

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*
S.B.C., 2002, CHAPTER 57**

AND

**IN THE MATTER OF CATALYST PAPER CORPORATION AND THE
PETITIONERS INCLUDED IN APPENDIX "A"**

MONITOR'S SEVENTEENTH REPORT TO COURT

June 17, 2012



**CATALYST PAPER CORPORATION, ET AL
MONITOR’S SEVENTEENTH REPORT TO COURT**

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1. INTRODUCTION

- 1.1 On January 31, 2012, on the application of Catalyst Paper Corporation and the entities included in Appendix A (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. was appointed Monitor of the Company (the "**Monitor**").
- 1.2 Currently, there is a stay of proceedings under the CCAA that continues until June 30, 2012.
- 1.3 The Monitor's 16th Report to the Court advised that the Company's Amended Plan of Compromise and Arrangement dated May 15, 2012 (the "**Amended Plan**") was not approved by Catalyst's creditors and, accordingly, the Company would be initiating the Sales and Investor Solicitation Process (the "**SISP**") in accordance with the Order of this Court made on March 22, 2012 (the "**Meetings Order**").
- 1.4 On June 14, 2012, the Company circulated a Notice of Application for an Order approving the filing of a Second Amended and Restated Plan of Compromise and Arrangement dated June 14, 2012 (the "**Second Amended Plan**") and authorizing and directing the Company to convene meetings of each of its classes of creditors on June 25, 2012 for the purposes of considering and voting upon the Second Amended Plan, all as set forth in the draft Supplemental Meetings Order attached to the Company's Notice of Application (the "**Supplemental Meetings Order**").
- 1.5 This is the Monitor's 17th Report to Court. The purpose of this report is to provide the Monitor's comments and, as applicable, recommendations concerning:
 - 1.5.1 The Second Amended Plan; and
 - 1.5.2 The proposed Supplemental Meetings Order being sought by the Company.
- 1.6 Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.

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- 1.7 All capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Second Amended Plan, the Supplemental Meetings Order or the Meetings Order dated March 22, 2012, as subsequently amended.

2. BACKGROUND

- 2.1 The facts surrounding the Company's application for the Initial Order were set out in the Petition filed by Catalyst in the CCAA proceedings on January 31, 2012. Details regarding the Amended Plan were discussed in the Monitor's 15th Report dated May 15, 2012, and the results of the creditor vote on the Amended Plan were discussed in the Monitor's 16th Report dated May 23, 2012. All of these documents, as well as copies of the Second Amended Plan and the Supplemental Meetings Order, can be found on the Monitor's website at:

www.pwc.com/car-catalystpaper

- 2.2 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 continue to post regular updates to the website and will add prescribed and other materials as required.
- 2.3 The United States Bankruptcy Court for the District of Delaware (the "**US Court**") has recognized these proceedings as a foreign main proceeding pursuant to Chapter 15 of the US Bankruptcy Code. The Monitor's website also contains materials relating to the Chapter 15 proceedings in the US Court.

3. SUMMARY OF THE SECOND AMENDED PLAN

Background

- 3.1 On May 23, 2012, at the Unsecured Creditors Meeting, the Unsecured Claims Class voted not to approve the Amended Plan. As outlined in the Monitor's 16th Report, 95% in number of the Unsecured Creditors (holding both admitted and disputed claims) voted in favour of the Amended Plan, but this represented only 64% of the total value of Unsecured Claims of those Creditors. This constituted a "Plan Failure" as defined in the SISP Order.

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- 3.2 As a result of the Plan Failure, the Company initiated the SISP. A number of prospective bidders have been qualified in accordance with the SISP and these bidders have until 5:00 p.m. (Vancouver time) on Wednesday, July, 11, 2012 to submit non-binding indications of interest as part of Phase 1 of the SISP.
- 3.3 In addition to the Company's secured and unsecured noteholders, the retired salaried employees of Catalyst and its predecessor companies (collectively the "**RSEs**") have a significant financial stake in the outcome of the restructuring process. The Company's estimated obligations to this group are approximately \$150 million in respect of both the Salaried Pension Plan solvency deficit and the cost of providing certain other post-retirement benefits in accordance with the RSEs' employment agreements. These obligations to fund post retirement benefits are not secured.
- 3.4 Under the Amended Plan, the Company's obligations to the RSEs were to be unaffected, and the Company was to continue funding the solvency deficit and the post retirement benefits in full. Conversely, under the SISP, purchaser(s) of the Company's assets were not obligated to assume any of the Company's obligations to the RSEs, in which case the solvency deficit and other post-retirement benefits would no longer be funded. The Stalking Horse Purchase Agreement contemplated by the SISP reflected this approach. Considering the foregoing, this stakeholder group is potentially significantly disadvantaged by the failure of the Amended Plan.
- 3.5 The RSEs are represented by two groups, the Catalyst TimberWest Retired Salaried Employees Association ("**RSEA**") and the Catalyst Salaried Employees & Pensioners Steering Committee ("**CSE&P**").
- 3.6 As a result of the outcome of the vote at the Creditor Meetings held on May 23, 2012, counsel representing RSEA and CSE&P engaged in discussions with the Company concerning the filing of an amended plan of arrangement and the compromise of the extended health care benefits of the RSEs. These discussions resulted in the Second Amended Plan.

Features of the Second Amended Plan

- 3.7 The Second Amended Plan is the same as the Amended Plan, except for the following two changes:

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- 3.7.1 The Company's obligations to fund the extended health care benefits to the RSEs (the "**Extended Health Benefits Claims**") have now been included as General Unsecured Claims and are to be compromised under the Second Amended Plan. The Amended Plan treated these obligations as Unaffected Claims.
- 3.7.2 As an additional condition precedent to plan implementation, Catalyst must have obtained regulatory relief from the Government of British Columbia to permit the Company to amortize its Salaried Pension Plan solvency deficit payment schedule over 15 years and implement a Special Portability Option to the Salaried Pension Plan. The B.C. Minister of Finance and Deputy Premier has confirmed that he is prepared to submit Catalyst's proposal to Cabinet for its consideration with a recommendation in favour of the necessary amendments.
- 3.8 Under the Second Amended Plan, Affected Creditors are still divided into two classes: the First Lien Notes Claims Class and the Unsecured Claims Class. The consideration offered under the Second Amended Plan remains the same as under the Amended Plan and is summarized in the table below:

Class	Estimated claims	Plan Distribution	Plan value of Distribution
(1) First Lien Notes Claims Class	US\$433.7 million	New First Lien Notes	US\$250 million
		100% of New Common Shares (subject to dilution by Equity Election Creditors)	Not identified
(2) Unsecured Claims Class			
(a) 2014 Noteholders and General Unsecured Creditors	2014 Noteholders: US\$263.2 million General Unsecured Creditors:US\$176.8 million	PREI Proceeds Pool or up to 4% of the New Common Shares subject to Equity Elections made	Unknown at present, estimated at \$15.8 million
(b) General Unsecured Cash Creditors (Claims of \$10,000 or less)	Convenience Claims estimated at US\$0.9 million plus Cash Election Creditors totalling US\$3.1 million	Convenience Cash Pool (plus share of PREI Proceeds Pool for any excess claims above the maximum Convenience Cash Pool)	\$2.5 million

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- 3.9 In addition to the new condition precedent noted above, the implementation of the Second Amended Plan remains conditional upon the following key conditions, each of which was a condition precedent to the Amended Plan:
- 3.9.1 The New Labour Contracts remain effective and the PPWC and the CEP continue to abide by the terms thereof. The PPWC and the CEP are currently working pursuant to the New Labour Contracts and have indicated to the Company that they will continue to do so in the event that the Second Amended Plan is approved and implemented;
 - 3.9.2 The letters of credit posted as collateral for the KERP shall have been cancelled and all cash collateral with respect to the letters of credit returned to the Company. These steps are now complete; and,
 - 3.9.3 A new ABL facility shall be secured to replace the DIP Facility. The Company is in continuing discussions with several parties to seek this exit financing.

Implications of the Pension Regulatory Relief sought

- 3.10 The Salaried Pension Plan deficit is estimated to be approximately \$115 million and the Company is currently required to make catch up payments over a period of seven years to eliminate the solvency deficit. These catch up payment requirements represent a significant demand on the Company's cash flow.
- 3.11 The Company has recently made a proposal to the B.C. Superintendent of Pensions proposing that it make catch up payments to resolve the solvency deficit over a period of fifteen years. This extension, if granted, is expected to reduce the annual special payments by at least \$6 million and accordingly improve the Company's cash flow from operations.
- 3.12 The Company has also proposed that plan members be given the option of taking a lump sum payment from the Salaried Pension Plan at a reduced commuted value, currently estimated at 65% of the full commuted value, plus a top up payment from the Company's cash flow of approximately 8% of the commuted value in full satisfaction of their entitlement from the Salaried Pension Plan. The cost of this top up payment will depend upon the number of RSE's who elect this option. Elections of

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this option will result in a reduction in the Company's solvency deficit and future solvency deficit catch up payments.

- 3.13 In summary, the implementation of this relief will not give rise to any additional claims to be compromised by the Second Amended Plan. The relief is designed to mitigate the Company's obligation for future payments in respect of the Salaried Pension Plan and to provide the RSE's with an option they currently do not have.

Implications of the Extended Health Benefits Claims

- 3.14 Catalyst maintains post-retirement benefit plans for active employees and the RSEs. Among the post retirement benefits, the Company provides extended health care benefits which are common amongst all the retirees although the value of the benefits varies for different retirees.
- 3.15 The Extended Health Benefits Claims consist of the extended health care portion of the post-retirement benefit plans for approximately 1,200 RSEs. The provision of extended health care benefits is administered by Pacific Blue Cross pursuant to those contracts listed in the Second Amended Plan. In all cases, the costs of the plans are currently funded out of the Company's current operating cash flow.
- 3.16 The Company has obtained and shared with the Monitor an actuarial valuation of the future extended health care benefit costs as at December 31, 2011, which values the current obligation associated with these benefits at approximately \$22.4 million. It is anticipated that this valuation will form the basis of the Extended Health Benefits Claims when filed. Based on these calculations, the Company estimates that it will eliminate future cash payments of approximately \$1.2 million per year and therefore improve the Company's cash flow subsequent to the implementation of the Second Amended Plan.

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- 3.17 The inclusion of the Extended Health Benefits Claims will increase the total amount of Unsecured Claims. As the amount of consideration being offered pursuant to the Second Amended Plan is the same as under the Amended Plan, the anticipated distribution to the Unsecured Class will, accordingly, be less. A comparison of the estimated recoveries by Unsecured Creditors under the SISP, the Amended Plan and the Second Amended Plan is presented in the table below:

(\$ millions)	Amended Plan	Second Amended Plan	SISP
Estimated Proceeds for Distribution			
Cash	-	-	- (1)
Sale of PREI	15.8	15.8	- (2)
Unencumbered Assets Acquired	-	-	19.9 (3)
Unencumbered Assets Not Acquired	-	-	31.6 (2)
Total	15.8	15.8	51.5
Creditor Group			
2014 Noteholders	263.6	263.6	263.6
2016 Noteholders Shortfall	-	-	155.0
Trade Creditor claims	30.8	30.8	34.8 (1)
Employee / Union Claims	102.1	102.1	102.1 (4)
Restructuring Claims	17.5	17.5	17.5
Environmental Claims	-	-	- (5)
Pension & PRB Claims	-	22.4	150.0 (6)
Total	414.0	436.4	723.0
Value per \$ of Claim	\$ 0.038	\$ 0.036	\$ 0.071
<p>(1) The \$2.5m cash offered in the Plan is used to pay the Convenience Creditors (\$900k) and Cash Election Creditors (\$3.1m). The cash and these creditors have been excluded from the Plan recoveries.</p> <p>(2) The net proceeds from the sale of PREI is the midpoint value contained in the Monitor's 9th Report - 50% for the Amended Plan, 100% for the SISP.</p> <p>(3) Includes the Surrey Distribution Centre and Barges, fibre supply agreements, and mobile equipment at the midpoint value noted in the Monitor's 9th Report.</p> <p>(4) Claims are disputed.</p> <p>(5) Claims are contingent and unliquidated, so cannot be valued.</p> <p>(6) Value is based on actuarial funding estimate as at December 31, 2011.</p>			

- 3.18 The Monitor estimates that the inclusion of the Extended Health Benefits Claims as Affected Claims under the Second Amended Plan will reduce the recovery by members of the Unsecured Claim Class by \$0.002 per dollar of claim as compared to their anticipated recovery under the Amended Plan. The Monitor does not consider this amount to be material and, accordingly, the inclusion of the Extended Health Benefits Claims as an Affected Claim under the Second Amended Plan does not

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change the Monitor's view on the fairness and reasonableness of the distribution to the Unsecured Claims Class.

Monitor's assessment of the Second Amended Plan

- 3.19 The Monitor's assessment of the Second Amended Plan is the same as its assessment of the Amended Plan as set forth in its 15th Report, as are the issues and concerns identified by the Monitor in that Report.
- 3.20 The estimated recoveries by Unsecured Creditors under the SISP are still subject to the same risks concerning the realization of the Company's assets, the 2016 Noteholders' assertion that their security extends to the Unencumbered Assets, and that the proceeds of realization under the SISP may not be available for distribution on a substantively consolidated basis (as is contemplated under the Second Amended Plan). Each of these factors could affect the estimated recoveries under the SISP such that the recoveries by the members of the Unsecured Claims Class under the SISP may not be higher than those under the Second Amended Plan.
- 3.21 Should the Second Amended Plan be approved by the Creditors and the Court and subsequently implemented, the Company will still have to address future liquidity concerns and, concurrently, its ability to service its cash interest costs, all of which is discussed in the Monitor's 15th Report. However, the Monitor notes that the Second Amended Plan helps to address these concerns as a result of the estimated combined \$7 million in annual cash flow savings anticipated to arise from the compromise of the Extended Health Benefits Claims and the extension of the solvency deficit payment period for the Salaried Pension Plan, representing savings of approximately \$1 million and \$6 million annually, respectively.
- 3.22 Based on the foregoing, the Monitor considers the Second Amended Plan to be fair and reasonable.

4. PROPOSED SUPPLEMENTAL MEETING ORDER

- 4.1 The proposed Supplemental Meetings Order includes terms:
- 4.1.1 Approving the filing of the Second Amended Plan;

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- 4.1.2 Regarding the provision of notice of the Second Creditor Meetings to Affected Creditors;
 - 4.1.3 Allowing for the filing of the Extended Health Benefits Claims and resolving any disputes regarding same;
 - 4.1.4 Convening the Second Creditor Meetings on June 25, 2012; and,
 - 4.1.5 Providing that votes cast in respect of the Amended Plan will be counted in the same manner in respect of the Second Amended Plan, subject to the right of Affected Creditors to revoke or change their earlier votes.
- 4.2 Affected Creditors will be given notice of the filing of the Second Amended Plan and the Second Creditor Meetings, and each will receive an Information Package that contains the following:
- 4.2.1 A Notice of Further Meetings;
 - 4.2.2 The form of revocation of proxy for General Unsecured Creditors;
 - 4.2.3 Voting instruction forms and master proxies for the 2014 Noteholders and the 2016 Noteholders;
 - 4.2.4 The Cash Election Form; and
 - 4.2.5 The Company's press release dated June 14, 2012 (the "**Press Release**").

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- 4.3 The timelines contemplated by the proposed Supplemental Meetings Order are presented in the table below:

Date	Step
June 18	Granting of Supplemental Meetings Order
Forthwith after the granting of the Supplemental Meetings Order but within 2 business days of June 18	The Monitor shall provide the Solicitation Agent with a copy of the Information Package (excluding the Cash Election form and the proxy for General Unsecured Creditors) who shall circulate it to the Noteholders' nominees.
Forthwith after the granting of the Supplemental Meetings Order but within 2 business days of June 18	The Monitor shall post the Information Package, the Supplemental Meetings Order, and its 17 th Report on its website.
As soon as practical but no later than June 19 – 10:00 am	The Monitor shall email the Information Package to all Affected Creditors who have filed a Proof of Claim and provided email addresses to the Monitor. The Information Package shall be couriered to all Affected Creditors who have not provided email addresses.
As soon as practical but no later than June 19 – 10:00 am	RSEA shall deliver by email to those members for whom it has email addresses the following: the Press Release, the Notice of Further Creditor Meetings, and the Second Amended Plan.
June 25	Second Creditor Meetings held
June 28	Application for the Sanction Order.

- 4.4 As noted above, the Supplemental Meetings Order contemplates that the votes cast at the Creditor Meetings held on May 23, 2012, whether in person or by proxy (and irrespective of whether a proxy was filed after the Creditor Meetings were commenced) shall be voted in the same manner at the Second Creditor Meetings unless a creditor takes action to revoke, change or record their vote by:

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- 4.4.1 Filing a new proxy;
 - 4.4.2 Filing or revoking a Cash Election (and, if filed, having their Claim deemed to be a vote in favour of the Second Amended Plan);
 - 4.4.3 Revoking a previously filed proxy; or
 - 4.4.4 If no proxy has otherwise been submitted, attending the Second Meeting and voting in person.
- 4.5 The Monitor is satisfied that the proposed voting process is appropriate in the circumstances. As noted previously, the reduction in the potential distribution to the Unsecured Claims Class between the Second Amended Plan and the Amended Plan do not change the Monitor's view on the fairness and reasonableness of the distribution to the Unsecured Claims Class.
- 4.6 The Monitor thinks that there is a reasonable opportunity and process available for creditors who wish to change their vote in respect of the Second Amended Plan. In light of this, and the immaterial reduction in distributions to Unsecured Creditors, the Monitor does not believe there is any real prejudice to Affected Creditors who previously voted in favour of the Amended Plan by having their votes carried forward and voted in the same manner in respect of the Second Amended Plan. The Monitor notes that there is precedent for the use of this voting process in other CCAA proceedings, specifically the Fraser Papers Inc. CCAA proceedings.
- 4.7 The Monitor notes that it has received 627 Proofs of Claim from General Unsecured Creditors and it has obtained email addresses for all but 11. Therefore, the Monitor anticipates being able to email the Information Package to General Unsecured Creditors on the same day the Supplemental Meetings Order is made.
- 4.8 The Solicitation Agent was also consulted by the Company and the Monitor to determine if Noteholders would have sufficient time to respond and, if so desired, revoke or change their vote. The Solicitation Agent suggested modifications to the Voting Instruction Form and Master Proxies to be delivered to the Noteholders and their nominees, respectively, which were made. The Solicitation Agent further confirmed that it believed there was an adequate process and sufficient opportunity for Noteholders to make their voting intentions known.

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- 4.9 The proposed voting process contemplates a relatively short notice period, which will facilitate a timely decision on the Second Amended Plan. The Monitor considers this desirable as it will minimize the risk that the SISP is delayed by the filing of the Second Amended Plan. In the event that the Second Amended Plan is not approved, the timely progression of the SISP is important to minimize uncertainty surrounding the Company's restructuring process.

5. CONCLUSIONS

- 5.1 The Second Amended Plan is the result of extensive discussions among the Company, the Initial Supporting Noteholders, legal counsel for RSEA and CSE&P, representatives of the B.C. Financial Institutions Commission responsible for pension regulatory matters, representatives of the unionized workforce and other Unsecured Creditors, all held with the objective of negotiating a fair compromise that would be acceptable to the requisite majorities of the members of the Unsecured Claims Class. The Monitor considers the Company's efforts to compromise additional liabilities as part of the Second Amended Plan and seek the regulatory relief relative to the Salaried Pension Plan to have been appropriate and undertaken in good faith.
- 5.2 The Monitor considers the Second Amended Plan to be fair and reasonable and the Monitor recommends that Affected Creditors vote in favour of the Second Amended Plan. As a result, the Monitor supports the filing of the Second Amended Plan and its distribution to Affected Creditors.
- 5.3 The Monitor considers the notice and timeframe proposed in the Supplemental Meetings Order to be reasonable and appropriate in the circumstances and supports the voting process contemplated thereby.

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This report is respectfully submitted this 17th day of June, 2012,

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



**Michael J. Vermette, CA, CIRP
Senior Vice President**



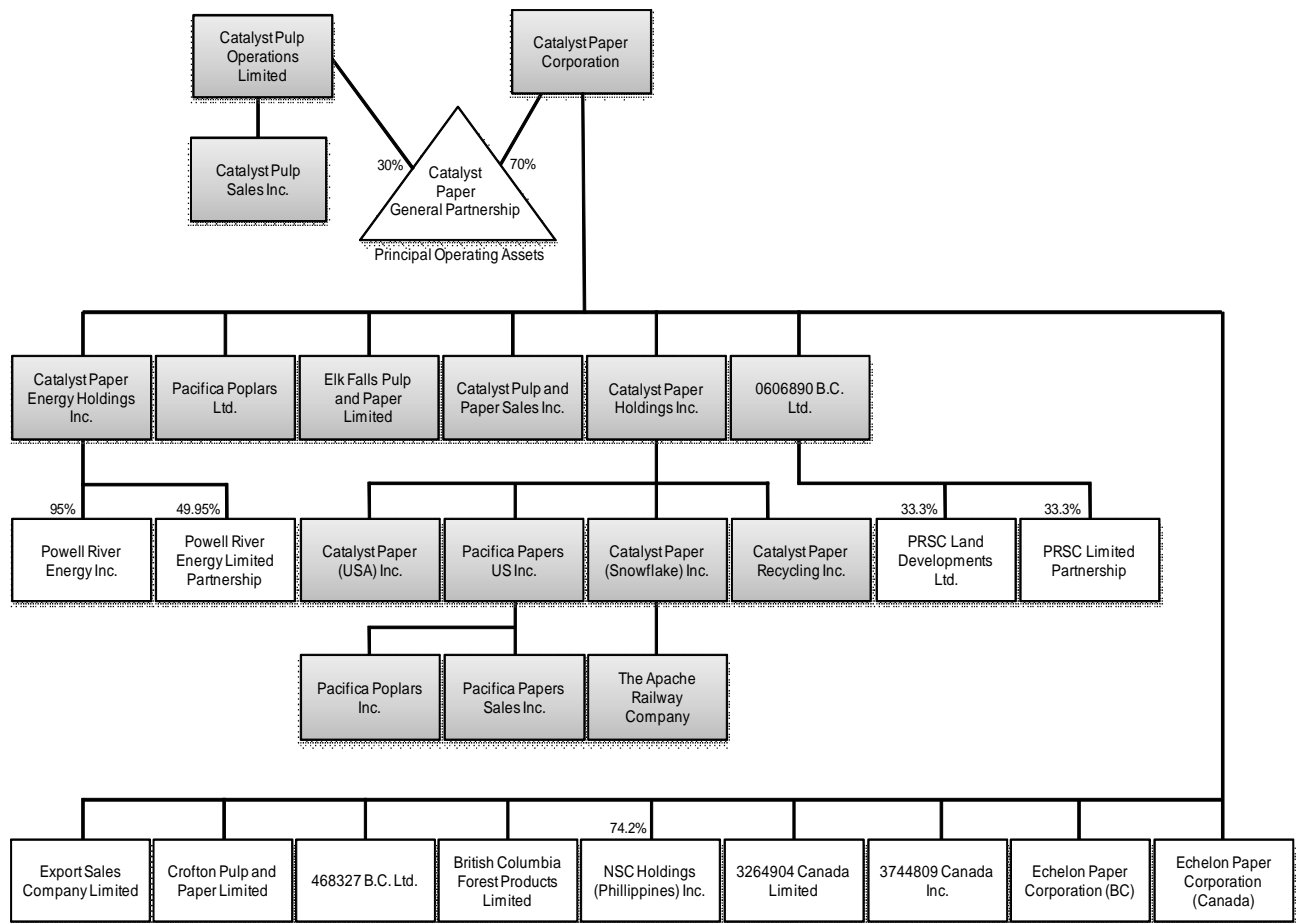
**Mica Arlette, CA, CIRP
Senior Vice President**

APPENDIX A

Petitioner Parties Organization Chart

Catalyst Paper Corporation Organizational Chart

APPENDIX A



Notes

1. Unless otherwise noted, Common share ownership is 100%. Preferred share ownership is not identified in this chart.
2. Shaded entities represent the Petitioners in the CCAA proceedings.
3. Catalyst Paper General Partnership is also subject to the CCAA proceedings.