rather than exhaustive.

### 1.6 Currency

Unless otherwise stated herein, all references to currency in this Plan are to lawful money of Canada. For the purposes of voting or distribution, all Claims shall be denominated in Canadian Dollars and all cash distributions under this Plan shall be paid in Canadian Dollars. Any Claim in a currency other than Canadian Dollars will be deemed to have been converted to Canadian Dollars at the spot rate of exchange quoted by the Bank of Canada for exchanging such currency to Canadian Dollars as at noon on the Filing Date.

### 1.7 Statutory References

Unless otherwise stated herein, any reference in this Plan to a statute includes all regulations made thereunder, all amendments to such statute or regulations in force from time to time to the date of this Plan and any statute or regulation that supplements or supersedes such statute or regulation to the date of this Plan.

### 1.8 Successors and Assigns

The rights, benefits and obligations of any Person named or referenced in this Plan shall be binding on and shall inure to the benefit of any heir, administrator, executor, legal personal representative, successor or assign, as the case may be, or a trustee, receiver, interim receiver, receiver and manager, liquidator or other Person acting on behalf of such Person, as permitted hereunder.

### 1.9 Governing Law

This Plan shall be governed by and construed and interpreted in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein, without regard to any conflict of law provision that would require the application of the law of any other jurisdiction. Any dispute or issue in connection with, or related to the interpretation, application or effect of this Plan and all proceedings taken in connection with this Plan and its revisions shall be subject to the exclusive jurisdiction of the Court.

### 1.10 Severability of Plan Provisions

If any provision of this Plan is or becomes illegal, invalid or unenforceable on or following the Effective Date in any jurisdiction, the illegality, invalidity or unenforceability of that provision will not affect the legality, validity or enforceability of the remaining provisions of this Plan, or the legality, validity or enforceability of that provision in any other jurisdiction.

### 1.11 Timing Generally

Unless otherwise specified, all references to time herein, and in any document issued pursuant hereto, shall mean local time in Thunder Bay, Ontario and any reference to an event occurring on a Business Day shall mean prior to 5:00 p.m. (Eastern Time) on such Business Day.

### 1.12 Time of Payments and Other Actions

Unless otherwise specified, time periods within or following which any payment is to be made or act is to be done shall be calculated by excluding the day on which the period commences and including the day on which the period ends and by extending the payment to the next succeeding Business Day if the last day of the period is not a Business Day. Wherever any payment to be made or action to be taken under this Plan is required to be made or to be taken on a day other than a Business Day, such payment shall be made or action taken on the next succeeding Business Day.

### 1.13 Schedules

The following are the Schedules to this Plan, which are incorporated by reference into this Plan and form an integral part hereof:

| | |
|---|---|
| Schedule "A" - | Form of Monitor's Certificate |
| Schedule "B" - | Plan Note Term Sheet |

## ARTICLE 2
## PURPOSE AND EFFECT OF PLAN

### 2.1 Purpose

The purpose of this Plan is to effect a compromise and arrangement of all Affected Claims against the Applicant in order to enable the business of the Applicant to continue, in the expectation that a greater benefit will be derived from the continued operation of the business of the Applicant than would result from the immediate sale or forced liquidation of its assets. This Plan will become effective on the Effective Date in accordance with its terms. Each Affected Claim against the Applicant will be fully and finally compromised in accordance with the terms of this Plan, as more particularly set out in Section 10.2.

## ARTICLE 3
## CLASSIFICATION OF CLAIMS

### 3.1 Classification of Claims

For the purposes of considering and voting on this Plan and receiving a distribution hereunder, the Affected Claims of the Affected Creditors are grouped into a single class, being the Unsecured Class.

### 3.2 Affected Persons

On the Effective Date, this Plan shall be binding upon the Applicant and the Affected Creditors and their respective heirs, executors, administrators, legal representatives, successors and assigns in accordance with its terms, but shall not affect Excluded Claims.

### 3.3 Claims Unaffected by the Plan

This Plan does not compromise, release or otherwise affect the following Claims (collectively, "**Excluded Claims**"):

(a) any Claim secured by the Administration Charge or the Directors' Charge;

(b) any Claim with respect to goods and/or services provided to the Applicant on or after the Filing Date;

(c) the portion of a Claim arising from a cause of action for which the Applicant is covered by insurance, but only to extent of such coverage;

(d) any Claim by a current or former employee of the Applicant in his or her capacity as an employee;

(e) Crown Claims;

(f) the Claim of the Province for unpaid stumpage fees;

(g) Claims that the Applicant is required to pay pursuant to Section 7(c) of the Initial Order; and

(h) the Claim of Lucky Star Holdings Inc. secured by a Lien against the assets, properties or undertaking of the Applicant, which Claim will be paid in full on the Effective Date.

Affected Creditors with Excluded Claims will not be entitled to vote at the Creditors' Meeting or receive any distributions under this Plan in respect of any portion of their Claim which is an Excluded Claim.

### 3.4 Defences to Unaffected Claims

Nothing in this Plan shall affect the Applicant's rights and defences, both legal and equitable, with respect to any Excluded Claims or any rights with respect to legal and equitable defences or entitlements to set-offs or recoupments against such Excluded Claims.

### 3.5 Claim of the Province

The Claim of the Province referred to in section 3.3(f) shall be paid in accordance with the Stumpage Agreement.

### 3.6 Crown Claims

All Crown Claims in respect of amounts that were outstanding at the Filing Date or related to the period ending on the Filing Date shall be paid in full to the Crown within six months of the Sanction Order as required by section 18.2(1) of the CCAA.

## ARTICLE 4
## TREATMENT OF UNSECURED CLAIMS

### 4.1 Voting by the Unsecured Class

Each holder of a Proven Unsecured Claim or a Disputed Claim shall be entitled to vote on this Plan at the Creditors' Meeting for the Unsecured Class to the extent of the amount of its Proven Unsecured Claim or Disputed Claim allowed for voting purposes. A Disputed Claim is allowed for voting purposes only and, following the Creditors' Meeting, will be finally determined to be a Proven Unsecured Claim or a Disallowed Claim, as provided in the Creditors' Meeting Order.

### 4.2 Treatment of Unsecured Claims

On the Effective Date, the Applicant shall issue to the Trustee, for and on behalf of each holder of a Proven Unsecured Claim, the Plan Note. On the Effective Date, each holder of a Proven Unsecured Claim will exchange its Proven Unsecured Claim for a Pro Rata Share of the Plan Note.

## ARTICLE 5
## IMPLEMENTATION OF THE PLAN

### 5.1 Issuance of Plan Note

On the Effective Date, the Applicant will issue the Plan Note to the Trustee, to be held by the Trustee for and on behalf of the holders of Proven Unsecured Claims, as more particularly set out in the Note Indenture.

### 5.2 Charges

On the Effective Date, all outstanding obligations, liabilities, fees and disbursements secured by the Administration Charge shall be fully paid or, in the alternative, a cash reserve in an amount sufficient to pay the Claims secured by the Administration Charge, as determined by the Monitor, will be established by the Applicant and administered by the Monitor. Upon payment of all outstanding obligations, liabilities, fees and disbursements secured by the Administration Charge, the Administration Charge shall be and be deemed to be discharged from the assets of the Applicant or, in the event of payment to the cash reserve, shall attach to the cash reserve. Any amount in the cash reserve in excess of the amount necessary to pay all outstanding obligations, liabilities, fees and disbursements secured by the Administration Charge shall be released to the Applicant by the Monitor upon payment of such obligations in full.

### 5.3 Effectuating Documents

The Vice-President and Treasurer of the Applicant shall be authorized to execute, deliver, file, or record such contracts, instruments, releases, indentures and other agreements or documents, and take such other actions, as may be necessary or appropriate, to effectuate and further evidence the terms and conditions of this Plan. The secretary or assistant secretary of the Applicant shall be authorized to certify or attest to any of the foregoing actions.

## ARTICLE 6
## PROVISIONS GOVERNING DISTRIBUTIONS

### 6.1 Voting and Distributions on Proven Unsecured Claims

Any Affected Creditor (i) that has not disputed the nature or amount of its Unsecured Claim as set out in the Claim Amount Notice, or (ii) has submitted a Proof of Claim in respect of its Unsecured Claim in accordance with the procedure set out in the Claims Process Order prior to the applicable Bar Date and has not been sent a Notice of Disallowance prior to the Creditors' Meeting, will be entitled to vote and receive distributions based on its Proven Unsecured Claim.

With respect to any Unsecured Claim not set out in a Claims Amount Notice, any Affected Creditor that has not submitted a Proof of Claim in respect of such Unsecured Claim in accordance with the procedure set out in the Claims Process Order prior to the applicable Bar Date will not be entitled to vote or receive distributions under this Plan in respect of such Unsecured Claim, unless otherwise ordered by the Court or agreed to by the Applicant and the Monitor in writing.

### 6.2 Voting and Distributions on Disputed Claims

(a) Any Affected Creditor holding a Disputed Claim as of the date of the Creditors' Meeting will be entitled to vote based on the amount of its Disputed Claim, subject to the terms of the Creditors' Meeting Order.

(b) The fact that a Disputed Claim is allowed for voting purposes shall not preclude the Applicant and the Monitor from disputing the Disputed Claim.

(c) To the extent that any Disputed Claim becomes a Proven Unsecured Claim in accordance with the Claims Process Order and this Plan from and after the Effective Date, the holder of such a Proven Unsecured Claim will exchange its Proven Unsecured Claim for a Pro Rata Share of the Plan Note, and, from and after the exchange, such holder will have the rights and obligations of a holder under the Note Indenture.

(d) The Monitor will finalize the allocation of each Affected Creditor's Pro Rata Share once all Disputed Claims have been finally determined to be either Proven Unsecured Claims or Disallowed Claims in accordance with the Creditors' Meeting Order.

### 6.3 Interest on Affected Claims

No interest or penalties shall accrue or be paid on an Affected Claim from and after or in respect of the period following the Filing Date and no holder of an Affected Claim will be entitled to any interest in respect of such Affected Claim accruing on or after or in respect of the period following the Filing Date. All interest accruing on any Affected Claim after or in respect of the period following the Filing Date shall be forever extinguished and released under this Plan.

### 6.4 Distributions in respect of Transferred or Assigned Claims

The Applicant and the Monitor shall not be obligated to give notice to or otherwise deal with any transferee or assignee of an Affected Claim as the holder of an Affected Claim unless actual notice of transfer or assignment, together with satisfactory evidence of such transfer and assignment has been delivered to the Applicant and the Monitor in accordance with the procedure set out in the Claims Process Order.

### 6.5 Tax Matters

(a) **Tax on Distributions.** Notwithstanding any other provision of this Plan, including subsection (b) below, each Affected Creditor that is to receive a distribution pursuant to this Plan shall have sole and exclusive responsibility for the satisfaction and payment of any Tax obligations imposed by any Authorized Authority on account of such distribution.

(b) **Withholding Rights.** All distributions under the Plan Note shall be subject to any withholding and reporting requirements imposed by any Applicable Law or any Taxing Authority, and such other restrictions as may be set out in the Note Indenture.

## ARTICLE 7
## CREDITORS' MEETING

### 7.1 Creditors' Meeting and Conduct

The Creditors' Meeting to consider and vote on this Plan shall be held and conducted by the Applicant and the Monitor in accordance with the terms of the Creditors' Meeting Order.

### 7.2 Acceptance of Plan

If the Plan is approved by the required majority of Affected Creditors entitled to vote at the Creditors' Meeting, this Plan shall be approved and shall be deemed to have been agreed to, accepted and approved by the Affected Creditors and shall be binding upon all Affected Creditors.

## ARTICLE 8
## CONDITIONS OF PLAN IMPLEMENTATION

### 8.1 Sanction Order

If this Plan is approved by the required majority of Affected Creditors entitled to vote at the Creditors' Meeting, the Applicant shall bring a motion before the Court for the Sanction Order, which Sanction Order shall provide, among other things, that:

(a) (i) this Plan has been approved by the required majority of Affected Creditors entitled to vote at the Creditors' Meeting in conformity with the CCAA; (ii) the Applicant acted in good faith and has complied with the provisions of the CCAA and the Orders made in the CCAA Proceedings in all respects; (iii) the Court is satisfied that the Applicant has not done nor purported to do anything that is not authorized by the CCAA; and (iv) this Plan and the transactions contemplated by it are fair and reasonable;

(b) this Plan (including the compromises, arrangements and releases set out herein) shall be sanctioned and approved pursuant to Section 6 of the CCAA and will be binding and effective as herein set out on the Applicant, all Affected Creditors and all other Persons as provided for in this Plan or in the Sanction Order;

(c) subject to the performance by the Applicant of its obligations under this Plan, and except to the extent expressly contemplated by this Plan or the Sanction Order, all obligations or agreements to which the Applicant is a party, other than agreements which were restructured, terminated, disclaimed or repudiated by the Applicant prior to the deadline specified in the Creditors' Meeting Order in accordance with the Initial Order, will be and shall remain in full force and effect as at the Effective Date, unamended except as they may have been amended by agreement of the parties subsequent to the Filing Date in accordance with the Plan, and no Person who is a party to any such obligations or agreements shall, following the Effective Date, accelerate, terminate, rescind, refuse to perform or otherwise repudiate its obligations thereunder, or enforce or exercise any right (including any right of set-off, option, dilution or other remedy) or make any demand under or in respect of any such obligation or agreement, by reason of:

    (i) any defaults or events of default arising as a result of the insolvency of the Applicant prior to the Effective Date;

    (ii) the fact that the Applicant has sought or obtained relief under the CCAA or that this Plan has been implemented by the Applicant;

(iii) any compromises or arrangements effected pursuant to this Plan; or

(iv) any other event(s) which occurred on or prior to the Effective Date which would have entitled any Person to enforce those rights and remedies, subject to any express provisions to the contrary in any agreements entered into with the Applicant after the Filing Date. For greater certainty, nothing in this paragraph shall waive any obligations of the Applicant in respect of any Excluded Claim;

(d) the appointment of the Claims Officer, if applicable, shall cease on the Effective Date, except with respect to matters to be determined or completed pursuant to the Claims Process Order and this Plan or further Order of the Court after the Effective Date (including, the resolution of the Disputed Claims), unless otherwise agreed with the Applicant and the Monitor;

(e) the commencement or prosecution, whether directly, indirectly, derivatively or otherwise, of any demands, claims, actions, counterclaims, suits, judgment, or other remedy or recovery with respect to any Claim released, discharged or terminated pursuant to this Plan shall be permanently enjoined;

(f) the releases effected by this Plan shall be approved, and declared to be binding and effective as of the Effective Date upon all Affected Creditors, the Monitor and all other Persons affected by this Plan and shall enure to the benefit of all such Persons; and

(g) all Charges established by the Initial Order or any other Order of the Court, shall be terminated, released and discharged effective on the Effective Date, save and except insofar as the Charges have attached to the reserve established by the Monitor pursuant to Section 5.2 herein.

**8.2 Conditions of Plan Implementation**

The implementation of this Plan shall be conditional upon the fulfillment or waiver, where applicable, of the following conditions on or before the Effective Date:

(a) this Plan shall have been approved by the required majority of Affected Creditors entitled to vote at the Creditors' Meeting;

(b) the Sanction Order shall have been granted by the Court and shall be in full force and effect and not reversed, stayed, varied, modified or amended;

(c) all applicable appeal periods in respect of the Sanction Order shall have expired and in the event of an appeal or application for leave to appeal, final determination shall have been made by the applicable appellate court;

(d) all approvals, orders, determinations or consents required pursuant to Applicable Law, if applicable, shall have been obtained on terms and conditions satisfactory to the Applicant and the Monitor, acting reasonably, and shall remain in full force and effect on the Effective Date;

(e) all necessary corporate action and proceedings of the Applicant shall have been taken to approve this Plan and to enable each Applicant to execute, deliver and perform its obligations under the agreements, documents and other instructions to be executed and delivered by it pursuant to this Plan;

(f) all agreements, resolutions, documents and other instruments, which are necessary to be executed and delivered by the Applicant, or any director or officer of the Applicant in order to implement this Plan and perform its obligations under this Plan (including the Note Indenture), shall have been executed and delivered;

(g) the Applicant shall have entered into the ABL Loan Agreement, and all conditions precedent to be completed under the ABL Loan Agreement shall have been satisfied or waived, subject only to the completion of the transactions contemplated under this Plan;

(h) the Applicant shall have entered into the Province Loan Agreement, and all conditions precedent to be completed under the Province Loan Agreement shall have been satisfied or waived, subject only to the completion of the transactions contemplated under this Plan;

(i) the Applicant shall have entered into the Stumpage Agreement, and all conditions precedent to be completed under the Stumpage Agreement shall have been satisfied or waived, subject only to the completion of the transaction contemplated under this Plan;

(j) the Applicant shall have entered into an agreement for the purchase of fibre located at the Applicant's premises and elsewhere on terms and conditions satisfactory to the Applicant, and all conditions precedent to be completed under such agreement shall have been satisfied or waived, subject only to the completion of the transaction contemplated under this Plan; and

(k) the Applicant shall have obtained a commitment from the Province with respect to the supply of fibre on terms and conditions satisfactory to the Applicant.

Except for the conditions set out in 8.2(a) and (b), each of the conditions set out in this Section 8.2 may be waived in whole or in part by the Applicant by written notice to the Monitor. If a condition set out above has not been satisfied or waived in accordance with this Section 8.2, this Plan shall automatically terminate, in which case the Applicant shall not be under any further obligation to implement this Plan.

### 8.3 Monitor's Certificate

Upon written notice from the Applicant to the Monitor that the conditions set out in Section 8.2 have been satisfied or waived, the Monitor shall, as soon as possible following receipt of such written notice, file with the Court a certificate which states that all conditions precedent set out in Section 8.2 hereof have been satisfied or waived, in substantially the form as the certificate attached as Schedule "A" to this Plan (the "**Monitor's Certificate**").

## ARTICLE 9
## AMENDMENTS TO THE PLAN

### 9.1 Amendments to Plan Prior to Approval

The Applicant reserves the right to file any variation or modification of, or amendment or supplement to, this Plan by way of a supplementary or amended and restated plan or plans of compromise or arrangement or both filed with the Court at any time or from time to time prior to the commencement of the Creditors' Meeting, with the prior consent of the Monitor. **Affected Creditors who wish to receive written notice of any variation, modification, amendment or supplement to the Plan should contact the Monitor in the manner set out in Section 11.8 of this Plan.** Any such supplementary or amended and restated plan or plans of compromise or arrangement or both shall, for all purposes, be deemed to be a part of and incorporated into this Plan. Any such variation, modification, amendment or supplement shall be posted on the Monitor's website (www.ey.com/ca/terracebay) on the day on which it is filed with the Court, served on the CCAA Proceedings service list, and notice will be given to all Affected Creditors who have filed proxies with the Monitor, to the extent that such Affected Creditors are not on the service list or have requested written notice in accordance with this Section. Affected Creditors are advised to check the Monitor's website regularly. Affected Creditors in attendance at the Creditors' Meeting will also be advised of any amendment made to the Plan.

In addition, the Applicant may propose a variation, modification of or amendment or supplement to this Plan during the Creditors' Meeting with the consent of the Monitor if such amendment would not be materially prejudicial to the interests of any of the Affected Creditors under the Plan, provided that notice of such variation, modification, amendment or supplement is given to all Affected Creditors entitled to vote present in person or by proxy at the applicable Creditors' Meeting prior to the vote being taken at such Creditors' Meeting, in which case any such variation, modification, amendment or supplement shall, for all purposes, be deemed to be part of the Plan. Any variation, amendment, modification or supplement at a Creditors' Meeting will be promptly posted on the Monitor's website (www.ey.com/ca/terracebay) and filed with the Court as soon as practicable following the applicable Creditors' Meeting.

### 9.2 Non-material Amendments to Plan

The Applicant may vary, amend, modify or supplement this Plan at any time and from time to time after the Creditors' Meeting (and both prior to and subsequent to the obtaining of the Sanction Order), without the need for obtaining an Order of the Court or providing notice to the Affected Creditors, if the Applicant and the Monitor, acting reasonably and in good faith, determine that such variation, amendment, modification or supplement is of a technical or administrative nature that would not be materially prejudicial to the interests of any of the Affected Creditors under this Plan and is necessary in order to give effect to the substance of this Plan or the Sanction Order.

## ARTICLE 10
## PLAN IMPLEMENTATION AND EFFECT OF THE PLAN

### 10.1 Implementation

On the Effective Date, subject to the satisfaction or waiver of the conditions contained in Section 8.2 of this Plan, this Plan shall be implemented by the Applicant and shall be binding upon all Affected Creditors in accordance with the terms of this Plan and the Sanction Order.

### 10.2 Effect of the Plan Generally

The payment, compromise or satisfaction of any Affected Claims under this Plan, if sanctioned and approved by the Court, shall be binding upon each Affected Creditor, his, her or its heirs, executors, administrators, legal personal representatives, successors and assigns, as the case may be, for all purposes and this Plan will constitute: (a) full, final and absolute settlement of all rights of any Affected Creditor against the Applicant in respect of the Affected Claims; and (b) an absolute release and discharge of all indebtedness, liabilities and obligations of or in respect of the Affected Claims against the Applicant and all Liens granted by the Applicant in respect thereof, including any interest or costs accruing thereon whether before or after the Filing Date.

### 10.3 Compromise Effective for All Purposes

No Person who has a Claim as a guarantor, surety, indemnitor or similar covenant in respect of any Claim which is compromised under this Plan or who has any right to claim over in respect of or to be subrogated to the rights of any Person in respect of a Claim which is compromised under this Plan shall be entitled to any greater rights than the Affected Creditor whose Claim was compromised under this Plan. Accordingly, the payment, compromise or other satisfaction of any Claim under this Plan, if sanctioned and approved by the Court, shall be binding upon such Affected Creditor, his, her or its heirs, executors, administrators, legal and personal representatives, and successors and assigns, as the case may be, for all purposes and, to such extent, shall also be effective to relieve any third party directly or indirectly liable for such indebtedness, whether as guarantor, surety, indemnitor, director, joint covenantor, principal or otherwise.

### 10.4 Contracts

As of the Effective Date, each contract to which the Applicant is a party as at the Filing Date, as it may have been modified, amended or varied after the Filing Date, remains in full force and effect as at the Effective Date (other than in respect of Claims arising thereunder which have been affected or compromised by this Plan) unless such contract: (a) is the subject of a notice of repudiation or disclaimer delivered prior to the deadline specified in the Creditors' Meeting Order in accordance with the Claims Process Order; or (b) has expired or terminated pursuant to its terms.

### 10.5 Plan Releases

Effective on the Effective Date:

(a) The Applicant shall be forever released and discharged from all Affected Claims.

(b) Except as otherwise provided in this Plan or the Sanction Order, and subject to the provisions of Section 5.1(2) of the CCAA, each Affected Creditor or other Person in consideration of the distributions made under this Plan will be deemed to have forever released and discharged (i) the Applicant and its present and former directors, officers, employees, agents, affiliates, professional advisors (including legal counsel) and associates (ii) the Monitor and its present and former partners, directors, officers, employees, agents, affiliates, professional advisors (including legal counsel) and associates, and (iii) any Person who may claim contribution or indemnification against or from the Applicant, from any and all demands, Claims, including Claims of any past and present officers, directors or employees for contribution and indemnity, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any Affected Creditor or other Person may be entitled to assert, including, without limitation, any and all Tax Claims, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act, omission, transaction, dealing, event or other occurrence existing or taking place on or prior to the Effective Date in any way relating to, arising out of or in connection with the Applicant, its assets or property, the business or affairs of the Applicant (whenever and however conducted), the transactions and events giving rise to any Claims, this Plan or the CCAA Proceedings, other than Excluded Claims and the right to enforce the Applicants' obligations under this Plan.

(c) The Applicant shall be deemed to have forever released and discharged each of its (i) present and former directors, officers and employees, and (ii) the Monitor and its present and former partners, directors, officers, employees, agents, affiliates, professional advisors (including legal counsel) and associates, from any and all demands, claims, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act, omission, transaction, dealing, event or other occurrence existing or taking place on or prior to the Effective Date in any way relating to, arising out of or in connection with the Applicant, its assets or property, the business or affairs of the Applicant (whenever and however conducted), the transactions and events giving rise to any Claims, this Plan or the CCAA Proceedings, that could be asserted by or on behalf of the Applicant.

### 10.6 Knowledge of Claims

Each Person to which Section 10.5 applies shall be deemed to have granted the releases set forth in Section 10.5 notwithstanding that it may hereafter discover facts in addition to, or different from, those which it now knows or believes to be true, and without regard to the subsequent discovery or existence of such different or additional facts, and such party expressly waives any and all rights that it may have under any Applicable Law which would limit the effect of such releases to those Claims or causes of action known or suspected to exist at the time of the granting of the release.

### 10.7 Exculpation

Neither the Applicant, the Monitor nor any of their respective present or former partners, directors, officers, employees, agents, affiliates, professional advisors (including legal counsel) and associates shall have or incur any liability to any holder of a Claim or equity interest in the Applicants, or other party in interest, or any of their respective members, officers, directors, employees, professional advisors (including legal counsel) or agents or any of their successors and assigns, for any act or omission in connection with, related to, or arising out of the CCAA Proceedings, the pursuit of sanction of the Plan, the consummation of the Plan or the administration of the Plan or the property to be distributed under the Plan, including the negotiation and solicitation of the Plan, except for wilful misconduct or gross negligence, and subject to the provisions of Section 5.1(2) of the CCAA. In all respects, the Applicant, the Monitor and each of their present and former partners, directors, officers, employees, agents, affiliates, professional advisors (including legal counsel) and associates shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the Plan.

### 10.8 Waiver of Defaults

From and after the Effective Date, and subject to any express provisions to the contrary in any amending agreement entered into with the Applicant after the Filing Date, all Persons shall be deemed to have waived any and all defaults of the Applicant then existing or previously committed by the Applicant or caused by the Applicant or any of the provisions hereof or non-compliance with any covenant, warranty, representation, term, provision, condition or obligation, express or implied, in every contract, agreement, mortgage, security agreement, indenture, trust indenture, loan agreement, commitment letter, agreement for sale, lease, personal property lease or other agreement, written or oral, any amendments or supplements thereto, existing between such Person and the Applicant. Any and all notices of default, acceleration of payments and demands for payments under any instrument, or other notices, including without limitation, any notices of intention to proceed to enforce security, arising from any of such aforesaid defaults shall be deemed to have been rescinded and withdrawn. For greater certainty, nothing in this paragraph shall waive any obligations of the Applicant in respect of any Excluded Claim.

### 10.9 Consents and Releases

From and after the Effective Date, all Affected Creditors shall be deemed to have consented and to have agreed to all of the provisions of this Plan as an entirety. In particular, each Affected Creditor shall be deemed to have granted, and executed and delivered to the Applicant all consents, releases, assignments and waivers, statutory or otherwise, required to implement and carry out this Plan in its entirety.

**10.10 Deeming Provisions**

In this Plan, the deeming provisions are not rebuttable and are conclusive and irrevocable.

## ARTICLE 11
## GENERAL PROVISIONS

**11.1 Different Capacities**

Affected Creditors whose Claims are affected by this Plan may be affected in more than one capacity. Unless expressly provided herein to the contrary, each such Affected Creditor shall be entitled to participate hereunder in each such capacity. Any action taken by an Affected Creditor in any one capacity shall not affect the Affected Creditor in any other capacity, unless expressly agreed by the Affected Creditor in writing or unless the Claims overlap or are otherwise duplicative.

**11.2 Further Assurances**

Notwithstanding that the transactions and events set out in this Plan may be deemed to occur without any additional act or formality other than as may be expressly set out herein, each of the Persons affected hereto shall make, do, and execute or cause to be made, done or executed all such further acts, deeds, agreements, assignments, transfers, conveyances, discharges, assurances, instruments, documents, elections, consents or filings as may be reasonably required by the Applicant in order to implement this Plan.

**11.3 Set-Off**

The law of set-off applies to all Claims made against the Applicant and to all actions instituted by it for the recovery of debts due to the Applicant in the same manner and to the same extent as if the applicable Applicant was plaintiff or defendant, as the case may be.

**11.4 Paramountcy**

Without limiting any other provision hereof, from and after the Effective Date, in the event of any conflict between this Plan and the covenants, warranties, representations, terms, conditions, provisions or obligations, expressed, or implied, of any contract, mortgage, security agreement, indenture, trust indenture, loan agreement, commitment letter, agreement for sale, lease, personal property lease or other agreement, written or oral and any and all amendments or supplements thereto existing between the Applicant and any other Persons affected by this Plan, the terms, conditions and provisions of this Plan shall govern and shall take precedence and priority.

To the extent the Plan is inconsistent with the Information Circular filed in connection with the Plan, the provisions of the Plan shall govern and shall take precedence and priority.

### 11.5 Revocation, Withdrawal, or Non-Consummation

The Applicant reserves the right to revoke or withdraw this Plan at any time prior to the Effective Date and to file subsequent plans of compromises or arrangement. If the Applicant revokes or withdraws this Plan, or if the Sanction Order is not issued, (a) this Plan shall be null and void in all respects, (b) any Affected Claim, any settlement or compromise embodied in this Plan (including the fixing or limiting of any Affected Claim to an amount certain), assumption or termination, repudiation of contracts or leases effected by this Plan, any document or agreement executed pursuant to this Plan shall be deemed null and void, and (c) nothing contained in this Plan, and no action taken in preparation for consummation of this Plan, shall (i) constitute or be deemed to constitute a waiver or release of any Affected Claims by or against the Applicant or any Person; (ii) prejudice in any manner the rights of the Applicant or any Person in any further proceedings involving the Applicant, or (iii) constitute an admission of any sort by the Applicant or any Person.

### 11.6 Preservation of Rights of Action

Except as otherwise provided in this Plan or in the Sanction Order, or in any contract, instrument, release, indenture or other agreement entered into in connection with the Plan, following the Effective Date, the Applicant will retain and may enforce, sue on, settle, or compromise (or decline to do any of the foregoing) all claims, rights or causes of action, suits and proceedings, whether in law or in equity, whether known or unknown, that the Applicant may hold against any Person or entity without further approval of the Court.

### 11.7 Responsibilities of the Monitor

The Monitor is acting solely in its capacity as Monitor in the CCAA Proceedings with respect to the Applicant and is not responsible or liable for any obligations of the Applicant. The Monitor will have the powers granted to it by this Plan, by the CCAA and by any Order, including the Initial Order.

### 11.8 Notices

Any notice or communication to be delivered hereunder will be in writing and will reference this Plan and may, subject to as hereinafter provided, be made or given by mail, personal delivery or by facsimile or e-mail transmission addressed to the respective parties as follows:

(a) if to the Applicant:

Terrace Bay Pulp Inc.
1120 Premier Way
Thunder Bay, ON P7B 0A3

Attention: Vice President and Treasurer
Fax: 807-346-5424

with a copy to:

Blake, Cassels & Graydon LLP
199 Bay Street, Suite 2800
Commerce Court West
Toronto, ON M5L 1A9

| | |
|---|---|
| Attention: | Pamela L.J. Huff |
| Fax: | 416.863.2958 |
| E-mail: | pamela.huff@blakes.com |

(b) if to an Affected Creditor:

To the last known address (including fax number or email address) for such Affected Creditor set out in the books and records of the Applicant or, if an Affected Creditor filed a Proof of Claim, the address specified in the Proof of Claim filed by such Affected Creditor or such other address as the Affected Creditor may from time to time notify the Monitor in accordance with this Section.

(c) if to the Monitor:

Ernst & Young Inc.
Court-appointed Monitor of
Terrace Bay Pulp Inc.
Ernst & Young Tower
222 Bay Street
Toronto, ON M5K 1J7

| | |
|---|---|
| Attention: | Alex Morrison/Franca Mazzulla |
| Telephone | 866.986.9676 |
| Fax: | 416.943.3300 |
| E-mail: | terracebay@ca.ey.com |

with a copy to:

Lang Michener
Brookfield Place
Suite 2500, 181 Bay Street
Toronto, ON M5J 2T7

| | |
|---|---|
| Attention: | Sheryl Seigel |
| Fax: | 416-365-1719 |
| email: | sseigel@langmichener.ca |

or to such other address as any party may from time to time notify the others in accordance with this Section. All such notices and communications which are delivered will be deemed to have been received on the date of delivery. All such notices and communications which are faxed or emailed will be deemed to be received on the date faxed or e-mailed if sent before 5:00 p.m. (Eastern Time) on a Business Day and otherwise will be deemed to be received on the Business Day next following the day upon which such fax or email was sent. Any notice or other communication sent by mail will be deemed to have been received on the third Business Day after the date of mailing.

**SCHEDULE "A"**

**FORM OF MONITOR'S CERTIFICATE**

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.**

**MONITOR'S CERTIFICATE**

**RECITALS**

A. Pursuant to the Order of this Honourable Court dated March 11, 2009 (the "Initial Order") Terrace Bay Pulp Inc. (the "Applicant") filed for and obtained protection from its creditors under the *Companies' Creditors Arrangement Act* R.S.C. 1985, c. C-36, as amended (the "CCAA").

B. Pursuant to the Initial Order, Ernst & Young Inc. was appointed the Monitor of the Applicant (the "Monitor") with the powers, duties and obligations set out in the Initial Order;

C. The Applicant has filed a Plan of Compromise and Arrangement under the CCAA dated May 21, 2010 (the "Plan"), which Plan has been approved by the Affected Creditors in accordance with the CCAA and sanctioned by Order of the Court; and

D. Unless otherwise indicated herein, initially capitalized terms used herein have the meaning set out in the Plan.

* * * * *

**THE MONITOR HEREBY CERTIFIES** that it has been advised by the Applicant in accordance with Section 8.3 of the Plan that the conditions precedent set out in Section 8.2 of the Plan have been satisfied or waived in accordance with the Plan on __________, 2010 and that accordingly, the Effective Date is __________, 2010.

**DATED** at Toronto, Ontario, this _______ day of ________________, 2010.

**ERNST & YOUNG INC.**, solely in its capacity as Monitor of Applicant and not in its personal or corporate capacity

By: ____________________________________
Name:
Title:

## SCHEDULE "B"

## PLAN NOTE TERM SHEET

On the Effective Date, the Applicant shall issue to the Trustee a non-interest bearing subordinated secured promissory note having the following characteristics:

**Principal Amount**: Cdn. $30,000,000

**Term**: The earlier of (the occurrence of either event set out below being the "Maturity Date"):

(a) six (6) years from the effective date of the Plan, or

(b) the day which is one (1) year following repayment in full of all amounts owing by the Applicant to the Province under the Province Loan Agreement and the Stumpage Agreement,

provided that, in both cases, no payment shall be made under or pursuant to the Plan Note until all obligations under the ABL Loan Agreement, the Province Loan Agreement, and the Stumpage Agreement have been paid in full and all commitments by the lenders under the ABL Loan Agreement and the Province Loan Agreement have been terminated.

**Payment on Maturity Date**: On the Maturity Date, in full and final satisfaction of its obligations under the Plan Note, the Applicant shall pay the amount set forth below based on its total cumulative net income, calculated in accordance with GAAP for the period from the effective date of the Plan until the Maturity Date ("Total Net Income"):

(a) if Total Net Income is equal to or greater than $80,000,000, $30,000,000;

(b) if Total Net Income is equal to or less than $40,000,000, $10,000,000; or

(c) if Total Net Income is less than $80,000,000 and more than $40,000,000, the amount payable under the Plan Note will be $30,000,000 less 1/2 of the amount by which Total Net Income is less than $80,000,000 (such that, for example, if Total Net Income is $60,000,000, the amount payable by Terrace Bay shall be $20,000,000).

**Security**: The Plan Note shall be secured by all assets, property and undertaking of Terrace Bay, subordinate in all respects to the ABL Loan Agreement, the Province Loan Agreement (including any replacement or refinancing of the ABL Loan Agreement or the Province Loan Agreement), and any other secured financing obtained by the Applicant from time to time, under a silent subordination agreement in form satisfactory to the lenders under the ABL Loan Agreement and the Province Loan Agreement.

**Optional Prepayment**: The Plan Note may be prepaid in whole or in part at any time at the option of the Applicant.

**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.**

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

**Double Click on mouse to Add space for Third Party**

**Double Click on mouse to Add more space to parties line**

***ONTARIO***
**SUPERIOR COURT OF JUSTICE - (COMMERCIAL LIST)**

Proceeding commenced at Toronto

**PLAN OF COMPROMISE AND ARRANGEMENT OF TERRACE BAY PULP INC.**
(May 21, 2010)

**BLAKE, CASSELS & GRAYDON LLP**
Barristers & Solicitors
Box 25, Commerce Court West
199 Bay Street, Suite 2800
Toronto, Ontario M5L 1A9

**Pamela L.J. Huff**, LSUC #27344V
Tel: (416) 863-2958

**Michael McGraw**, LSUC #46679C
Tel: (416) 863-4247
Fax: (416) 863-2653

Lawyers for the Applicant

# Appendix B

**Terrace Bay Pulp Inc. – Summary of Claims Process as at June 11, 2010**
**CDN$000s**

| | | As Filed[1] | | As Per Claim Amount Notice[2] | | Not Anticipated to be Disallowed or Revised[3] | | Disallowed or Revised/ Not Yet Accepted[5] | |
|---|---|---|---|---|---|---|---|---|---|
| | | Count | Value | Count | Value | Count | Value | Count | Value |
| **Proof of Claim Filed** | Unsecured | 79 | 53,482 | - | - | 64 | 25,520 | 15 | 27,962 |
| | Secured[4] | 29 | 13,595 | - | - | - | - | 29 | 13,595 |
| **Claim for which a Claim Amount Notice was sent and no Proof of Claim was filed** | Unsecured | - | - | 272 | 8,080 | 272 | 8,080 | - | - |
| | Secured | - | - | - | - | - | - | - | - |

1. This column reflects the value of claims for which a Proof of Claim was filed.

2. This column reflects the value of claims for which a Claim Amount Notice was sent, but in respect of which no Proof of Claim was filed. As per the Claims Process Order, the amount of the Pre-Filing Claim described in the Claim Amount Notice is the Creditors Unsecured Claim.

3. This column reflects the value of claims for which a Claim Amount Notice was sent, or a Proof of Claim was filed, in respect of which the Monitor has not disputed the amount claimed, nor does the Monitor anticipate that a Notice of Revision or Disallowance will be issued.

4. Certain of Terrace Bay's creditors claim to have secured claims, including pursuant to liens provided by statute. One creditor included in this column has asserted a claim for constructive trust. The Monitor has issued Notices of Revision or Disallowance whereby some or all of the amounts claimed as secured have been allowed as unsecured claims.

5. The Monitor has delivered 49 Notices of Revision or Disallowance as at June 11, 2010. Other claims received up to June 11, 2010, which remain subject to consideration, are also included in this column. In addition, the period for creditors to file Notices of Dispute with respect to all of the claims for which Notices of Revision or Disallowance have been issued by the Monitor has not elapsed, in all cases. As at June 11, 2010 none of the claims that are the subject matter of a Notice of Dispute delivered in response to a Notice of Revision or Disallowance had been resolved or finally determined. Certain secured claims relate to construction lien claims that have been asserted. The Monitor has issued Notices of Revision or Disallowance with respect to the secured construction lien claims whereby the Monitor has allowed certain of these claims as unsecured claims. If such claims are determined to be unsecured claims, that would result in additional unsecured claims having a value of approximately $1.871 million, which are not included in this summary.

# Appendix C

**TERRACE BAY PULP INC. ("Terrace Bay" or the "Applicant")**

**Illustrative Estimated Liquidation Analysis**

**As at June 30, 2010**

## Background

1. On March 11, 2009, Terrace Bay filed for and obtained protection under the *Companies' Creditors Arrangement Act* (the "**CCAA**") pursuant to an order (the "**Initial Order**") of the Ontario Superior Court of Justice (the "**Court**"). 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 pursuant to further orders of the Court. Absent a further extension, the Stay Period will expire on June 30, 2010.

2. If Terrace Bay is unable to implement a Plan of Compromise and Arrangement pursuant to the CCAA (the "**Plan**"), then the stay of proceedings granted by the Court in the Initial Order may be terminated. If the stay is terminated, substantially all of Terrace Bay's debt obligations would become due and payable or subject to immediate acceleration. Terrace Bay is unlikely to have sufficient financial resources to meet these obligations. Terrace Bay idled the mill facilities on February 23, 2009. The failure by Terrace Bay to implement the Plan would likely result in a liquidation of the property and assets of Terrace Bay (the "**Assets**"), either under the CCAA, pursuant to the *Bankruptcy and Insolvency Act* (Canada) (the "**BIA**") or pursuant to other remedies pursued by its creditors. Terrace Bay does not have sufficient resources to restart its operations absent moving forward with the Plan and securing the additional financial support and entering into the agreements contemplated by the Plan. In the Monitor's view, given the current circumstances the failure to implement the Plan would most likely result in a liquidation of the Assets. The implications for creditors of a liquidation of the Assets are more particularly described below.

3. The Monitor has prepared an illustrative estimated realization value for the Assets as at June 30, 2010 using a pro forma Balance Sheet for Terrace Bay. This illustrative estimated realization value is referred to herein as the "**Liquidation Analysis**".

**Assumptions and Qualifications**

4. The Liquidation Analysis has been prepared from information provided by Terrace Bay and based on discussions with its management. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such financial information. The Liquidation Analysis has been compiled solely for the purpose of assessing the estimated liquidation value of the Assets and readers are cautioned that this Liquidation Analysis may not be appropriate for other purposes and remains subject to the qualifications and assumptions referenced herein.

5. Each prospective user must rely on its own inspection and investigation as to the estimated liquidation value of the Assets and no representations or warranties are made by the Monitor in respect of any such matters or otherwise. Prospective users of this analysis are cautioned that the actual proceeds from the realization of the Assets could deviate materially from the amounts set out in the Liquidation Analysis, as can the aggregate value of the provable claims of the creditors of Terrace Bay. The Monitor makes no representation or warranty and expresses no opinion or other form of assurance that the actual proceeds realized from a liquidation will approximate those as set out below. This Liquidation Analysis will not be updated for events and circumstances occurring after its date, therefore, actual results achieved may vary from these estimates due to subsequent events at the Applicant or in the marketplace and such changes in the results may be material.

**Unsecured Creditor Claims**

6. Pursuant to the claims process (the "**Claims Process**") approved pursuant to the Order issued by the Court on December 18, 2009, as amended (the "**Claims Process Order**"), the Monitor estimates that the total amount of the secured and unsecured claims filed in the CCAA proceedings to date is approximately $75 million. The Monitor cautions that the

Claims Process is not complete and that this estimate may differ, materially, from the actual amount of the creditor claims that are determined pursuant to the Claims Process. The Monitor currently estimates, on a preliminary basis, and subject to the conclusion of the Claims Process, that the total value of provable claims, if the Applicant implements a Plan, will be determined to be in the range of $45 million to $50 million. In the event of a bankruptcy or liquidation of the Applicant, however, the Monitor is of the view that the total amount of provable claims will increase substantially due to additional environmental remediation and clean-up costs, employee termination and severance claims, as well as various claims for damages and other claims that will be asserted, which increased claims amounts are reflected in the liquidation analysis below.

**Liquidation Analysis**

Considerations

7. This Liquidation Analysis has been prepared on the basis that Terrace Bay will be permanently closed and the Assets will be liquidated over a six to twelve month timeframe.

Illustrative Estimated Liquidation Proceeds

8. Based on the probable and hypothetical assumptions described below, the Monitor estimates that the net illustrative estimated realizable value of the Assets available for distribution to the unsecured creditors would range from nil to $9.954 million as outlined below:

| (Canadian $000s) | Notes | June 30, 2010 Projected Net Book Value | Estimated Realizable Value High | Low |
|---|---|---|---|---|
| Cash | a | $7,235 | $7,235 | $7,235 |
| Inventory | b | 13,411 | 3,390 | 1,339 |
| Fixed Assets | c | 17,104 | - | - |
| Income Tax | d | 8,173 | - | - |
| Other Assets | e | 695 | - | - |
| Net Realizable Value | | | 10,625 | 8,574 |
| Less: Liquidation costs | f | | 500 | 1,000 |
| Less: Priority claims | g | | 171 | 171 |
| Less: Critical Environmental Expenditures | h | | - | 7,403 |
| Available for for Proven Unsecured Claims | | | 9,954 | - |
| Estimated Unsecured Creditors in a liquidation or bankruptcy | i | | 125,000 | 167,000 |
| Percentage Recovery | | | 8% | 0% |

9. Key probable and hypothetical assumptions underlying the Liquidation Analysis include:

a. the forecast cash on hand is at June 30, 2010 which is estimated to be realizable at its book value.

b. the estimated realizable value in respect of the inventories is based on an appraisal by an independent appraisal firm familiar with these types of assets. The independent appraisal values, which are net of costs of liquidation, represent the liquidator's estimated realizable value in an orderly liquidation in the "High" scenario and an estimate by the Monitor based on its experience for the "Low" scenario. Inventories principally include chemicals, fuels, spare parts and operating supplies.

c. the estimated realizable value in respect of the fixed assets at the plant, including immovables, is based on an appraisal on an orderly liquidation basis by an independent appraisal firm familiar with these types of assets. The appraisal value is $6.8 million, which is net of costs of liquidation. However, the likelihood of achieving value from such assets is considered extremely low as it is unlikely that a trustee in bankruptcy (a "**Trustee**"), receiver or similar party would be willing to take possession or control of the plant to realize on these assets, due to the small asset value and the magnitude of their potential exposure to the environmental condition of the real property as described in (h) below.

d. the income tax assets are based on the book value of the Applicant's tax losses. These were assumed to have no realizable value in a liquidation proceeding as the losses would likely be reduced by debt forgiveness.

e. the other assets which primarily represent prepaid utility deposits. It was assumed that these would be either consumed or have limited expected realizable value in a realization proceeding.

f. liquidation costs include payroll costs and professional costs, such as the costs of a Trustee and legal costs and expenses associated with a liquidation process of this nature.

g. priority claims include potential priority liabilities including wage arrears, source deductions, vacation pay and amounts owing to employees under the *Wage Earner Protection Program Act*.

h. estimates of the potential liabilities and expenditures in relation to the environmental condition of the real property of Terrace Bay are based on a report prepared by an experienced environmental consultant. The report of the environmental consultant considered the likely costs to remediate the Terrace Bay site in the event of the liquidation of the Applicant, including the demolition of the buildings and site grading, removal of underground storage tanks, various pond and containment structure draining and removal, closing of the onsite landfills and ongoing monitoring of certain locations at the site. The environmental consultant has estimated the costs of remediating the environmental condition of the property to be in the range of approximately \$48 million to \$87 million. The environmental consultant has also identified the costs of proceeding with certain critical environmental expenditures (the "**Critical Environmental Expenditures**"), on a priority basis, relating to the removal and disposal of various contaminants that are subject to freezing and rupturing their containment facility which would result in further environmental contamination and additional clean-up costs. The Critical Environmental Expenditures are estimated to be approximately $13.1 million.

Under the "Low" scenario it is assumed that Terrace Bay or any Trustee or receiver that agreed to take possession or control of the real property of Terrace Bay (which, as noted above, is not a certainty), would wish to expend, at a minimum, the Critical Environmental Expenditures (although, per the estimate above, there would be insufficient resources to complete all of the work related to the Critical Environmental Expenditures, which may dissuade a Trustee or a receiver from accepting an engagement) and that total environmental remediation claims will approximate $87 million.

The "High" scenario is based on the estimated costs that would be required to remediate the Terrace Bay property of approximately $48 million, and the assumption that the work related to the Critical Environmental Expenditures would not be performed.

Under the BIA, the costs of remedying the environmental condition or environmental damage affecting the real property and immovables of the debtor is secured by a charge on such real property or immovables, and on any contiguous property of the debtor used in the business, ahead of any other claim, right, charge or security against the property.

i. Included in the estimated claims of unsecured creditors in a liquidation or a bankruptcy (without limitation) are:

(a) Claims for the environmental liabilities associated with the real property owned by Terrace Bay (estimated to be in the range of $48 million ("High") to $87 million) ("Low"), on the basis that the value of the real property and immovables of Terrace Bay is substantially less than the realizable value of the real property and immovables of Terrace Bay;

(b) claims by creditors who have security or liens or might benefit from the existence of a statutory charge or lien against the real property and immovables of Terrace

Bay, including the balance owing to the Township of Terrace Bay for property tax arrears and various statutory lien claims asserted pursuant to the *Construction Lien Act (Ontario)*, on the basis that the property against which such liens could be asserted has no value due to the anticipated environmental remediation costs described in h) above; and

(c) claims asserted pursuant to the *Forestry Workers Lien for Wages Act (Ontario)* (the "**FWLA**"), on the basis that Terrace Bay does not assert an ownership interest in, or have in its possession, any property against which these claimants may assert a lien under the FWLA.

For the purposes of this liquidation analysis it therefore assumed that such claims are unsecured claims, as the claimants would be unable to recover any amounts pursuant to any security or statutory charges or liens that they might assert against the property of Terrace Bay.

Summary

10. If the Plan is not approved and the Assets are liquidated, the Monitor estimates that Terrace Bay's unsecured creditors would likely receive a distribution in the range of 0% to 8% on their claims.

# Appendix D

## Terrace Bay Pulp Inc.

Illustrative Recovery Analysis

($000's)

| | High Scenario | | Low Scenario | |
|---|---|---|---|---|
| | $ | % | $ | % |
| Plan Note | $ 30,000 | | $ 10,000 | |
| Illustrative Estimate of Unsecured Creditors Claims (1) | $ 45,000 | 66.7% | $ 50,000 | 20.0% |

(1) The Illustrative Estimate of Unsecured Creditor Claims is for illustration purposes only, the actual value of Unsecured Claims will be determined through the Claims Process, which is not complete at this time.

Note:

The estimated illustrative recoveries have been complied solely for the creditors of Terrace Bay Pulp Inc. for the purpose of assessing estimated recoveries. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such financial information. Additional claims may arise and claims filed are subject to review and finalization which may impact the final dollar amount of Claims and the anticipated recovery.

In addition, no analysis has been completed to estimate the likely realizable value of the Plan Note, or to adjust the Plan Note's value on a present value basis.

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

**THIRTEENTH 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