



No. S-120712
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

**IN THE MATTER OF THE *CANADA BUSINESS CORPORATIONS ACT*
R.S.C., 1985, c. C-44 AS AMENDED**

AND

**IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*
SBC, 2002, CHAPTER 57**

AND

**IN THE MATTER OF CATALYST PAPER CORPORATION AND THE
PETITIONERS LISTED IN APPENDIX "A"
(COLLECTIVELY THE "COMPANY")**

**MONITOR'S FIRST REPORT TO COURT
[Prepared for the February 3, 2012 Court Hearing]**

February 2, 2012



**CATALYST PAPER CORPORATION, ET AL
MONITOR'S FIRST REPORT TO COURT**

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1. INTRODUCTION

- 1.1 On January 31, 2012, on the application of Catalyst Paper Corporation, Catalyst Pulp Operations Limited, Catalyst Pulp Sales Inc., Pacifica Poplars Ltd., Catalyst Pulp and Paper Sales Inc., Elk Falls Pulp and Paper Limited, Catalyst Paper Energy Holdings Inc., 0606890 B.C. Ltd., Catalyst Paper Recycling Inc., Catalyst Paper (Snowflake) Inc., Catalyst Paper Holdings Inc., Pacifica Papers U.S. Inc., Pacifica Poplars Inc., Pacifica Papers Sales Inc., Catalyst Paper (USA) Inc. and The Apache Railway Company (collectively referred to as "Catalyst" or the "Company"), the Supreme Court of British Columbia (the "Court") made an order (the "Initial Order") granting Catalyst protection from its creditors pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA"). Under the Initial Order, PricewaterhouseCoopers Inc. ("PwC") was appointed Monitor of the Companies (the "Monitor").
- 1.2 Pursuant to the Initial Order, among other things, all creditors were stayed from commencing or continuing any proceedings against Catalyst until February 14, 2012, the date set for the Comeback Hearing.
- 1.3 A pre-filing report dated January 31, 2012 (the "Pre-filing Report") was produced by PwC as proposed Monitor. This is our first report as Monitor. It is not intended to be a comprehensive review of the affairs of the Company. It is the intention of the Monitor to file a comprehensive report in advance of the Comeback Hearing.
- 1.4 The purpose of this limited scope report is to provide the Court with the Monitor's views on the following matters to be considered during an application scheduled for February 3, 2012:
 - 1.4.1 The Company's application for the creation of a DIP Lender's Charge;
 - 1.4.2 The Company's application for authorization to pay certain key suppliers for expenses incurred prior to the date of the Initial Order and the Company's application for the creation of a charge to secure the Company's post-filing obligations to certain critical suppliers (the "Critical Suppliers' Charge);

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- 1.4.3 The Company's application for the creation of a charge (the "D&O Charge") in favour of its directors and officers ("D&Os") as security for the Company's obligation to indemnify its D&Os for any obligations and liabilities that they may incur as directors or officers of the Company after the commencement of the CCAA Proceedings; and
- 1.4.4 The Company's Key Employee Retention Program ("KERP").
- 1.5 Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars. Capitalized terms not otherwise defined herein are as defined in the Company's application materials, including the first affidavit of Brian Baarda dated January 31, 2012 (the "Baarda Affidavit").
- 1.6 The Monitor has set up a website at www.pwc.com/car-catalystpaper. All prescribed materials filed by Catalyst and the Monitor relating to this CCAA proceeding are available to creditors and other interested parties in electronic format on the Monitor's website. The Monitor will make regular updates to the website to ensure creditors and interested parties are kept current and to add prescribed materials as required.

2. DIP FINANCING

- 2.1 The Cash Flow Statement prepared by management, a copy of which is attached to the Pre-Filing Report and the Baarda Affidavit, highlights the Company's liquidity challenges and need for interim financing in order to continue operations and restructuring efforts. Specifically, the Cash flow Statement indicates:
 - 2.1.1 The Company is cash flow negative in the amount of \$22.9 million over the period February 1, 2012 to April 30, 2012;
 - 2.1.2 At the outset of the CCAA proceedings, the Company owed \$81.0 million under the ABL Facility. Under the terms of the proposed DIP Credit Agreement, post-filing collection of pre-filing accounts receivable are to be used first to repay the outstanding balance of the ABL Facility. The ABL is forecast to be repaid in full by the week ending February 29, 2012; and

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- 2.1.3 In order to maintain a sufficient cash balance through to April 30, 2012, the Company is forecast to draw a total of \$75.7 million on the DIP Facility to fund operations during that period. The peak DIP Facility requirement is forecast to be \$83.2 million during the week ending February 29, 2012.
- 2.2 The Company negotiated a term sheet for a DIP Facility from JPMorgan Chase Bank, N.A., Toronto Branch ("JPMorgan"), the existing ABL Facility Agent. The Company did not canvas the market for other potential lenders, in part due to the stability that was to be created from obtaining interim financing from a familiar party and to avoid disrupting a complex cash management system.
- 2.3 The offer from JPMorgan did not require any alteration of the Company's accounts and included similar terms to those under the ABL Facility, including the full flexibility of the letters of credit. It was expected that other offers would have been time consuming and expensive to pursue, could have required a new cash management system and would have caused additional issues in terms of the relative priority of the security granted under the ABL Facility.
- 2.4 The DIP Facility is primarily secured against the current assets of the Company, which typically are in the range of \$300 million at any given time.
- 2.5 The Monitor and its counsel have reviewed a comparison of the DIP Credit Agreement compared to the ABL Facility agreement provided to them by the Company. The Monitor and its counsel have also reviewed the description of the DIP Financing and DIP Credit Agreement set out at paragraphs 124 – 146 of the Baarda Affidavit. The Monitor and its counsel are of the view that the Baarda affidavit accurately and fairly describes the terms of the DIP Credit Agreement and that there are no material omissions.
- 2.6 The Monitor has reviewed the fee letter referred to at paragraph 130 of the affidavit of Brian Baarda. The Monitor sees nothing in the fee letter which seems to suggest that it contains sensitive or unusual information. However, it includes a term requiring that it be kept confidential and, accordingly, the Monitor has not attached a copy of the fee letter to this Report.
- 2.7 The fee letter contains an underwriting fee and an agency fee. The Monitor has compared those fees to equivalent fees charged in other publicly disclosed Canadian interim financing transactions of which the Monitor has knowledge. In the view of the Monitor,

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the underwriting fee and agency fee are reasonable and within the range of other transactions of this nature.

- 2.8 The Monitor has reviewed the seven key factors to be considered under s. 11.2(4) of the CCAA in determining whether to grant a charge in favour of a DIP lender. The Monitor is of the view that these factors are met, specifically:
- 2.8.1 The DIP Facility has a maturity date which will give the Company a reasonable timeframe within which to restructure (18 months);
 - 2.8.2 The Company's business and financial affairs are intended to be managed in the ordinary course throughout the CCAA proceedings;
 - 2.8.3 The Company is forecasting negative cash flow and requires funding to continue to operate. The DIP Facility offers financial stability and without this funding the Company would be unable to operate;
 - 2.8.4 The DIP Facility is granted the same security as the ABL facility, and accordingly, the Monitor does not believe that any creditor will be materially prejudiced by having the DIP Facility and DIP Charge in place.
- 2.9 The Monitor concludes that the proposed DIP Facility is necessary to allow the Company to continue to operate and allow it to pursue a viable restructuring.

3. KEY SUPPLIERS AND CRITICAL SUPPLIERS' CHARGE

- 3.1 The Company has identified a number of suppliers who it considers important to its operations. The Monitor has reviewed the list of such suppliers with the Company and agreed on a subset that can be considered necessary for the uninterrupted operation of the Company's business (collectively, the "Key Suppliers"). The identification of the Key Suppliers was based on the following criteria:
- 3.1.1 The unique nature of goods/services supplied, and the ability to substitute supply;
 - 3.1.2 The volume supplied, and the ability to substitute that volume; and
 - 3.1.3 The impact on operations of a loss of supply.

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- 3.2 The Monitor worked with the Company to evaluate which of its suppliers were necessary for the continued operation of the business based on the criteria outlined above, and to estimate the potential credit exposure to each supplier based on pre-filing credit terms and purchasing levels. The Monitor's conclusions concerning the Company's identification of Key Suppliers are set forth in the Pre-Filing Report, the relevant portion of which is attached as Appendix B. A more specific analysis of the types of goods and services supplied by these suppliers, and their criticality, is set forth in Appendix C.
- 3.3 The Company intends to continue obtaining goods and services from the Key Suppliers during the CCAA Proceedings, and has considered two potential options to ensure continued supply, being either to:
- 3.3.1 pay some portion of the pre-filing arrears owing a particular Key Supplier (as authorized by paragraph 7(d) of the Initial Order); or
- 3.3.2 designate a supplier as a Critical Supplier (as that term is defined in section 11.4 of the CCAA) and require them to continue supply under pre-filing terms (including credit terms) on the condition that any amounts owing to such supplier for the post-filing provision of goods or services are secured under a Critical Suppliers' Charge.
- 3.4 Of the total group of Key Suppliers, the Company has identified 16 suppliers it intends to have designated as Critical Suppliers, with a total estimated credit exposure of \$11.8 million. The Company proposes to retain the option to pay all or some of the Critical Suppliers a portion of their arrears, in exchange for which the Critical Supplier in question would be required to give up any claim under the Critical Suppliers' Charge and also agree to continue supplying goods or services on terms acceptable to the Company. Accordingly, the actual exposure under the Critical Suppliers' Charge may be less than \$11.8 million.
- 3.5 The remaining Key Suppliers comprise those identified to date by the Company to whom the Company may agree to pay some portion of pre-filing arrears subject to reaching an agreement to continue supplying goods or services on terms acceptable to the Company. Additional Key Suppliers may be identified during the course of the CCAA proceedings.
- 3.6 The Key Suppliers also include certain suppliers which the Company believes (and the Monitor agrees) are financially dependent on their business relationship with the

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Company and may not be able to continue in business without the payment of pre-filing arrears, leaving the Company without those suppliers' necessary goods or services.

- 3.7 Paragraph 7(d) of the Initial Order provides that, in order for payments in respect of pre-filing claims to be made to the categories of suppliers identified therein, the Company and the Monitor must be of the opinion that the supplier is critical to the business and ongoing operations of the Company and that the supplier is not pursuant to the terms of the Initial Order compelled to continue providing goods or services.
- 3.8 Paragraph 7(e) of the Initial Order provides that, with the consent of the Monitor and the DIP Agent, payments can be made on account of pre-filing claims to those creditors who, prior to the date of the Initial Order, had lawfully retained property of the Company or exercised valid possessory liens against property of the Company. The Key Suppliers likely include a number of such suppliers. The Company is of the view (and the Monitor agrees) that payments to such lien claimants are appropriate if the liens are valid and the value of the goods in transit exceeds the amount of the asserted lien claims.
- 3.9 The Monitor has established a protocol with the Company and other stakeholders for the review and approval of any payments pursuant to paragraphs 7(d) and 7(e), whereby the Company is required to provide the Monitor with sufficient evidence that the payment is necessary and appropriate. Payments will be subject to the relevant supplier and the Company entering into an agreement governing the terms of such payments and the continued supply of goods and services on appropriate terms, including as to credit.
- 3.10 No payments have been made pursuant to paragraph 7(d) or 7(e) of the Initial Order during the first three days of the CCAA proceedings. Several of the identified Key Suppliers have requested that pre-filing arrears be paid, but all such requests have been deferred.
- 3.11 Some suppliers have asserted liens against goods in transit and payments totalling approximately \$1.3 million were made to three suppliers to release raw materials and finished goods in their possession. These payments were consented to by the DIP Agent and the Monitor.
- 3.12 The Monitor is of the view that the proposed Critical Suppliers ought to be designated as such and the Critical Suppliers' Charge should be granted, including for the following reasons:

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- 3.12.1 Based on the Monitor's previous analysis, the goods and services provided by the proposed Critical Suppliers are necessary for the business and ongoing operations of the Company, and generally comprise the larger and more significant suppliers to the Company;
 - 3.12.2 The Company anticipated that the proposed Critical Suppliers had the potential to cause significant disruption to operations if they were not directed to continue to supply. This has been borne out to a degree since the start of the proceedings, as many of these suppliers have contacted the Company to demand payment and have indicated that absent payment of arrears or cash on delivery terms they may discontinue supply; and
 - 3.12.3 The Company's working capital requirements will be reduced if the proposed Critical Suppliers require deposits, cash on delivery or cash in advance payments.
- 3.13 The Monitor has considered the proposed Critical Suppliers Charge and note the following:
- 3.13.1 The Critical Suppliers Charge is to rank behind the Administration Charge, the DIP Lenders' Charge and the ABL Facility Security in respect of the DIP Lenders' First Lien Collateral. This collateral includes the Company's accounts receivable and inventory.
 - 3.13.2 The Company has provided the Monitor with a calculation of the estimated available liquidity on the DIP Facility, based on the Cash Flow Forecast, which indicates the available security value in excess of the borrowings under the DIP Facility and the ABL Facility. Over the period of the cash flow forecast, the available liquidity is projected to range from \$32.0 million to \$61.7 million. As such, the cash flow forecast projects that there is more than sufficient excess value in the assets securing the DIP Facility to cover the full amount of the Critical Suppliers' Charge (i.e. \$12 million).

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3.13.3 The Critical Suppliers' Charge is to rank behind only the Administration Charge in respect of the Notes First Lien Collateral. This collateral includes the Company's property, plant and equipment. The net book value of the Company's assets is in the range of \$1 billion. While the Monitor has not performed a liquidation analysis or valuation of these assets or evaluated other potential priority claims against these assets, it is likely that these assets would be of sufficient value to secure the full amount of the Critical Suppliers' Charge.

3.14 For the foregoing reasons, the Monitor is of the view that the amount and priority of the Critical Suppliers' Charge sought by the Company is appropriate.

4. D&O CHARGE

4.1 The Initial Order included provisions (the "D&O Provisions") creating a charge over the Property (the "D&O Charge") in favour of the D&Os as security for the Company's obligation to indemnify its D&Os for any obligations and liabilities that they may incur as directors or officers of the Company after the commencement of the CCAA proceedings ("D&O Claims"). The D&O Charge is in the aggregate amount of \$31 million.

4.2 The D&O Provisions were granted by the Court on the basis that the Company would have to apply on February 3, 2012 for an Order that the D&O Provisions continue. In the Pre-Filing Report, the Monitor provided some comments with respect to the proposed D&O Charge. In this section, the Monitor provides additional comments concerning the D&O Charge.

4.3 The Initial Order provides that D&Os shall only be entitled to the benefit of the D&O Charge to the extent that they do not have coverage under any D&O insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with the Initial Order.

4.4 The Company's existing D&O insurance (the "Policy") is underwritten by six insurers and provides up to \$100 million in coverage for obligations for which the D&Os may be liable. Coverage under the Policy includes, but is not limited to, employee-related liabilities and HST. The Policy does not include coverage for employee related liabilities arising from operations in the United States;

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- 4.5 As noted in the Pre-Filing Report, the Monitor's counsel has conducted a preliminary review of the Policy, and while the Policy would appear to insure against most statutory liabilities in an amount sufficient to cover most obligations which might arise during the CCAA proceedings, there are a number of issues regarding the Policy. Those issues are identified in the Pre-Filing Report and the Monitor has not repeated them herein.
- 4.6 An additional issue regarding the Policy and the D&O Charge generally is the possibility that the D&Os may incur legal costs in claiming and, possibly, establishing by way of legal proceedings, coverage under the Policy for any number of claims for which they are to be indemnified by the Company. These legal costs could be significant and there is recent authority in British Columbia holding that those costs are covered under the D&O Charge.
- 4.7 The amount of the D&O Charge was calculated based on the estimated maximum liability of the D&Os arising from statutory obligations for employee related liabilities and sales taxes that may arise during the CCAA proceedings (the "D&O Exposure"). The potential employee-related liabilities were calculated with reference to the provisions of the Canada Business Corporations Act ("CBCA") as that is the statute under which Catalyst Paper Corporation, the parent company, is incorporated.
- 4.8 The estimate of the D&O Exposure is summarized in Appendix D and includes the following:
- 4.8.1 Employee related liabilities for salaries and wages and the cost of supplemental benefits (such as health care and group life insurances), based on the recent average of employee costs that accrue between payment intervals in normal course operations. For example, the hourly payroll is paid bi-weekly but one week in arrears. The maximum D&O exposure for an hourly payroll is therefore three weeks of wages (two weeks earned and then an additional week of earnings until the payroll for the first two weeks is paid). The minimum D&O exposure for an hourly payroll is one week and exists on the pay day after the employees are paid (and the third week has now accrued as outstanding).

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- 4.8.2 Employee related liabilities for the cost of post retirement benefits and vacation pay accruing in a six month period, based on the Company's recent average benefit and salary costs. This assumes that no active employees retire during the CCAA proceedings and thereafter begin collecting benefits, which would reduce the D&O Exposure. This also assumes that there would be no payment of accrued vacation obligations during the proceedings. The D&O Exposure for this category of costs simply rises daily to a maximum of six months of costs.
- 4.8.3 Harmonized Sales Tax ("HST") obligations for two Petitioners that have historically been net remitters of HST, based on their average monthly remittances over the past year. Other Petitioners are normally in a net refund position based on the input tax credits that they generate. Despite this, a D&O Exposure exists as the Canada Revenue Agency does not set off HST liabilities among different companies within a corporate group. The D&O Exposure is based on two months of remittances as payments are made at the end of the month following the month for which the remittance is due.
- 4.9 We note that the D&O Exposure varies over time and depends on payment intervals. Generally, the various components of the D&O Exposure fall into one of two categories:
- 4.9.1 Payment Interval Liabilities which consist of salaries, wages, pension contributions, supplemental benefits and the Harmonized Sales tax. This exposure rises and falls periodically as costs are incurred and then discharged by a payment. The maximum D&O Exposure arising from these Payment Interval Liabilities is \$14.5 million.
- 4.9.2 Accrual Liabilities which include post retirement benefits and vacation pay. This exposure simply rises daily to a maximum of six months of costs or \$16.5 million (a monthly increase of \$2.75 million).
- 4.10 Given potential exclusions in the Policy, including those identified in the Pre-Filing Report, as well as the legal costs that might be incurred by D&Os in proving coverage under the Policy, the Monitor supports the creation of a D&O Charge. From the D&O's perspective, a safe D&O Charge would consist of the full \$31 million. The Monitor understands that the bondholders are not content to provide that level of a D&O Charge for the benefit of the D&O's which ranks in priority to their position. The Monitor is to

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the view that the parties should attempt to agree amongst themselves what level of comfort the D&O's can accept and what level of charge the bondholders can tolerate.

- 4.11 In this regard, the Monitor notes the following:
 - 4.11.1 If the Policy is adequate, then there will be minimal, if any, claim against the D&O Charge; and
 - 4.11.2 If the D&Os are not comfortable with the exposure they perceive exists, then the logical outcome is that they will resign while there is minimal exposure to them.
- 4.12 These factors should align the objectives of the two parties such that they find a reasonable compromise.

5. KEY EMPLOYEE RETENTION PROGRAM (KERP)

- 5.1 We understand the Company is adjourning its application for approval of the payments under the KERP. The Monitor intends to provide comments concerning the KERP when the matter is brought before the Court.

6. ACTIVITIES OF THE MONITOR TO DATE

- 6.1 On February 1, 2012 the Monitor activated its website (www.pwc.com/car-catalystpaper) and all materials circulated by the Company in these proceedings have now been posted to the website.
- 6.2 The Monitor has completed its notice requirements pursuant to subsection 23(1)(a) of the CCAA and as provided in paragraph 67 and 69 of the Initial Order. In particular:
 - 6.2.1 A notice in the prescribed form along with a letter from the Company to its creditors was mailed to creditors on February 1, 2012. This notice was also provided to the parties listed in paragraph 69 of the Initial Order;
 - 6.2.2 The Initial Order has been posted on the Monitor's website along with a list of creditors including their names, addresses and amounts; and

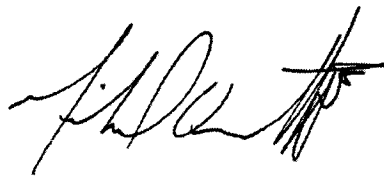
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- 6.2.3 Notices were published in the Vancouver Sun, the National Post and the Victoria Times Colonist.
- 6.3 Since its appointment, the Monitor has, among other things:
 - 6.3.1 Attended the Company's Richmond, B.C. premises to review its books and records and operations. Catalyst has cooperated with the Monitor in providing unrestricted access to their books and records;
 - 6.3.2 Commenced reviewing the Company's receipts and disbursements and monitoring the Company's performance relative to the initial cash flow projections;
 - 6.3.3 Conducted extensive review of the Company's analysis and identification of Key Suppliers and Critical Suppliers; and
 - 6.3.4 Engaged in negotiations and discussions with the Company, the Noteholders and other significant stakeholders in order to assist in the resolution of outstanding issues.

This report is respectfully submitted this 2nd day of February, 2012.

PricewaterhouseCoopers Inc.
Court Appointed Monitor of
Catalyst Paper Corporation et al



Michael J. Vermette
Senior Vice President



Neil Bunker
Vice President

APPENDIX A

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List of Petitioners

Catalyst Paper Corporation
Catalyst Pulp Operations Limited
Catalyst Pulp Sales Inc.
Pacifica Poplars Ltd.
Catalyst Pulp and Paper Sales Inc.
Elk Falls Pulp and Paper Limited
Catalyst Paper Energy Holdings Inc.
0606890 B.C. Ltd.
Catalyst Paper Recycling Inc.
Catalyst Paper (Snowflake) Inc.
Catalyst Paper Holdings Inc.
Pacifica Papers U.S. Inc.
Pacifica Poplars Inc.
Pacifica Papers Sales Inc.
Catalyst Paper (USA) Inc.
The Apache Railway Company

APPENDIX B

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Excerpt from the Pre-Filing Report

4. SUPPLIERS

- 4.1 Paragraph 7 of the proposed Initial Order provides, among other things, for the following:
- 4.1.1 7. Subject to the terms and conditions of and availability under the DIP Facility, the Petitioner Parties shall be entitled, but not required, to pay the following expenses which may have been incurred prior to the Order Date:
- 4.1.2 [. . .]
- 4.1.3 (d) all amounts owing for goods and services actually supplied to the Petitioner Parties:
- 4.1.4 (i) by chemical suppliers, fibre suppliers, utility and fuel suppliers, old newspaper suppliers and other related products, with the prior consent of the Monitor and the DIP Agent, if, in the opinion of the Petitioner Parties, the supplier is critical to the business and ongoing operations of any of the Petitioner Parties;
- 4.1.5 (ii) by freight and logistics suppliers, third party customs brokers, agents, freight carriers, freight forwarders, warehousemen, and shippers, with the prior consent of the Monitor and the DIP Agent, if, in the opinion of the Petitioner Parties, the party providing the good or service is critical to the business and ongoing operations of any of the Petitioner Parties; and
- 4.1.6 (iii) by other parties providing goods or services, with the prior consent of the Monitor and the DIP Agent, if, in the opinion of the Petitioner Parties, the supplier is critical to the business and ongoing operations of any of the Petitioner Parties.
- 4.2 The Proposed Monitor understands that on February 3, 2012, the Company plans to apply for an order requiring critical suppliers to continue to supply to the Company pursuant to section 11.4(2) of the CCAA, and to declare a charge in favour of critical suppliers pursuant to section 11.4(3) of the CCAA.
- 4.3 As indicated in the Baarda Affidavit, the Proposed Monitor has discussed the Company's evaluation of the suppliers that it considers key to the Company's ongoing operations

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with senior management of the Company, and has reviewed the Company's intentions for dealing with these suppliers during the CCAA proceedings. We set out below the Proposed Monitor's considerations in this regard.

- 4.4 The Company's business is dependent, *inter alia*, on the ongoing provision of key goods and services, including the following:
 - 4.4.1 Ability to obtain raw material inputs, including wood fibre, chemicals, and old newsprint ("ONP"), to be used in the paper manufacturing process;
 - 4.4.2 Continued supply of energy and utilities, including electricity and gas, to power the Company's mills and continue manufacturing;
 - 4.4.3 Maintenance of the Company's specialized production equipment; and
 - 4.4.4 Transportation of both raw material inputs and finished products.
- 4.5 These goods and services are provided by a range of suppliers, many of whom are considered critical by the Company. The Proposed Monitor considered the following in order to assess whether a particular supplier is critical to the Company:
 - 4.5.1 The unique nature of goods/services supplied, and the ability to substitute supply;
 - 4.5.2 The volume supplied, and the ability to substitute that volume; and
 - 4.5.3 The impact of loss of supply on operations.
- 4.6 In summary, certain suppliers to the Company are considered key suppliers for the following reasons:
 - 4.6.1 The Company maintains limited supplies of raw material inputs at its mills, and they rely on continuous (often just-in-time) shipments of significant volumes of raw materials as part of their ongoing production. Suppliers of these inputs generally cannot be substituted easily in the short term because of the large volumes required, the product or chemical specifications of those inputs needed for the manufacturing process, or due to the limited number of global suppliers of those inputs.

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- 4.6.2 Energy is critical to the manufacturing process. In addition to being a major consumer of electricity, the Company also relies on fossil fuel inputs at its various mills. Many of these energy providers are currently backstopped by letters of credit, which are expected to be fully drawn against the outstanding pre-filing obligations of the Company.
- 4.6.3 The production equipment to produce paper and Kraft pulp is designed to operate at high speeds and efficiencies. Some components experience normal wear from continuous use and are designed specifically for certain machines and operating conditions. This includes machine clothing, large machine rolls, and electronic control mechanisms, which are made to a custom specification by the Company's current suppliers. In addition, there are specialized maintenance functions that need to be performed on a periodic basis to comply with safe running procedures and applicable regulations. There are a limited number of suppliers and service providers globally that can do this work.
- 4.6.4 Multiple modes of transport are used by the Company to carry both raw materials and finished goods. Many of these suppliers will have goods in transit as at the date of filing, and will have the ability to assert a possessory lien over those goods. Some of these transporters carry a significant volume of the Company's goods (particularly for sea and rail), and would be difficult or impossible to substitute in the short term. Certain road carriers are sole-sourced because they are the only carrier on given routes for the Company today, and the Company may not be able to obtain a cost-effective alternative carrier in the short run.
- 4.7 Any interruption of the supply of these goods or provision of these services could have an adverse impact on the Company's business, operations and cash flow. In some cases this impact would be immediate, and for others the full impact would be felt within 1-2 weeks. For many of these inputs, particularly chemical inputs, this is insufficient time to find an alternate or substitute source of supply.
- 4.8 Based on the foregoing, the key suppliers identified by the Company could potentially have a significant negative impact on operations by refusing to supply post-filing, notwithstanding the provisions of the CCAA and the Initial Order requiring continued supply. The Company anticipates that this negative impact can be mitigated by allowing the Company, where necessary, to make payment of some pre-filing obligations or deposits to these suppliers, or potentially by the declaration of a charge in favour of

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certain of those suppliers. The Company expects that any such payments or declarations will be tied to actual receipt of goods and services after the date of the Initial Order, or the granting of mutually agreeable credit terms.

- 4.9 If the Initial Order is granted as proposed and the appointment of the Proposed Monitor is confirmed, the Proposed Monitor will in each instance be able to make an independent assessment of each supplier that the Company considers to be critical. In doing so, the Proposed Monitor will consider the Company's analysis of that supplier together with the key factors set out above and its knowledge of the Company's operations.

APPENDIX C

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Additional comments on types of critical suppliers

1. Chemical suppliers

- a. The Company's manufacturing process relies on a range of chemical inputs. The specific inputs depend on the particular type of paper being manufactured, but these can include hydrogen peroxide, chlorine dioxide, and caustic soda in the kraft pulp making process, and various fillers, furnish, pigments and solutions in the paper making process. These chemical inputs must meet certain specifications in order to be compatible with the Company's manufacturing process, and to meet the requirements of end users of the Company's products.
- b. The Company has a number of dedicated suppliers providing these chemicals in accordance with the Company's specifications. In some cases, the Company relies on one supplier for the provision of all of a particular chemical input, either due to their ability to meet the Company's volume requirements or because they are the only producer of those inputs. In addition, there are a limited number of global suppliers of certain of the Company's inputs, so the Company is reliant on the continued supply from its existing supplier base. As a result, the Company's ability to switch suppliers in the short term, without causing a significant disruption to its operations, is very limited.
- c. If a new supplier of a chemical input was required, that input would need to be able to meet the Company's specifications for its manufacturing process. The process for evaluating chemical inputs from new suppliers is time consuming and costly, and could have a material negative impact on operations in the interim.

2. Fibre suppliers

- a. The Company's manufacturing process relies on a wide range of fibre inputs which are provided by its existing supplier base. The specific inputs vary depending on the particular type of paper being manufactured, but can include blends of pulp, chips and logs and generally require specific species of wood to be used. Catalyst uses several species of wood from three major supply regions and fibre blends are optimized for each mill based upon the type of product produced. The manufacturing process requires specific proportions of each fibre input to be processed with specific chemicals in order to produce an end product which meets the end user's requirements. Changes to the fibre inputs would require changes to the manufacturing process and the chemical process that the fibre undergoes. Changing a fibre input may take months in order to determine the

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correct process. Each supplier typically supplies only one or two types of wood and therefore it is critical that the Company continue to receive supply from each of its major fibre suppliers to avoid any major disruptions to the manufacturing process.

- b. The Company has a number of dedicated suppliers, many of which are obligated to provide minimum levels of fibre in accordance with the Company's requirements. In some cases, the Companies rely on one supplier to provide a large proportion of a particular fibre requirement. There are a limited number of regional suppliers in each area and consequently the Company is reliant on the continued supply from existing suppliers. Certain suppliers' operations are integrated with the Company's supply chain and are critical to the ongoing supply of fibre. As a result, if one or more of its suppliers refuse to supply, the Company's ability to substitute suppliers in the short term without causing a significant disruption to its operations, is very limited.
- c. The Company has a number of long term fibre supply contracts which include terms that guarantee minimum levels of fibre supply at prices which are beneficial to the Company. The Company requires these contracts to remain in place in order to ensure continued supply of fibre inputs to its mills at cost effective pricing. If major suppliers did not honour their contracts, there are no other economically reasonable sources of fibre available that would be able to fill the supply gap. The significant majority of volumes of sawmill fibre supplies in BC are essentially under contract as well as much of the pulp log supply. It would not be economically viable to replace a major supply of sawmill fibre with whole log chipping supply.

3. Utility and fuel suppliers

- a. The Company's manufacturing process relies on a steady and uninterrupted supply of significant volumes of utilities and fuel, for which few or no substitute suppliers are immediately available. Any disruption would immediately interrupt the manufacturing process and impair the Company's ability to service its customers. Many of these energy providers are currently backstopped by letters of credit, which are expected to be fully drawn against the outstanding pre-filing obligations of the Company.

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4. Old Newspaper (ONP) suppliers

- a. The Company's Snowflake mill depends on buying ONP as the fibre furnish supply for the mill operations. Three major suppliers account for over 60% of the ongoing supply and it is essential that these suppliers continue regular deliveries given the significant volumes that they supply. There are a number of smaller suppliers that provide the balance of the required supply, but these alternative suppliers would not be able to replace the volumes currently provided by the Company's two major ONP providers. These suppliers operate on a small margin and can readily ship their ONP to China or Mexico if domestic demand or pricing declines. Both these export markets have paid premium prices for ONP supply and the sources of supply for Snowflake regularly maintain an export position to avoid being captive to domestic demand. If the Company is unable to obtain sufficient volumes continuing operations at the mill may be jeopardized.

5. Freight and logistics suppliers

- a. The Company uses a wide range of carriers to move both raw material inputs and finished goods. These include different modes of transport including sea, rail and road. At the time of a filing, many of these suppliers will be holding goods in transit that are either necessary for production or for delivery to customers, and the suppliers arguably will be able to assert a possessory lien over the goods in their possession. The benefit to the Company of these goods being delivered should exceed the cost of completing those shipments, so the Company needs the ability to pay these suppliers in respect of pre-filing shipping costs in order to realize those benefits (product received or sale completed).
- b. With respect to sea carriers, there are a limited number of suppliers who control capacity for shipments, and substitution of these suppliers is unlikely in the short term. For example, one carrier controls virtually all movement by sea of the Company's raw materials on the B.C. coast, and the majority of the capacity for all paper product shipments into the Company's distribution centre in Surrey, which distributes over 90% of paper produced by the Company. Another supplier interfaces with all ocean carriers for the Company's export markets, and ocean carriers will not release paperwork to transfer title of product until they are paid. If goods are in transit waiting for payment, an ocean carrier would likely take steps to seize the goods in transit until payment is received. These carriers are foreign owned (although some may have banking arrangements in Canada) and can exercise rights over goods in transit pursuant to

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maritime law. Any delay in the release of goods in transit could impact the manufacturing operations and/or delivery of finished goods.

- c. With respect to rail suppliers, two US-based railways carry approximately 40% of the shipments from the Company's BC-based mills to the Company's large United States customer base, as well as all of the shipments from the Snowflake mill. Given their locations, these railways may not respond immediately to the Initial Order. In addition, while the Company has access to all major class one railways, their customers are often served by a single railway. The Company would incur significantly higher costs if it were to attempt to change railways at its shipping point. As well, for certain customers there are very few alternatives to rail other than road, which may be unaffordable from a delivery cost perspective due to distance, and many customers are not able to handle large volumes of trucks. As such, an interruption in rail transport may result in disruption of the manufacturing process or the inability to deliver finished products to customers.

- d. The Company has a number of truck carriers designated as core carriers that are assured certain volumes into specific trade lanes, so that equipment and backhauls can be optimized. There may be some alternatives available, but in the near term, the Company would incur higher costs and may be unable to secure sufficient capacity. Additionally, no alternatives exist for certain transportation companies due to the high volumes required and the specific trailers that need to be used to transport raw materials. The Company uses substantial volumes of truck transportation every day and finding alternative, cost-effective capacity to service its customers on short notice would be very difficult. Approximately 20% of the trucking companies used by the BC mills are located in the US and all of the trucking in and out of the Snowflake mill is based in the US and, therefore, these suppliers may not immediately respond to the provisions of the Initial Order. A disruption in shipments could negatively impact both production and delivery of finished goods.

APPENDIX D

Catalyst Paper Corporation
Consolidated Estimate of D&O Exposure
(\$ thousands)

Appendix D

	Canadian Operations	US Operations	Total
Salaries & Wages	\$ 7,069	\$ 1,168	\$ 8,237
Pension costs for current service	1,079	135	1,213
Supplemental benefit costs	1,423	99	1,521
Employment cost exposure based on payment intervals	9,570	1,401	10,971
Post retirement benefits accrued over six months	4,460	-	4,460
Vacation benefits accrued over six months	10,907	1,097	12,004
Total employment liability exposure	24,937	2,498	27,435
Harmonized sales tax exposure	3,500	-	3,500
Total estimate of required D&O charge	\$ 28,437	\$ 2,498	\$ 30,935
Rounded to:			<u><u>\$ 31,000</u></u>