Court File No.: CV-09-824700CL

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 GRANT FOREST PRODUCTS INC., GRANT ALBERTA INC., GRANT FOREST PRODUCTS SALES INC. AND GRANT U.S. HOLDINGS GP

Applicants

SEVENTH REPORT OF THE MONITOR DATED JANUARY 27, 2010

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SUPERIOR COURT OF JUSTICE

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Applicants

SEVENTH REPORT OF THE MONITOR DATED JANUARY 27, 2010

INTRODUCTION

1. On June 25, 2009, Grant Forest Products Inc. ("**GFPI**"), Grant Alberta Inc. ("**GAI**"), Grant Forest Products Sales Inc. ("**GFPSI**") and Grant U.S. Holdings GP (the "**Grant Partnership**" or "**U.S. Holdings**") (collectively the "**Original Applicants**") obtained protection under the *Companies' Creditors Arrangement Act* ("**CCAA**") in order to restructure the business and affairs of the Original Applicants. Pursuant to the Order of this Honourable Court dated June 25, 2009 (the "**Initial Order**"), Ernst & Young Inc. ("**EYI**") was appointed as the Monitor of the Original Applicants (the "**Monitor**") in the CCAA proceeding. The Initial Order provided for a stay of proceedings through to July 24, 2009. The stay of proceedings has been subsequently extended, most recently to February 26, 2010 (the "**Stay Period**") pursuant to an Order of this Honourable Court dated November 30, 2009.

2. On January 15, 2010, The Toronto-Dominion Bank (the "**First Lien Lenders' Agent**"), the agent of the first lien lenders who were owed approximately $399 million plus accrued interest as of May 31, 2009 (the "**First Lien Lenders**")

brought a motion to this Honourable Court to, among other things, include Southeast Properties LLC ("**Southeast**"), Grant Newco LLC ("**Newco**"), Grant US Sales Inc. ("**U.S. Sales**"), Grant Clarendon LP ("**Clarendon**"), Grant Allendale LP ("**Allendale**"), and Grant Excluded GP ("**Excluded**") as additional applicants to these CCAA proceedings (collectively, the "**Additional Applicants**", and together with the Original Applicants the "**Applicants**").

3. On January 22, 2010, the Original Applicants brought a motion to this Honourable Court to approve an employee retention plan (the "**ERP**") and authorize the Monitor to take steps to cause the distributions contemplated therein.

PURPOSE

4. The purpose of this Seventh Report of the Monitor (the "**Seventh Report**") is to report to this Honourable Court with respect to the Applicants' motion to:

    i. approve an ERP for certain employees of GFPI and GFPSI and authorize the Monitor to take the steps contemplated in the plan;

    ii. seal and treat as confidential Exhibit 'B' to the Affidavit of Mr. Peter Lynch dated January 22, 2010 (the "**January 22 Lynch Affidavit**"); and

    iii. approve this Seventh Report and the conduct and activities of the Monitor as set forth herein.

TERMS OF REFERENCE

5. In preparing this Report, the Monitor has been provided with and in making the comments herein, relied upon unaudited financial information, the Applicants' books and records, financial information prepared by the Applicants and discussions with management of the Applicants. 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 Seventh Report. Some of the information referred to in this Seventh 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 report was prepared based on management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.

6. Unless otherwise stated all monetary amounts contained herein are expressed in U.S. Dollars.

7. Capitalized terms not defined in this Report are defined in the Initial Order or previous Reports of the Monitor.

BACKGROUND

8. GFPI and certain of its subsidiaries are privately owned corporations carrying on an oriented strand board ("**OSB**") manufacturing business from facilities located in Canada and the United States. OSB is an engineered, mat-formed panel product made of strands, flakes or wafers sliced from logs and bonded with an exterior-type binder under heat and pressure. The most common uses are sheathing in walls, floors and roofs in the construction of buildings and residential housing.

9. The Applicants and Footner have interests in three mills in Canada located at Englehart and Timmins in Ontario and High Level in Alberta, and two mills in the United States located in the counties of Allendale and Clarendon in South Carolina.

10. The OSB mills located in Englehart (the "**Englehart Mill**") and Timmins (the "**Timmins Mill**") in Ontario are owned by GFPI, and as such, are subject to these CCAA proceedings.

11. GFPI also has a 50% interest in an OSB mill located at High Level in Alberta (the "**Footner Mill**"). This OSB mill is held by Footner Forest Products Ltd.

("**Footner**") as bare trustee and GFPI owns 50% of the shares of Footner. The Applicants and Footner have a total annual capacity to produce 3.7 billion square feet of OSB, which makes them the third largest OSB manufacturer in North America. The Footner mill itself is not directly subject to these CCAA Proceedings.

12. The OSB mills located in Allendale (the "**Allendale Mill**") and Clarendon (the "**Clarendon Mill**") in South Carolina are owned by Allendale and Clarendon respectively, each of which is owned by Southeast. Each of these entities are included as Additional Applicants, and subject to issuance of an order by this Honourable Court at the motion returnable February 1, 2010, would become subject to these CCAA Proceedings.

13. In addition to the above noted OSB mills, GFPI owns certain assets which are not required for the operations of the OSB business, including premises in Haileybury (the "**Haileybury Office**"), a golf course in Earlton (the "**Golf Course**"), a 65 foot custom built motor boat which is currently located in Florida (the "**Boat**") and certain property located at New Liskeard in Ontario (the "**MTO Property**") (collectively, the "**Non-Core Assets**"). With the exception of the MTO Property, a full description of the Non-Core Assets was provided in the Second Report of the Monitor dated July 21, 2009 (the "**Second Report**").

14. On June 25, 2009, this Honourable Court issued the Initial Order which, among other things, approved the continuation of the engagement of Stonecrest Capital Inc. ("**Stonecrest**") as Chief Restructuring Advisor (the "**CRA**") of the Applicants with services to be provided by Hap Stephen and Sandra Rosch.

PURCAHSE AGREEMENT WITH GEORGIA PACIFIC

18. As set out in the Sixth Report of the Monitor dated January 15, 2010 (the "**Sixth Report**"), the Original Applicants brought a motion to this Honourable Court to approve a transaction (the "**Transaction**") as contemplated by a purchase agreement (the "**PSA**") between the Applicants and GP International Acquisition III, Ltd. (the "**Canadian Purchaser**"), Georgia-Pacific LLC (the "**U.S.**

Purchaser"), and GP Palmetto Holding LLC (the "**Additional U.S. Purchaser**") (collectively, "**Georgia Pacific**") to sell a substantial portion of the Applicants' assets and operations. An overview of the key terms of the PSA (with commercially sensitive terms redacted) is attached as Appendix 'M' to the Sixth Report.

19. In order to satisfy the Applicants' pre-closing obligations under the PSA and to maintain the financial results of the operations prior to the closing date, for the benefit of its stakeholders, GFPI and GFPSI must maintain its workforce prior to the closing of the PSA.

20. As set out in the PSA, and summarised in the PSA overview included in Appendix M to the Sixth Report, the Applicants are required to maintain their operations in the ordinary course up to the closing of the Transaction and, among other things, to:

a. maintain certain representation and warranties made at the signing of the PSA, including maintaining the books and records, monitoring certain intercompany transactions and keeping current on the payment of certain expenses;

b. work with the Canadian Purchaser to obtain a forest resource facility licence and an optimized fibre supply agreement for the Englehart Mill;

c. produce a working capital estimate within five days of closing; and

d. prepare a statement no later than five business days prior to closing of the Transaction, of (i) an estimate of the outstanding trade accounts payable incurred subsequent to the date of the Initial Order; and (ii) the estimate of the outstanding wages, vacation pay and other amounts owed to employees to be hired by the Canadian Purchaser.

21. In order to ensure that the Applicants are able to meet their commitments to operate the Englehart Mill and the Allendale Mill in the ordinary course prior to closing and to ensure that the Applicants meet their other conditions contained in the PSA, as well as to ensure that the financial results are maximized prior to

closing, the Applicants must retain their employee base.

22. The Applicants also continue to undergo a process to sell the assets not included in the PSA, including the Timmins Mill, the Footner Mill, and the Non-Core Assets (the "**Excluded Assets**"). Certain of the employees of GFPI are assisting in this process. Furthermore, certain employees of GFPI will be required after the closing of the Transaction to assist with the remaining activities and sales processes being undertaken by the Applicants.

23. The PSA contemplates that Georgia Pacific will acquire the Allendale Mill and the Clarendon Mill through an acquisition of a partnership interest in the Grant Partnership, as more fully described in paragraph 60 of the Sixth Report. The effect of this transaction is that the employees of the U.S. subsidiaries of the Applicant will continue their employment with their existing employer post closing, subject to normal employment obligations in their jurisdiction.

24. The Transaction contemplates the Canadian Purchaser purchasing certain assets set out in the PSA from GFPI, GAI and GFPSI, including the Englehart Mill.

25. The Monitor understands that the Canadian Purchaser will initially operate the Englehart Mill in a manner similar to GFPI, and anticipates increasing production as market conditions allow. Also, the Canadian Purchaser will be assuming the collective bargaining agreement with the Englehart unionized employees as required by the PSA and applicable law.

26. Although the Canadian Purchaser may offer employment to salaried employees of GFPI and GFPSI (GAI does not have any employees), the PSA does not require the Canadian Purchaser to offer employment to all of the non-union staff. As a result, GFPI and GFPSI consider it necessary to take certain steps to induce salaried employees to continue to remain with GFPI and GFPSI and perform their duties, until the closing of the PSA or until they receive an offer of continued employment from the Canadian Purchaser.

27. The Canadian Purchaser has provided in the PSA that it will fund up to CDN$1.0

million toward the ERP for up to 60 non-union salaried employees.

OVERVIEW OF THE EMPLOYEE RETENTION PLAN

28. The ERP contemplated by the Applicants is being provided to certain non-union employees of GFPI and GFPSI who may not be offered continued employment with the Canadian Purchaser following closing. As described above, the PSA requires, among other things, that the Applicants continue to operate the business in the ordinary course until closing, including maintaining the status quo in the current workforce. Therefore, the Applicants are proposing an ERP to ensure the services of certain key employees who may not be offered employment by the Canadian Purchaser, be retained with GFPI and GFPSI until closing.

29. A copy of the ERP along with the related schedules are attached to the January 22 Lynch Affidavit. As certain of the schedules related to the ERP contain sensitive information, the Applicants are requesting a sealing order with respect to Exhibit 'B' to the January 22 Lynch Affidavit.

30. The ERP does not include non-unionized employees of the Applicants who are offered employment by the Canadian Purchaser on or before the closing date, on terms similar to their current employment.

31. As set out in detail in the January 22 Lynch Affidavit, the ERP contains three parts:

    i. *Part 1*: Payment of three months' base salary to all non-union employees not retained by the Canadian Purchaser on closing, to a maximum of 60 employees. The maximum payment under *Part 1* of the ERP is CDN$1 million, to be paid by the Canadian Purchaser in addition to the purchase price as described in the Sixth Report;

    ii. *Part 2*: Payment of either three or sixth months' base salary to certain employees of GFPI and GFPSI identified by management as integral to the continued operation of the business and the maximization of the financial performance of the business during the period up to the closing date; and

iii. *Part 3*: Offer of continued employment to approximately eight employees who will continue to be employed by GFPI post-closing.

32. The three different parts of the ERP are described in greater detail below.

Part 1

33. As described above, all non-union employees of GFPI and GFPSI who remain an employee until the closing date and are not offered employment by Georgia Pacific on or before the closing date on employment terms similar to their current terms are eligible to receive a payment under Part 1 of the ERP.

34. The employees who qualify under *Part 1* would be eligible for a maximum payment of three months' salary, within 30 days of the closing of the transaction. The Canadian Purchaser has agreed to fund *Part 1*, to a maximum of CDN$1 million and no more than 60 employees. If the aggregate amount for *Part 1* is greater than CDN$1 million, the amounts paid to each employee will be reduced pro-rata so the total payments made under *Part 1* are not greater than CDN$1 million.

Part 2

35. The Applicants have identified 60 employees who are eligible to participate in *Part 2* of the ERP. These employees were identified by senior management of the Applicants, and reviewed with the CRA and the Monitor. Their roles and skills were viewed by management as integral to the continued operations of the OSB business and the maximization of stakeholder value in relation to the PSA. The maximum payment under *Part 2* is approximately CDN$1.26 million. If the aggregate amount for Part 2 is greater than CDN$1.26 million, the amounts paid to each employee will be reduced pro-rata so the total payments made under *Part 2* are not greater than CDN$1.26 million.

36. The payment made under *Part 2* of the ERP is to be funded by the Applicants. These employees will be eligible to receive an additional three to six months' base salary, based on their 2009 base salary, on closing provided the employee

remains employed by GFPI or GFPSI and is not offered continued employment by the Canadian Purchaser on similar terms to their current employment terms.

37. Management's criteria to select these employees was based on, among other things, the role of each employee, the ability of other employees to complete the same functions as that employee and the likelihood of finding a suitable replacement within the time required to avoid an interruption to the business.

38. Payment under *Part 2* is based on the Applicants' meeting certain operating income targets as further described in the Lynch Affidavit. These operating income targets are based on the Allendale Mill and the Englehart Mill meeting certain sales and production cost targets from January 2010 to the closing of the PSA.

Part 3

39. The employees who are eligible for payments under *Part 3* are determined by the Applicants in consultation with the Monitor and the CRA as necessary to perform certain services after the closing of the PSA.

40. These employees are eligible for payment under *Part 3* provided the employee remains employed by GFPI or GFPSI and is not offered continued employment by the Canadian Purchaser on similar terms to their current employment terms. These employees are required to enter into an employment contract with GFPI, prior to closing, for a term of two to six months. These employees are included in the *Part 2* payments, and based on the terms of the ERP, will be eligible to receive one-half of their *Part 2* payment within 30 days of closing of the PSA, with the remaining one-half payment received at the end of their employment term with GFPI.

DISTRIBUTION OF THE ERP PAYMENTS

41. The ERP sets out that on the closing of the PSA, the amount payable under *Part 1* will be paid by the Canadian Purchaser to the Monitor on the closing of the PSA. In addition, the amount payable under *Part 2* will be retained by the Monitor from the purchase price payable by the Canadian Purchaser under the PSA. These

amounts will be held in trust for the beneficiaries in *Part 1,* and *Part 2* and *Part 3* respectively.

42. The Monitor will cause distributions to be made to employees in *Part 1, and Part 2* and *Part 3* as provided for in the ERP.

CERTAIN ADDITIONAL PROVISIONS INCLUDED IN THE EMPLOYMENT RETENTION PLAN

43. A summary of certain additional provisions of the ERP are summarized below:

   a. If an employee's employment is terminated for cause prior to the closing date, the employee is not eligible for payment under the ERP;

   b. In the event that a *Part 3* employee is terminated by GFPI for cause after the closing date but prior to the last day of the employment contact, the employee would not be eligible to receive the second half of the *Part 2* payment;

   c. Retention payments shall not occur if the closing of the Transaction does not occur;

   d. Retention payments shall be deemed earnings and be subject to all income tax and statutory deductions required by law;

   e. The terms of the ERP are to be kept confidential by each employee and may only be disclosed to certain individuals as identified in the ERP; and

   f. Non-unionized employees who are offered employment on similar terms by Georgia Pacific will not be eligible to receive any ERP payment.

CONCLUSIONS

44. In order to continue to manage its operations in the ordinary course, maximize the financial results from the operations, and maintain the representations and warranties contemplated in the PSA prior to the closing of the PSA, the Applicants need to ensure that they retain the appropriate skilled staff in order to oversee the process until closing of the PSA. Further, the Applicants require

certain salaried staff after the closing of the PSA to preserve the value of the Applicants and the Excluded Assets for the benefit of its stakeholders.

45. The Monitor has reviewed the ERP with the Applicants and is of the view that the ERP is appropriate and necessary to complete the Transaction and to preserve the value of the Applicants for its stakeholders.

46. Only salaried employees not offered employment by Georgia Pacific on similar terms will receive ERP payments.

47. The *Part 2* ERP payments are adjusted downward if the Englehart Mill and the Allendale Mill fail to meet certain financial benchmarks, thereby providing an incentive to maximize financial results of the Applicants prior to closing of the PSA.

48. The ERP will assist the Applicants to retain salaried staff as necessary after the closing of the PSA to maintain the assets of the Applicants for the benefit of the stakeholders.

49. The ERP will further provide the Applicants with the ability to retain its workforce in the event the PSA does not close.

RECOMMENDATIONS

50. Accordingly, the Monitor recommends that this Honourable Court:

    i. approve the ERP and authorize the Monitor to take the steps contemplated in the plan;

    ii. seal and treat as confidential, Exhibit 'B' to the January 22 Lynch Affidavit; and

    iii. approve this Seventh Report and the conduct and activities of the Monitor as set forth herein.

All of which is respectfully submitted this 27th day of January, 2010.

ERNST & YOUNG INC.
in its capacity as the Monitor of
Grant Forest Products Inc.,
Grant Alberta Inc.,
Grant Forest Products Sales Inc., and
Grant U.S. Holdings G.P.

Per:

Alex Morrison
Senior Vice President

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

Court File No. CV-09-824700CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF GRANT FOREST PRODUCTS INC., GRANT ALBERTA INC., GRANT FOREST PRODUCTS SALES INC. AND GRANT U.S. HOLDINGS GP

ONTARIO
SUPERIOR COURT OF JUSTICE
Proceeding commenced at Toronto

SEVENTH REPORT OF THE MONITOR, ERNST & YOUNG INC.
(Dated JANUARY 27, 2010)

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