

**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 PROPOSED PLAN OF  
COMPROMISE OR ARRANGEMENT WITH RESPECT TO  
**FRASER PAPERS INC.**, FPS CANADA INC., FRASER  
PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER  
PAPERS LIMITED and FRASER N.H. LLC (collectively, the  
"Applicants")

Applicants

**MOTION RECORD  
(Returnable June 26, 2009)**

June 25, 2009

**ThorntonGroutFinnigan LLP**  
Barristers and Solicitors  
100 Wellington Street West  
Suite 3200  
Toronto, Ontario  
M5K 1K7

**Michael Barrack** (LSUC# 21941W)  
**Robert I. Thornton** (LSUC# 24266B)  
**D.J. Miller** (LSUC #34393P)

Tel: 416-304-1616  
Fax: 416-304-1313

Lawyers for the Applicants.

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# TAB 1

**ONTARIO  
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"Applicants")

**AMENDED NOTICE OF MOTION**

The **APPLICANTS** will make a motion before a Judge of the Ontario Superior Court of Justice (Commercial List) on Friday, June 26, 2009 at a time to be determined at 330 University Avenue, in the City of Toronto.

**PROPOSED METHOD OF HEARING:** The motion is to be heard orally.

**THE MOTION IS FOR:**

1. an Order abridging the time for service of the Notice of Motion and Motion Record herein such that this Motion is properly returnable today, that all parties entitled to notice of the Motion have been duly served with notice, that no other parties are affected by the proposed Order and that any requirement for service of the Notice of Motion and the

Motion Record upon any other party other than the parties served is dispensed with and that the service of the Notice of Motion and the Motion Record is validated in all respects;

2. an Order stating that the Applicants shall not make any past service contributions or special payments to fund any going concern unfunded liability or solvency deficiency of the Pension Plans during the Stay Period (as defined in the Initial Order), pending further Order of the Court;
3. an Order stating that none of the Applicants or their respective officers or directors shall incur any obligation, whether by way of debt, damages for breach of duty, whether statutory, fiduciary, common law or otherwise, or for breach of trust, nor shall any trust be recognized, whether express, implied, constructive, resulting, deemed or otherwise, as a result of the failure of any Person to make any contribution or payments other than Current Contributions during the Stay Period, that they might otherwise have been required to make to any Pension Plans maintained by any of the Applicants;
4. an Order stating that if any claim, lien, charge or trust arises as a result of the failure of any Person to make any contribution or payment (other than Current Contributions in accordance with Sections 81.5 and 81.6 of the *Bankruptcy and Insolvency Act* during the Stay Period that such Person might otherwise have become required to make to any Pension Plans but for the stay provided for herein, no such claim, lien, charge or trust shall be recognized in these proceedings or in any subsequent receivership, interim receivership or bankruptcy of any of the Applicants as having priority over the claims of the *Companies' Creditors Arrangement Act* Charges as set out in the Initial Order;

5. an Order declaring that that nothing in the Order obtained shall be taken to extinguish or compromise the obligations of the Applicants, if any, regarding payments under the Pension Plans; and
6. such further and other relief as counsel may advise and this Honourable Court may deem just.

**THE GROUNDS FOR THE MOTION ARE:**

1. on June 18, 2009, the Applicants filed for protection from their creditors pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA"). The Honourable Justice Morawetz granted a CCAA stay of proceedings pursuant to the terms of the Initial Order;
2. the Applicants sponsor five defined benefit pension plans in three jurisdictions: two registered in the Province of New Brunswick (the "**NB Hourly Plan**" and the "**NB Salaried Plan**"), two registered in the Province of Quebec and one in the U.S. (individually, the "Pension Plan" and collectively, the "**Pension Plans**"). In total, there are 2,997 retirees and 1,412 active employees who are members of the Pension Plans;
3. based on information received by the Company from its actuaries for the purpose of preparing the annual audited financial statements, and in accordance with GAAP, the Applicants' accrued pension benefit obligations in its five defined benefit Pension Plans exceed the value of the Pension Plan assets by approximately \$171.5 million as at December 31, 2008;

4. the Applicants expect that they will be required to make special payments in respect of unfunded going concern and solvency deficiencies (the “**Pension Deficits**”) with respect to the Pension Plans in the amount of \$13.5 million in 2009 (the “**Special Payments**”). This is in addition to \$3.3 million required to be paid in 2009 on account of normal cost contributions to the Pension Plans;
5. the Applicants have no ability to pay the Special Payments at this time;
6. additionally, the Applicants expect that contributions required to be paid to the defined benefit components of the Pension Plans in 2009 will almost double in 2010. The Applicants estimate that they will be required to pay an average of \$34.7 million per year for the years 2010 to 2013 to fund the Pension Deficits and a further \$5.1 million for normal cost contributions (for current service of members) to the Pension Plans in 2010;
7. the Applicants will be unable to satisfy these combined funding obligations;
8. the Applicants have obtained and the Court has approved certain DIP financing. CIT Business Credit Canada Inc. and Brookfield Asset Management Inc. (collectively the “**DIP Lenders**”) have entered into separate financing agreements with the Applicants (collectively the “**DIP Term Sheets**”). The Applicants were authorized to enter into the DIP Term Sheets pursuant to the Initial Order;
9. pursuant to the conditions of the DIP Term Sheets the Applicants are not allowed to pay the Special Payments without the prior written consent of the DIP Lenders. In fact, payment of the Special Payments is an explicit Event of Default that triggers a potential termination of the Applicants’ ability to draw upon the DIP financing;

10. if the DIP Lenders withdrew their funding the Applicants would not be able to continue in business. It is imperative to any restructuring that the Fraser Group continues to receive financing from the DIP Lenders.
11. the relief sought by the Applicants maintains the *status quo* and does not extinguish or compromise the obligations of the Applicants, if any, regarding payments under the Pension Plans; and
12. such further and other grounds as counsel may advise and this Honourable Court may permit.

**THE FOLLOWING DOCUMENTARY EVIDENCE** will be used at the hearing of this Motion:

1. the Affidavit of J. Peter Gordon, sworn June 17, 2009, previously filed;
2. First Report to the Court submitted by PricewaterhouseCoopers Inc. in its capacity as proposed CCAA Monitor of the Applicants dated June 18, 2009;
3. Second Report to the Court submitted by PricewaterhouseCoopers Inc. in its capacity as Court-Appointed Monitor of the Applicants, to be filed; and
4. such further and other evidence as counsel may advise and this Honourable Court may permit.

June 25, 2009

**ThorntonGroutFinnigan LLP**  
Barristers and Solicitors  
Canadian Pacific Tower  
100 Wellington Street West  
Suite 3200, P.O. Box 329  
Toronto, ON M5K 1K7

**Michael E. Barrack** (LSUC# 21941W)  
**Robert I. Thornton** (LSUC# 24266B 1B)  
**D.J. Miller** (LSUC# 34393P)  
Tel: 416-304-1616  
Fax: 416-304-1313

Lawyers for the Applicants

**TO: THIS HONOURABLE COURT**  
**AND TO: THE ATTACHED SERVICE LIST**

## SERVICE LIST

### **THORNTON GROUT FINNIGAN LLP**

Barristers and Solicitors  
100 Wellington Street West  
Suite 3200  
Toronto, ON M5K 1K7

#### **Michael Barrack / Robert Thornton / D.J. Miller**

Tel: (416) 304-1616  
Email: [mbarrack@tgf.ca](mailto:mbarrack@tgf.ca)  
[rthornton@tgf.ca](mailto:rthornton@tgf.ca)  
[djmiller@tgf.ca](mailto:djmiller@tgf.ca)

Fax: (416) 304-1313  
Lawyers for the Applicants

### **TORYS LLP**

Suite 3000, 79 Wellington St. W.  
Box 270, TD Centre  
Toronto, ON M5K 1N2

#### **Tony DeMarinis / David Chernos**

Tel: (416) 865.0040  
Email: [tdemarinis@torys.com](mailto:tdemarinis@torys.com)  
[dchernos@torys.com](mailto:dchernos@torys.com)  
Fax: (416) 865-7380  
Lawyers for Brookfield Asset Management Inc.

### **BLAKE, CASSELS & GRAYDON LLP**

199 Bay St.  
Suite 2800, Commerce Court West  
Toronto, ON M5L 1A9

#### **Susan Grundy / Pamela Huff / Chris Burr**

Tel: (416) 863-2400  
Email: [susan.grundy@blakes.com](mailto:susan.grundy@blakes.com)  
[pamela.huff@blakes.com](mailto:pamela.huff@blakes.com)  
[chris.burr@blakes.com](mailto:chris.burr@blakes.com)  
Fax: (416) 863-2653  
Lawyers for CIT

**STIKEMAN ELLIOTT LLP**

5300 Commerce Court West  
199 Bay St.  
Toronto, ON M5L 1B9

**Sharon C. Polan / Kathy Mah**

Tel: (416) 869-5500  
Fax: (416) 947-0866  
Email: [spolan@stikeman.com](mailto:spolan@stikeman.com)  
[kmah@stikeman.com](mailto:kmah@stikeman.com)

Lawyers for CIBC

**OFFICE OF THE ATTORNEY GENERAL**

on behalf of the Province of New Brunswick  
Commercial, Corporate and Property Law Group  
Centennial Building, P.O. Box 6000  
Fredericton, NB E3B 5H1

**John Logan**

Tel: (506) 453-2222  
Fax: (506) 453-3275  
Email: [john.logan@gnb.ca](mailto:john.logan@gnb.ca)

Lawyers for the Province of New Brunswick

**GOODMANS LLP**

Suite 2400  
250 Yonge St.  
Toronto, ON M5B 2M6

**Robert Chadwick / Cathy Costa**

Tel: (416) 979-2211  
Fax: (416) 979-1234  
Email: [rchadwick@goodmans.ca](mailto:rchadwick@goodmans.ca)  
[ccosta@goodmans.ca](mailto:ccosta@goodmans.ca)

Lawyers for the Monitor, PricewaterhouseCoopers Inc.

**LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP**

Suite 2600, 130 Adelaide St. W.  
Toronto, ON M5H 3P5

**Peter H. Griffin / Naomi D. Loewith**

Tel: (416) 865-9500

Email: [pgriffin@litigate.com](mailto:pgriffin@litigate.com)  
[nloewith@litigate.com](mailto:nloewith@litigate.com)

Fax: (416) 865-9010

Lawyers for the Directors of Fraser Papers Inc.

**PAULA TURTLE**

Canadian Counsel, United Steelworkers  
234 Eglinton Ave East, 8<sup>th</sup> Floor  
M4P 1K7

Tel: (416) 544-5980

Fax: (416) 487-8826

Email: [pturtle@usw.ca](mailto:pturtle@usw.ca)

Canadian Counsel, United Steelworkers

**BAKER & HOSTLETTLER LLP**

65E. State Street, Suite 2100  
Columbus, Ohio 43215

**Sherri B. Lazear**

Tel: (614) 462-2631

Fax: (614) 462-2616

Email: [slazear@bakerlaw.com](mailto:slazear@bakerlaw.com)

Counsel for Specialty Minerals Inc.

**CALEY WRAY**

1600 – 65 Queen Street West  
Toronto, ON M5h 2M5

**Jesse B. Kugler**

Tel: (416) 775-4677  
Fax: (416) 366-3292  
Email: [kuglerj@caleywrap.com](mailto:kuglerj@caleywrap.com)  
Lawyers for the CEP Union

**STEIN MONAST**

70 Dalhousie Street, Suite 300  
Quebec, ON G1K 4B2

**Karine Dionne**

Tel: (418) 640-4438  
Fax: (418) 523-5391  
Email: [karine.dionne@steinmonast.ca](mailto:karine.dionne@steinmonast.ca)  
Counsel for the municipality of Thurso

**CIT FINANCIAL LTD.**

5035 South Service Road  
Burlington, ON L7R 4C8

**Isobel Fraser**

Tel: (905) 633-2097  
Fax: (905) 633-2130  
Email: [Isobel.Fraser@cit.com](mailto:Isobel.Fraser@cit.com)  
Lawyers for DIP Lender

**PRICEWATERHOUSECOOPERS INC.**

Royal Trust Tower  
20th Floor, 77 King Street West  
Toronto, ON M5K 1K7

**John McKenna / Diane Cesta / Tracey Weaver**

Tel: (416) 863 1133

Email: [john.p.mckenna@ca.pwc.com](mailto:john.p.mckenna@ca.pwc.com)

[diane.c.cesta@ca.pwc.com](mailto:diane.c.cesta@ca.pwc.com)

[tracey.weaver@ca.pwc.com](mailto:tracey.weaver@ca.pwc.com)

Fax: (416) 941-8378

Court-Appointed Monitor for Fraser Papers Inc.

**ARAV, ROBILLARD & LANIEL**

Régie des rentes du Québec  
2600 boulevard Laurier, Bureau 501  
C.P. 5200  
Québec, QC G1K 7S9

**Louis Robillard**

Tel: (418) 657-8702 ext. 3038

Fax: (418) 643-9590

Email: [louis.robillard@rrq.gouv.qc.ca](mailto:louis.robillard@rrq.gouv.qc.ca)

Lawyers for Régie des rentes du Québec, a Pension Supervisory Authority for two Applicants' Pension Plans in the province of Québec

**Deborah McPhail**

Financial Services Commission of Ontario  
17th Floor, Box 85  
5160 Yonge St.  
Toronto, ON M2N 6L9

Phone: 416 226-7764

Fax: 416 590-7070

Email: [DMcphail@fscsco.gov.on.ca](mailto:DMcphail@fscsco.gov.on.ca)

**Peter H. MacPhail**

Gorman Nason Lawyers  
121 Germain Street  
P.O. Box 7286, Station "A"  
Saint John, NB E2L 4S6

Tel: (506) 636-7324

Fax: (506) 634-8685

Email: [peter.macphail@gormannason.com](mailto:peter.macphail@gormannason.com)

Lawyers for the Superintendent of Pensions for New Brunswick

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c.C-36 AS AMENDED  
AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO FRASER PAPERS INC.,  
FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER PAPERS LIMITED and FRASER N.H. LLC  
(collectively, the "Applicants")

Court File No.: CV-09-8241-00CL

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

Proceedings commenced at Toronto

**AMENDED NOTICE OF MOTION**  
(returnable June 26, 2009)

**ThorntonGroutFinnigan LLP**  
Barristers and Solicitors  
Suite 3200, P.O. Box 329  
Canadian Pacific Tower  
Toronto-Dominion Centre  
Toronto, ON M5K 1K7

**Michael E. Barrack** (LSUC# 21941W)  
**Robert I. Thornton** (LSUC# 24266B 1B)  
**D.J. Miller** (LSUC #34393P)

Tel: 416-304-1616  
Fax: 416-304-1313

Lawyers for the Applicants

## **TAB 2**

Court File No.:

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OR ARRANGEMENT WITH RESPECT TO **FRASER PAPERS**  
**INC.**, FPS CANADA INC., FRASER PAPERS HOLDINGS INC.,  
FRASER TIMBER LTD., FRASER PAPERS LIMITED and FRASER  
N.H. LLC

Applicants

**AFFIDAVIT OF J. PETER GORDON**  
**(Sworn June 17, 2009)**  
**(CCAA Initial Order)**

I, J. Peter Gordon, of the City of Toronto, in the Province of Ontario, **MAKE OATH AND SAY AS FOLLOWS:**

1. I am the Chief Executive Officer and a Director of Fraser Papers Inc. ("Fraser Papers" or the "Company"), and hold the office of Chairman of each of the other Applicants (collectively, with Fraser Papers, the "Fraser Group") and as such I have personal knowledge of the matters to which I herein depose. Where the source of my information or belief is other than my own personal knowledge, I have identified the source and the basis for my information and verily believe it to be true.
2. All reference to currency in this Affidavit is \$USD unless otherwise noted.

## I. OVERVIEW - NEED FOR PROTECTION

3. Fraser Papers is a specialty paper company with integrated paper, pulp and lumber operations. The Fraser Group is a consolidated business comprising various facilities in Canada and the United States of America (the "U.S."), operating under a combined cash management and accounting system and senior management decision making, including extensive intercompany transactions such as the sale and use of products and services among various business operations and legal entities. As such, the business is operationally and functionally integrated and not easily divisible based on legal entity or geographic boundaries.

4. The Fraser Group's operations and financial results are influenced by a number of factors, many of which are beyond the Applicants' control. The five most significant factors, in no particular order of importance, are: (i) the cyclical nature of the business; (ii) the competitive environment of the industry; (iii) product demand; (iv) cost control; and (v) foreign currency risk.

5. The Applicants have experienced many of the challenges faced by other companies in the North American forest products industry. The challenges faced by the Applicants include market issues and financial issues, the most pressing of which are as follows:

- (a) negative cash flow from its operations (prior to changes in non-cash working capital) of \$65.4 million and \$55.5 million in 2007 and 2008 respectively, combined with a further shortfall of \$9.7 million in the first quarter of 2009. The Company no longer has the ability to finance cash flow shortfalls of this magnitude;
- (b) the aforementioned cash flow shortfalls are being driven by a sharp deterioration at the Company's pulp operations, continuing losses from its lumber operations and are only partially offset by the turnaround in its specialty papers business;
- (c) under the current collective agreement, aggregate severance payments to unionized employees at the Company's Thurso facility of CDN\$7.8 million are due in two equal payments on November 9 and December 21, 2009, following the mill's temporary

closure on June 1, 2009. The Applicants have no ability to pay these amounts at this time;

- (d) the Applicants are required to repay or refinance a \$25 million term loan with Canadian Imperial Bank of Commerce ("CIBC") in September 2009 and they have no ability to do so at this time;
- (e) the Applicants have a substantial deficit, as determined in accordance with Generally Accepted Accounting Principles in Canada ("GAAP"), of approximately \$171.5 million at December 31, 2008 in five defined benefit pension plans and three Supplemental Executive Retirement Plans ("SERPs") and are required to make payments of \$3.5 million by September 30, 2009 and an additional \$10.1 million by December 31, 2009. Average annual payments of approximately \$34.7 million per year from 2010 to 2013 are expected to be required to fund the Pension Plans. Unless the Applicants are able to obtain a temporary funding holiday or an alternative funding formula is achieved, the Applicants have no ability to meet these funding obligations; and
- (f) the Applicants owe trade suppliers in excess of \$10 million beyond normal credit terms and owe an additional \$7.7 million in property taxes to six municipalities.

6. The Cash Flow Forecast (as hereafter defined) indicates that, in the absence of any DIP Financing (as hereafter defined), the Applicants will have insufficient cash with which to operate after June 30, 2009. Existing liquidity under the Applicants' revolving working capital facility is not expected to meet the Applicants' operating requirements beyond the next few weeks. The Applicants are insolvent, and their need for protection is immediate and urgent.

**II. CORPORATE STRUCTURE OF THE APPLICANTS**

**A. Fraser Papers Inc. and its U.S. Subsidiaries**

7. Fraser Papers was incorporated pursuant to the provisions of the *Canada Business Corporations Act*, and its registered head office is in Toronto, Ontario. On July 1, 2004 Fraser Papers, formerly a wholly-owned subsidiary of Nexfor Inc., became a separate publicly traded company. Its stock is listed on the Toronto Stock Exchange under the symbol "FPS".

8. As at June 1<sup>st</sup>, 2009, the issued and outstanding capital of Fraser Papers consisted of 50,166,789 common shares. There are no other classes of shares outstanding at this time. As at December 31, 2008 Brookfield Asset Management Inc. ("Brookfield") owned, directly or indirectly, approximately 70.5% of the outstanding common shares of Fraser Papers.

9. Each of the other Applicants are direct or indirect wholly-owned subsidiaries of Fraser Papers. Annexed hereto and marked as Exhibit "A" is a simplified corporate chart showing the relationship of the Applicants to one another.

10. Fraser Papers owns all of the issued and outstanding shares of FPS Canada Inc. ("FPS Canada") and Fraser Papers Holdings Inc. ("Holdings"). Holdings owns all of the issued and outstanding shares of Fraser Timber Ltd. ("Timber") and Fraser Papers Limited ("Fraser Madawaska"). Fraser Madawaska is the sole member and manager of Fraser N.H. LLC ("Fraser Gorham").

11. FPS Canada acts as agent for Fraser Papers and manages the Company's pulp, paper and lumbermill assets in Canada. These assets owned by Fraser Papers include:

- (a) a sulphite pulp mill, a groundwood pulp mill and a biomass cogeneration power plant (the "CoGen Facility") in Edmundston, New Brunswick;
- (b) a hardwood pulp mill in Thurso, Quebec;
- (c) two lumbermills in Juniper and Plaster Rock, New Brunswick; and
- (d) a corporate office in Toronto, Ontario

12. Holdings is incorporated under the laws of the State of Delaware and holds the Company's investments in Fraser Madawaska and Timber, which are the Fraser Group's operating entities in the State of Maine, in the U.S.

13. Fraser Madawaska:

- (a) owns and manages the Company’s paper operations in Madawaska, Maine;
- (b) is the sole member of Fraser Gorham, a limited liability corporation incorporated under the laws of Delaware;
- (c) is the sole member of Katahdin Services Company LLC (“Katahdin Services”) which, on behalf of the Fraser Group, manages (but does not fund) the operations of Katahdin Paper Company LLC (“Katahdin Paper”) an indirect, wholly owned subsidiary of Brookfield that owns a paper mill in Maine; and
- (d) owns 10,000 convertible, term, preferred units of Katahdin Paper and also holds an option to purchase all common units of Katahdin Paper.

14. Fraser Gorham owns and operates a paper mill in Gorham, New Hampshire.

15. Timber owns and manages the Company’s two lumbermills in Masardis and Ashland, Maine.

**B. Management of the Applicants**

16. The Board of Directors of Fraser Papers is currently comprised of five directors, including myself. Three of the directors are non-independent, as defined by the *Ontario Securities Act*, National Policy 58-201, given their relationship to the Company or the Company’s major shareholder, Brookfield. The other two directors are independent.

17. There are common officers and directors for each of the other Applicants and those persons hold such role by virtue of their position on the senior management team of Fraser Papers.

18. It is expected that all existing management will remain in place during this restructuring and there is no intention to hire a chief restructuring officer or similar officer at this time.

**C. Integration of Applicants and Center of Main Interest**

19. The Applicants are of the view that the restructuring to be undertaken under the *Companies’ Creditors Arrangement Act* (the “CCAA”) will require a review of the operations of the Fraser Group as a whole and may involve a restructuring of certain businesses and the sale of the remaining businesses and

related assets. It is anticipated that this process will require a judicial proceeding and approval in the U.S., in view of the assets and operations located there.

20. The business of the Fraser Group is fully integrated including between the Canadian and the U.S. operations. The four lumbermills supply wood chips and biomass (bark and other wood fibre residuals), byproducts of the lumber manufacturing process, to the sulphite pulp mill in Edmundston, New Brunswick. The hardwood pulp mill in Thurso, Quebec supplies pulp to the Company's two paper mills in Madawaska, Maine and Gorham, New Hampshire. The pulp and energy operations in Edmundston, New Brunswick and the paper mill in Madawaska, Maine (collectively referred to as the "East Papers Operations") are physically connected, with pipelines joining the two plants across the international border between New Brunswick and Maine. Pulp and steam are produced at the Edmundston facilities and delivered by pipeline to the Madawaska paper mill, where specialty papers are manufactured. A diagram outlining the physical location and proximity of each of the Fraser Group's facilities is annexed hereto and marked as Exhibit "B".

21. The Applicants are of the view that the restructuring of the Fraser Group will be administered most efficiently through a single, centralized restructuring process. Such a process would likely minimize the cost of the restructuring, minimize the time necessary to effect the restructuring and thereby maximize the overall value of the assets and operations for all stakeholders.

22. It is contemplated that the CCAA proceeding in Canada will be the primary court supervised process for the restructuring of the Fraser Group. While the restructuring will be undertaken in Canada, the Applicants will seek an Order pursuant to Chapter 15 of the U.S. *Bankruptcy Code* to have this proceeding recognized as a foreign main proceeding in order to facilitate the implementation of matters in the U.S. that have been approved in the CCAA proceeding.

23. The Applicants are of the view that Fraser Papers' centre of main interest ("COMI") is Ontario. Its registered head office is in Toronto and all corporate, management, banking, and strategic functions are undertaken from its head office in Ontario.

24. In support of the Applicants' position that the COMI for the other Applicants is also Ontario:

- (a) all corporate strategic decision-making for the Fraser Group occurs at the Fraser Papers' head office, and the Chief Executive Officer and Chief Financial Officer have their primary business office in Ontario;
- (b) as CEO of Fraser Papers and Chairman of each of the other Applicants I am involved, along with other members of the senior management team, in all material decisions regarding the operations of all Applicants including the terms and conditions for any material contracts and all such decisions are directed from, made in or monitored from our offices in Ontario;
- (c) budgeting for each facility is approved at Fraser Papers' head office in Ontario;
- (d) human resource policy and administration, including certain human resource functions, pension plan administration and certain compensation and benefits functions are performed and located in Ontario;
- (e) all treasury management functions including a centralized cash management system and centralized banking arrangements for the Fraser Group are conducted from Fraser Papers' head office in Toronto;
- (f) financial reporting of the Applicants is done on a consolidated basis and the audited financial statements are prepared in Ontario;
- (g) investor communications functions are undertaken at the head office;
- (h) all corporate minute books for the Applicants are located and maintained in Ontario;

- (i) each Applicant has a bank account in Ontario with at least a small credit balance;
- (j) with the exception of a term loan made available to Fraser Papers by the Province of New Brunswick (the "N.B. Loan"), all credit facilities of the Applicants are with lenders who manage such facilities in Toronto, Ontario, and all loans are advanced to Fraser Papers as borrower;
- (k) the Board of Directors' meetings are held in Ontario; and
- (l) the location of the Company's major shareholder is in Ontario.

25. As the business operations of the Applicants are functionally integrated, there are a number of suppliers, creditors and other stakeholders of the Fraser Group that are common to several of the Applicants.

26. All credit facilities and loans advanced to the Fraser Group are advanced to Fraser Papers as borrower. However, with the exception of the N.B. Loan, all of the Applicants have directly or indirectly guaranteed those credit facilities.

27. In addition, as described in more detail below, there is a significant degree of integration in the cash management arrangements among the Applicants, with the companies borrowing and advancing funds within the Fraser Group as needed, further demonstrating the integrated operations of the Fraser Group and the necessity for dealing with the restructuring in a procedurally-consolidated manner. As the operations of the Fraser Group are managed centrally at the Fraser Papers level, the Applicants are of the view that Ontario is the most appropriate forum for overseeing the restructuring of the entire Fraser Group.

### **III. THE APPLICANTS' BUSINESS**

28. The specialty papers business of the Applicants comprises two paper mills, one market pulp mill, two internal pulp mills, the CoGen Facility and four lumbermills in New Brunswick, Quebec, Maine and

New Hampshire. Fraser Papers has been in operation since the late 1800's and employed approximately 2,400 people in the U.S. and Canada as at December 31, 2008.

**A. Principal Products**

29. The principal products manufactured by the Fraser Group are paper, pulp and lumber.

*(a) Paper*

30. The Applicants' paper products can be grouped into six categories: specialty packaging, specialty printing, speciality high-bright groundwood, commodity free sheet, commodity groundwood and towel.

31. Specialty packaging papers are made to customer specifications, primarily for flexible packaging required for food products, and require a high degree of technical expertise. Specialty packaging papers are generally sold to manufacturing intermediaries (converters) who will manufacture a value added flexible package or bag through various processes based on end customer specifications. Certain specialty packaging papers require chemical treatment for moisture and grease resistance.

32. Specialty printing papers include a broad array of both coated and uncoated grades and include products that are used in thermal printing applications, label papers and for commercial printing purposes. These grades are characterized by narrow technical specifications and require unique manufacturing capabilities. Specialty printing grades are sold directly to customers or through paper merchants who have a well established distribution network. Thermal based papers are used for point-of-sale receipts, and lottery and gaming tickets. Label papers are used in a variety of packaging applications from bottling and cans and for labelling boxes, containers and luggage. Commercial printing papers are used for manuals, direct mail inserts and brochures. The Company's lightweight opaque papers are used for bibles, financial printing, pharmaceutical inserts and reference applications.

33. Specialty high-bright groundwood papers are used in commercial printing and publishing applications. These products have a blend of both groundwood and chemical pulp fibre that provide

comparable performance to traditional free sheet applications, but at a lower cost. Specialty high-bright groundwood papers are sold through merchants or directly to printers and publishers.

34. Commodity free sheet papers typically include book papers, off-set papers, tablet and envelope grades. These commodity papers are subject to significant competition from much larger paper producers due to their more generic specifications and lower technical requirements. In addition, prices for these grades tend to be more volatile than for specialty grades. Book papers are used in novels and trade books. Off-set papers, tablet and envelope papers are used in office applications.

35. Commodity groundwood papers are generally used in mass circulation publications such as directories, magazines, catalogues and advertising inserts. Commodity groundwood papers are generally sold through paper merchants and to printers and publishers.

36. Towel is primarily bleached and unbleached paper towel for the "away-from-home" market segment, typically restrooms in restaurants, airports, and other locations accessible by the public. This product is sold to converters through an agent.

*(b) Pulp*

37. The pulp mills are integrated with other parts of the Fraser Group's operations, as the wood fibre in pulp is a fundamental component in the manufacture of paper. Production of sulphite and groundwood pulp from the Edmundston, New Brunswick facility are used exclusively at the Company's Madawaska, Maine paper mill. The hardwood pulp, called northern bleached hardwood kraft pulp ("NBHK") produced at the Thurso, Quebec pulp mill, in excess of the requirements at the Company's paper mills in Madawaska, Maine and Gorham, New Hampshire is sold to customers in North America, Europe and Middle Eastern countries in Asia either directly or through agents.

38. NBHK pulp produced at Thurso, Quebec that is sold to external customers competes with similar product that is manufactured by suppliers in North America, Scandinavia, South America, Asia and other

regions. NBHK pulp is a commodity with competition essentially based on price with lesser emphasis on certain technical qualities of the product and service. Market demand is largely a function of global paper production rates in the principal markets of Western Europe, United States and Asia.

(c) *Lumber*

39. The Fraser Group produces softwood dimension lumber used in home building construction, renovation and repair. Lumber is a commodity and competition is based on price. The Applicants compete in a large, fragmented North American market that includes approximately one thousand domestic mills. Historically, demand has been cyclical and has been strongly correlated with new home building activity. Lumber is sold primarily to wholesale distributors, with some sales directly to home builders and lumber yards.

40. Wood chips and biomass are important byproducts of the lumber production process. The softwood chips from the Company's four lumbermills are a significant and secure source of wood fibre for the Edmundston pulp mill. The bark is used as a source of fuel for the CoGen Facility. In 2008, approximately 30% of the softwood chips required by the Edmundston sulphite pulp mill were supplied from the Applicants' four lumbermills, 55% were supplied from independent mills and 15% were produced at the internal chipping facilities at the Edmundston mill, albeit at a significantly higher cost.

41. Whole logs used in the production of groundwood pulp at Edmundston are (i) obtained under long term fibre supply agreements, (ii) harvested from the Applicants' crown licenced lands in New Brunswick and (iii) purchased from private land owners.

42. A chart providing an overview of the wood fibre flow in the production processes of the Fraser Group is annexed hereto and marked as Exhibit "C".

**B. Facilities**

**(a) Paper Mills**

**Edmundston and Madawaska (East Papers Operations)**

43. The Applicants' East Papers Operations is its largest paper manufacturing facility. This is an integrated complex that is located on either side of the St. John River, representing the international border between Edmundston, New Brunswick and Madawaska, Maine. The Edmundston facility produces bleached softwood sulphite pulp and groundwood pulp which are delivered via pipeline to the Madawaska paper mill in slurry form. The CoGen Facility at the Edmundston plant produces electrical power that is sold under a long term supply agreement to the New Brunswick Power Corporation ("NB Power") and byproduct steam that is delivered via pipeline to the Madawaska paper mill.

44. The Madawaska paper mill currently has five paper machines in operation with broad capabilities to produce light weight, coated and uncoated specialty papers. Since 2007, three paper machines (out of a total of eight) have been permanently shut down at the Madawaska mill. The Madawaska mill has taken market related downtime in 2009 as a result of weak demand and low prices for its products.

45. In 2009, the Madawaska paper mill has received approximately 75% of its pulp requirement from Edmundston with the remainder purchased from Thurso and third parties.

46. Following the temporary shutdown of the Edmundston and Madawaska operations on June 8, 2009, as described below, most of the East Papers Operations are expected to resume and continue throughout this restructuring, with the exception of the Edmundston sulphite mill where further efforts are required to lower costs, as discussed below. The other operations may be required to operate at reduced capacity or subject to periodic downtime based on market demand for specialty paper.

**Gorham**

47. The Gorham paper mill currently has two paper machines that produce specialty printing and commodity free sheet papers and a third machine that produces towel products for the "away from home"

market segment. The Gorham mill currently purchases its hardwood kraft pulp requirements from Thurso and the balance of its pulp requirements from third parties. During 2008, the Company announced the shutdown of two paper machines at the Gorham mill, representing approximately 40% of its manufacturing capacity.

*(b) Pulp Mills*

Thurso

48. The NBHK mill in Thurso, Quebec produces pulp for sale to the Applicants' two paper mills and on the open market. Approximately 25% of the mill production in 2008 was specialty pulp for use in the manufacture of high quality printing and writing and decorative laminated papers. Approximately 40% of Thurso's pulp production was shipped to either Madawaska or Gorham in 2008; the balance is sold to third parties.

49. Wood is supplied to the Thurso mill in both whole log form and chip form with approximately 60% of requirements from whole logs and 40% from chips. Of the total fibre supply, approximately 35% is provided from timberland under Crown licence, with the remainder purchased from third party lumbermills, in the case of chips, or logs from private wood lots.

50. The Thurso pulp mill was closed indefinitely in early June, 2009, as described below.

*(c) Lumbermills*

Plaster Rock and Juniper, New Brunswick

51. The Applicants' lumbermills in New Brunswick produce dimension lumber for sale into the northeastern U.S. market and byproduct wood chips and biomass for use at the pulp mill in Edmundston. In 2008, 100% of the chips produced at the New Brunswick lumbermills were sold to the Edmundston pulp mill and represented about 10% of all chips used by the Edmundston pulp mill. Approximately 30%

of the sawlogs for the two New Brunswick lumbermills was harvested under Crown licence or purchased under long term fibre supply contracts, with the remainder purchased from private land owners.

52. Fraser Papers is completing a capital improvement project at the Plaster Rock lumbermill in order to modernize certain areas of the manufacturing process including the boiler, kiln and saw line. These improvements are expected to reduce costs and increase productive capacity. The budget for this project is CDN\$17.6 million, with funding provided to Fraser Papers through the N.B. Loan. The modernization project is on budget and is scheduled for completion by the end of June, 2009.

53. The lumbermills at Plaster Rock and Juniper are currently closed, due to lack of demand for lumber and low prices. The market factors reflect the depressed conditions in the U.S. housing construction market.

#### Ashland and Masardis, Maine

54. The lumbermills in Maine also produce dimension lumber for sale into markets in the northeastern U.S. The majority of the byproduct chips and biomass from the mills are sold to the Edmundston pulp mill, representing 20% of all chips consumed by Edmundston, while the remainder is sold to third parties. The mills obtain a portion of their log requirements under long-term fibre supply agreements with the remainder purchased on the open market.

55. The Applicants' lumbermill in Ashland is currently closed, due to the lack of demand and poor prices for lumber. The Masardis mill re-started on May 26, 2009 to process an existing inventory of saw logs, which is expected to take approximately eight weeks, at which time it is expected to be shut down on an indefinite basis. On June 8, 2009 the Company provided employees at the Masardis mill with sixty days' notice that the mill would be closing for market reasons effective August 7 (the sawmill) and August 14 (the planer mill).

**C. Forest Resources and Crown Licenses**

56. Access to an adequate source of timber is a critical requirement for an integrated lumber, pulp and paper business. Insufficient timber resources result in an inability to obtain a sufficient volume of wood chips to make pulp, thereby requiring a pulp producer to purchase its fibre from a third party.

57. Fraser Papers previously owned timberlands in New Brunswick and Maine that were sold in 2005 and 2006. In May, 2005, Fraser Papers sold its timberland in Maine to the Heartland Forest Group for net cash proceeds of \$78 million. In January 2006 the Company sold its freehold timberlands in New Brunswick to Acadian Timber Income Fund ("Acadian") for total proceeds of \$93.5 million in cash plus 3,613,780 securities that were convertible into units of Acadian, representing approximately 22% of the equity of Acadian on a fully diluted basis. In 2007 the Company sold its remaining interest in Acadian for net proceeds of \$38.4 million. Proceeds from these transactions were used to repay indebtedness and fund operating losses.

58. At the time of the sale of the timberlands, the Company entered into twenty-year fibre supply agreements whereby the right to purchase fibre (in an amount substantially equal to the volume previously obtained from these lands when they were owned) was retained. These fibre supply agreements provide approximately 36% of the round wood fibre used in the Applicants' operations in New Brunswick and Maine.

59. In addition to the fibre supply agreements, the Applicants have licences in New Brunswick on Crown forest lands equivalent in area to approximately 1.3 million acres, subject to certain allowances for annual cutting on these Crown lands. Crown licences held by the Applicants provide approximately 30% of the round wood fibre used in the Applicants' lumbermill operations.

60. When Fraser Papers sold the New Brunswick timberlands it entered into an agreement with Acadian, whereby Acadian provided management services relating to the Crown lands for a fee. This management agreement has a term equal to the term of the Crown licences, including renewal terms.

61. All forest operators on Crown lands are accountable for their activities on these lands under the Crown licences. The Provincial licences generally include provisions for royalty fees (or stumpage charges), levy fees for reforestation and the development and care of the forests and sub-licencing requirements for certain amounts of the annual allowable cut to third parties. The Provinces have various legislative programs governing utilization of their forest resources which change from time to time, resulting in changes in land tenure and cutting rights. The major tenure agreements with the Provinces are for terms of 20 to 25 years, with provisions for renewal thereafter.

62. The Applicants' access to timber on Crown lands is subject to an allocation received from the provincial government. In New Brunswick, Fraser Papers consumes approximately 28% of the Province's fibre market (sawlogs, pulpwood, chips from sawmills or forest biomass) but receives only 9% of the total Crown wood allocations. The Applicants have been in negotiations with the Province of New Brunswick for an increased allocation of the Province's fibre supply to allow the Applicants to have access to a secure wood fibre supply that can be harvested at economies of scale. On June 5, 2009 the Province agreed to provide the Applicants with an increased fibre allocation, subject to certain terms and conditions as described in further detail below.

#### **D. Energy**

63. The Applicants require significant quantities of power to operate the various manufacturing processes at each of the mills. Fraser Papers purchases all of its power for the Canadian mills from the provincial power utilities in Quebec and New Brunswick. With the objective of establishing a competitive advantage in energy costs at the East Papers Operations, Fraser Papers' predecessor Fraser Inc. built a 38 megawatt CoGen Facility on the Edmundston site in 1995 at a cost of approximately CDN \$120 million.

64. The CoGen Facility burns approximately 800,000 tons of biomass annually to produce steam for the East Paper Operations and electricity which is sold to NB Power.

65. When the CoGen Facility was built, Fraser Papers entered into a thirty-year power purchase agreement with NB Power dated May 16, 1995 (the "CoGen Agreement") whereby Fraser Papers supplies all of the electricity produced at the CoGen Facility to NB Power. The CoGen Agreement was structured such that Fraser Papers receives two monthly payments over the term of the agreement: (i) a fixed capacity payment, and (ii) a variable payment for each unit of electricity produced. Fraser Papers negotiated a higher capacity payment in the early years of the contract, under an amortizing schedule of payments. These higher capacity payments represented, in effect, an advance on future capacity payments and Fraser Papers was required to post a letter of credit with NB Power to secure performance under the long term contract. At this time, the letter of credit is approximately CAD \$23 million and utilizes a significant portion of Fraser Papers' borrowing capacity under its revolving credit facility with CIT. A copy of the CoGen Agreement is annexed hereto and marked as Exhibit "D".

66. Under the CoGen Agreement, the purchase price for the units of electricity generated and sold to NB Power was to increase each year based on changes to the Consumer Price Index ("CPI"). Since 1997, this adjustment has resulted in a 13% increase in the price paid to Fraser Papers for the electricity produced. However, over that same time period the cost of biomass fuel used to generate the electricity has increased by approximately 300%. By 2009, this had reduced the anticipated operating margins of the CoGen Facility by approximately CDN\$15 million per year.

67. The combined effect of the reduced operating margin for power sold under the CoGen Agreement, coupled with the high price paid by the Applicants for power in the Province of New Brunswick (relative to the price paid for power in other Provinces, including Quebec and British Columbia) has resulted in a significant competitive disadvantage for the Applicants. The Applicants' East Papers Operations purchase approximately CDN\$30 million of power for its operations annually from NB Power.

68. The Applicants have requested amendments to the CoGen Agreement and to date have received relief in one area that will provide the opportunity to reduce costs and improve operating efficiency, as discussed below. In my opinion, more relief is necessary and this has been the subject of ongoing discussions with NB Power.

**E. Employees**

69. As at December 31, 2008 Fraser Papers employed approximately 2,400 people at its eight manufacturing locations in Canada and the U.S. Approximately 70% of these employees are represented by labour unions. One of the collective agreements has already expired and three other collective agreements are due to expire this year.

70. The Communication, Energy and Paper Workers Union ("CEP") represents approximately 660 bargaining employees at the Edmundston and Thurso mills. The United Steel Workers ("USW") represents employees at Madawaska and Gorham. Approximately 150 lumbermill bargaining employees at Plaster Rock are represented by the New Brunswick Regional Council of Carpenters, Millwrights and Allied Workers ("CMAW").

71. A five year Collective Agreement with the CEP in Edmundston was ratified in May 2005 and expires June 30, 2009. A six year agreement was reached with the USW in 2003 for employees in Madawaska, and expires October 31, 2009.

72. In 2006 a four year agreement covering approximately 300 employees at the Thurso pulp mill was ratified with the CEP and expired April 30, 2009. Discussions to establish a new agreement have started. In a meeting held on May 27, 2009, the employees voted favourably to amend the terms of the severance payments from six weeks after closure to twenty-two weeks, to provide for additional time to find a solution for the situation at the mill.

73. In 2008 a two year extension was negotiated to the Gorham labour agreement with the USW, which was otherwise set to expire on May 31, 2008. The current Collective Agreement with the USW for the Gorham facility expires May 31, 2010 and provides for a one time profit sharing of 10% of earnings before interest, taxes, and depreciation ("EBITDA") in excess of \$8 million in the twelve months prior to May 31, 2010.

74. The existing four year Collective Agreement with the CMAW at the Plaster Rock lumbermill expired January 31, 2009. A negotiated settlement was reached on a new five year agreement with the bargaining team representing the unionized employees but was rejected in a vote held early in 2009. The Company's offer was subsequently withdrawn and no further negotiations have taken place.

75. The Applicants' lumbermills at Juniper, New Brunswick and Ashland and Masardis, Maine are not subject to any collective agreements.

76. The Applicants have been involved in discussions with each of the unions regarding the terms and concessions required to achieve a successful restructuring of the Applicants' business. To date those discussions have not resulted in any agreements.

#### **F. Pension Plans, Benefits and Funding Issues**

77. The Applicants sponsor five defined benefit pension plans in three jurisdictions: two registered in the Province of New Brunswick (the "NB Hourly Plan" and the "NB Salaried Plan"), two registered in the Province of Quebec and one in the U.S. (individually, the "Pension Plan" and collectively, the "Pension Plans"). Fraser Papers Inc. is the plan sponsor and CIBC Mellon is the trustee for each of the four Pension Plans in Canada. Holdings is the plan sponsor and BNY Mellon is the trustee for the Pension Plan in the U.S. The two Pension Plans registered in Quebec are administered by pension committees comprised of representatives from Fraser Papers and representatives from the union or the salaried employees, as the case may be. In total, there are 2,997 retirees and 1,412 active employees who are members of the Pension Plans.

78. In addition, the Applicants have one non-registered, unfunded SERP in Canada and two unfunded SERPs in the U.S. The obligations under these SERP's are "pay-as-you-go". The Applicants also sponsor a registered defined contribution pension plan in Canada and one in the U.S.

79. Based on information received by the Company from its actuaries for the purpose of preparing the annual audited financial statements, and in accordance with GAAP, the Applicants' accrued pension benefit obligations in its five defined benefit Pension Plans and SERP's exceed the value of the Pension Plan assets by approximately \$171.5 million as at December 31, 2008.

80. In 2008, actuarial valuations as at December 31, 2007 were filed for the two registered Pension Plans in New Brunswick and one registered Pension Plan in the U.S. Actuarial valuations as at December 31, 2008 are required to be filed for the NB Hourly Plan and the one US plan during 2009. Actuarial valuations as at December 31, 2009 are required for the two registered Pension Plans in the Province of Quebec. The NB Salaried Plan requires an actuarial valuation report to be prepared as at December 31, 2010. These actuarial reports set out the annual cash contribution requirements for each of the Pension Plans.

81. Recent changes in global capital markets and borrowing rates has affected the funded status, funding requirements and pension expense associated with the Applicants' Pension Plans. Based on current market conditions, regulatory filing requirements and preliminary estimates in relation to the actuarial valuation reports as at December 31, 2008, the Applicants expect that they will be required to make special payments in respect of unfunded going concern and solvency deficiencies (the "Pension Deficits") with respect to the Pension Plans in the amount of \$13.5 million in 2009. This is in addition to \$3.3 million required to be paid in 2009 on account of normal cost contributions to the Pension Plans. The Applicants have no ability to pay the combined amount at this time.

82. Based on current market conditions, regulatory filing requirements, preliminary estimates in relation to the actuarial valuation reports as at December 31, 2008 and the last filed actuarial valuations,

the Applicants expect that contributions required to be paid to the defined benefit components of the Pension Plans in 2009 will almost double in 2010. The Applicants estimate that they will be required to pay an average of \$34.7 million per year for the years 2010 to 2013 to fund the Pension Deficits and a further \$5.1 million for normal cost contributions (for current service of members) to the Pension Plans in 2010. The Applicants expect that they will be unable to satisfy these combined funding obligations.

83. The Applicants fund post-retirement health care benefits costs on an ASO (administrative services only) and insured basis. As at December 31, 2008, the present value of the accrued benefit obligations of these post-retirement health care benefits was \$46.8 million. In 2008, the Company paid \$3.4 million to provide these post-retirement health care benefits.

84. Many of the health and related benefits payable by the Applicants to active and retired employees in Canada are funded through a Health and Welfare Trust, established by Agreement and Declaration of Trust dated January 1, 1988. A Health and Welfare Trust is a means by which trustees can receive contributions from employers and employees, where applicable, and provide, either through direct payment of benefits or through the payment of insurance premiums, the health and welfare benefits that the employer has agreed to provide.

85. The Health and Welfare Trust is a true trust arrangement with four individuals (Jean Paul Fournier, Linda Pellizzari, William Peterson and Carole Savage) currently acting as Trustees. Fraser Papers has no interest in the monies in the trust unless and until all benefits payable at any time to beneficiaries have been paid in full. At this time there is a balance of approximately \$1 million in the trust, which amount, in the ordinary course of business of the Applicants, would fund benefits payable to active and retired employees for a period of approximately four to five months. In view of the existing balance in the trust, the Applicants intend to make no further payments into this trust after the date of filing until such time as the funds are fully depleted through the payment of benefits to employees. Once these funds are depleted, the company will contribute sufficient funds to the trust in order to meet its

obligations under its retiree and employee benefit plans as they may exist at that time, subject to the provisions of the Initial Order and the DIP Financing (as hereafter defined).

86. Fraser Madawaska is party to a Deferred Compensation Plan and Deferred Compensation Plan Trust Agreement in the U.S., with Mellon Bank N.A. acting as Trustee. Participation in the program was curtailed some time ago, although two current employees and seven retired employees are Participants (as that term is defined in the agreements). The program was a means of deferring the tax payable on compensation, with Participants receiving payments either as a lump sum or over a number of years following their retirement.

87. Pursuant to the agreements referred to in the immediately preceding paragraph, the Participants have no beneficial interest in the monies in the trust, the Trustee is required to cease making payment of benefits to the Participants if Fraser Madawaska becomes insolvent, and upon the insolvency of Fraser Madawaska any money in the trust must be held by the Trustee for the benefit of Fraser Madawaska's general creditors. The Applicants intend to immediately notify the Trustee of Fraser Madawaska's insolvency and the commencement of this proceeding. There is approximately \$100,000 currently held by the Trustee.

**G. Hedging Activities**

88. Almost all of the Applicants' sales are denominated in U.S. dollars while a significant portion of the operating costs are incurred in Canadian dollars. Accordingly, financial results for the Applicants are highly sensitive to changes in the exchange rate for Canadian and U.S. dollars.

89. From time to time the Applicants hedge a portion of their net foreign currency-denominated cash flows using foreign exchange forward contracts or other derivatives. The Applicants enter into foreign exchange forward contracts, or other hedging contracts, to fix or "lock-in" the future foreign exchange for a portion of its Canadian dollar denominated costs thus reducing the risk of foreign exchange fluctuations negatively affecting the operations and cash flows of the Company.

90. The Applicants also hedge the net Canadian dollar denominated monetary liabilities on their balance sheet, as the reporting currency for the Company is in U.S. dollars and the Company has net liabilities on the balance sheet that are denominated in Canadian dollars.

91. Brookfield has provided the Fraser Group with a facility that enables the Applicants to enter into forward foreign exchange contracts as part of the Company's hedging activities, with the maximum "notional" value of derivatives outstanding at any given time being no more than \$350 million. As at May 2, 2009 the Company had \$32.7 million in foreign exchange contracts outstanding as a hedge against certain Canadian dollar-denominated net monetary liabilities. In addition, as at May 2, 2009 the Company notionally had \$160.7 million in net forward foreign exchange contracts outstanding under this facility as a hedge against future net Canadian dollar cash flows.

92. From time to time, the Fraser Group also enters into lumber forward contracts to fix the price for a portion of its future lumber sales. At this time, the Applicants have no outstanding future contracts for lumber.

#### **H. Financing Activities in 2008**

93. During 2008, the Applicants required \$73.0 million to fund cash operating losses, meet pension funding obligations and capital expenditures necessary to sustain the business. The Applicants (i) raised CDN\$60 million of equity capital from a rights offering to shareholders that was fully underwritten by Brookfield, (ii) expanded availability under the existing revolving term facility with CIT Business Credit Canada Inc. ("CIT") by \$25 million which was guaranteed by Brookfield, and (iii) secured an additional \$25 million loan under a new one year term facility with CIBC that was also guaranteed by Brookfield.

94. In addition, the Province of New Brunswick agreed to provide a CDN\$40 million six year term loan (previously defined as the N.B. Loan) with proceeds that were restricted to the financing of capital upgrades at the Edmundston pulp mill and the Plaster Rock lumbermill. At June 16, 2009, borrowings under the N.B. Loan were \$25.9 million (or CDN\$29.3 million).

95. The cash realized from these debt facilities and the rights offering provided the Applicants with immediate liquidity in 2008 but this was not sufficient to avert the financial crisis that the Applicants now face.

#### **I. Key Factors Affecting the Business**

96. The Fraser Group's operations and financial results are influenced by a number of factors, many of which are beyond the Applicants' control. The five most significant factors, in no particular order of importance, are: (i) the cyclical nature of the business; (ii) the competitive environment of the industry; (iii) product demand; (iv) cost control; and (v) foreign currency risk.

97. Other risks to the Fraser Group's business include those of general application to all capital intensive manufacturing and distribution businesses in the forest product sector. They include:

- (a) market issues such as the dramatic decline in lumber sales due to a collapse in the U.S. housing industry and a drop in global economic activity, which has reduced demand for market pulp;
- (b) the availability of, and prices for, wood fibre in its various forms including saw logs, pulp logs, softwood chips, and biomass;
- (c) the effect of U.S. pulp industry tax subsidies (often referred to as "black liquor tax credits"), as described below;
- (d) the general decline in demand for paper grades manufactured by the Applicants reflecting the lower economic activity in North America;
- (e) the effect of environmental litigation, regulatory developments and aboriginal land claims on timber supply and operations;
- (f) the effect of environmental and other government regulations on the cost of doing business;
- (g) an increase in the cost of purchased energy including oil and other raw materials, leading to higher manufacturing costs, thereby reducing operating margins;

- (h) trade restrictions regarding trade in softwood lumber products between the U.S. and Canada;
- (i) operational risks for which adequate insurance may not be available;
- (j) mill shutdowns for unscheduled maintenance or lack of demand;
- (k) labour disruptions;
- (l) insufficient capital to maintain the operating facilities; and
- (m) financial obligations including long term debt, guarantees, indemnities and pension obligations.

98. The manufacture of pulp and paper is a capital intensive business requiring a significant investment in large machinery and equipment. The geographical breakdown of property, plant and equipment at the end of 2008 was 47% in the United States and 53% in Canada. A significant portion of the Applicants' operating costs are incurred in Canadian dollars, while almost all of the Applicants' sales are transacted in U.S. dollars. Therefore, an increase in the Canadian dollar relative to the U.S. dollar increases the Applicants' operating costs relative to sales, which reduces the operating margins and the cash flow available to fund the Applicants' operations. As a result, the significant fluctuations in relative currency values over the past twelve to eighteen months has negatively affected the cost competitiveness of some of the operating facilities, the value of the Applicants' foreign investments and ultimately the financial position of the Fraser Group.

99. In addition, certain U.S. pulp and paper companies are currently benefiting from a significant tax credit available to those who operate kraft pulp mills. The original legislation, entitled the *Safe, Accountable, Flexible, Efficient Transportation Equity Act*, enacted in 2005, was designed to encourage the use of alternative fuels, like ethanol, to reduce the consumption of diesel fuel in highway vehicles. In late 2008 certain U.S. pulp mills identified a loophole in this legislation that would enable them to receive

a tax credit by adding diesel fuel to "black liquor", which has been burned as a fuel in recovery boilers in pulp mills for many years. Black liquor is a residue byproduct of the traditional kraft pulping process.

100. The Applicants believe that this tax credit has produced the opposite effect to the intended result, as pulp operators have begun to add diesel fuel that was not previously required or used in their pulping process. Industry analysts have estimated that this tax credit is now widespread in the U.S. pulp industry, and is subsidising the oversupply of kraft pulp and the paper manufactured from it during a time when the market is already weak. The Applicants' estimate that the black liquor tax credit is worth between \$150 to \$200 per ton of pulp produced, which translates to a savings of 30 to 40 % of the cost of production. The Applicants are not able to take advantage of the tax credit, which creates a significant competitive disadvantage for the Applicants relative to U.S. pulp producers who can claim the tax credit.

101. The Applicants were able to address the combined negative impact of these factors through the financing activities described above and by reducing working capital levels to cover losses and fund required pension and other obligations. The Fraser Group is now experiencing a severe liquidity crisis and has immediate and pending financial obligations that it is unable to pay.

**J. Bank Accounts and Cash Management**

102. The Applicants operate a centralized cash management system. Daily financial requirements of the Applicants are funded by a revolving operating facility with CIT that is provided to Fraser Paper as borrower, with an unlimited guarantee from each of the other Applicants.

*Funding of Canadian Operations*

103. Fraser Papers maintains Canadian dollar and U.S. dollar corporate bank accounts in Toronto to facilitate the funding requirements for the entire Fraser Group. Canadian dollar and U.S. dollar accounts are also maintained by Fraser Papers for each of the Canadian facilities (Edmundston, Thurso, Plaster Rock and Juniper) to fund mill operations and receive tax refunds. The mill accounts are funded from

Fraser Papers' Canadian dollar or U.S. dollar corporate account, depending on whether the required disbursements from the mill account are denominated in Canadian or U.S. dollars. Fraser Papers has a Canadian lockbox account in Toronto to receive all deposits for Canadian dollar denominated sales made by the Canadian mills. Fraser Papers also maintains a lockbox account in the U.S. to receive deposits for U.S. dollar denominated sales. In addition to these primary cash management accounts, Fraser Papers maintains three accounts which are used as impressed accounts for payroll disbursements to employees and other miscellaneous activity.

104. The primary bank accounts for each mill are swept daily to Fraser Papers' corporate account, which provides the necessary funds for daily disbursements. This activity leads to interdivisional account balances between the various divisions. These balances are not paid but allowed to accumulate, and are then cleared infrequently. These balances eliminate at the legal entity level for divisions within Fraser Papers.

#### *Funding of U.S. Operations*

105. Similar banking arrangements exist with respect to the plants owned and operated by the U.S. subsidiaries of Fraser Papers. Holdings maintains a Canadian and U.S. dollar corporate account in the U.S. Separate U.S. dollar bank accounts are maintained for each of the mills in that jurisdiction (Fraser Madawaska, Fraser Gorham, and Timber) to fund disbursements relating to that mill. The Applicants' U.S. operations are funded in part from the receipts generated from daily operations and these receipts are used to fund their disbursements, both to third parties and to Fraser Papers. These cash receipts are deposited to three lockbox accounts that are controlled by Fraser Madaawaska and Timber, to receive deposits for all U.S. sales of the U.S. Applicants. Any shortfall or excess cash in each of the U.S. Applicant's accounts is swept to the Holdings' corporate account. Holdings will generally use any excess funds to repay amounts owing to Fraser Papers. Any shortfall in the Holdings corporate account will be funded by Fraser Papers as described below.

106. Holdings, Fraser Madawaska and Timber also have bank accounts in Canadian dollars to fund disbursements in this currency. Similar to the U.S. dollar accounts, any shortfall or excess in the Fraser Madawaska or Timber accounts is swept to the Canadian dollar Holdings' account which, in turn, is funded by the U.S. dollar account.

107. Each of Timber, Fraser Madawaska, and Fraser Gorham also have bank accounts in Canada to facilitate any cash flows that may occur directly between Fraser Papers and its indirect, wholly-owned subsidiaries. These accounts are rarely used, as all funding of the U.S. operations occurs through intercompany loans between Fraser Papers and Holdings.

108. Funding between Fraser Papers and Holdings is effected through an inter-company revolving working capital line note agreement dated July 20, 2005 and amended in August, 2007 (the "Intercompany Note Agreement"), a copy of which is attached hereto and marked as Exhibit "E". Holdings owed Fraser Papers approximately \$71.8 million as at May 2, 2009 under the Intercompany Note Agreement.

109. The amount outstanding under the Intercompany Note Agreement decreases as any excess cash in Holdings is paid to Fraser Papers. The amount outstanding under the Intercompany Note Agreement increases if Fraser Papers is required to fund any cash shortfalls in Holdings.

110. Each of the Applicants has their own accounts payable function. Fraser Madawaska performs the accounts payable function for the Madawaska, Maine, Edmundston, New Brunswick and Portland, Maine locations.

111. It is anticipated that the Fraser Group will continue to use the existing cash management system and will continue to maintain the bank accounts and funding arrangements already in place. This approach will minimize any disruption to the business operations of the Fraser Group as it seeks to restructure its affairs. CIT and Brookfield, who have each indicated that they will make DIP Financing

(as hereafter defined) available to the Applicants if the Initial Order is granted, have confirmed that they support the continued operation of the existing cash management system during the CCAA proceedings.

#### IV. CURRENT STATUS OF THE COMPANY

##### A. Financial Status

112. Fraser Papers' annual audited financial statements are prepared on a consolidated basis and include each of the other Applicants. The most recent audited statements are for the fiscal year ending December 31, 2008, a copy of which is annexed hereto and marked as Exhibit "F".

113. The Applicants have also prepared consolidating financial statements for the Fraser Group as at May 2, 2009, a copy of which is annexed hereto and marked as Exhibit "G".

114. On a consolidated basis the Fraser Group has experienced negative EBITDA for three consecutive years, including negative EBITDA of \$33.6 million in 2008 and \$41.9 million in 2007. The Fraser Group had negative EBITDA of \$11.8 million in the first quarter of 2009.

##### *a) Indebtedness to Lenders*

115. Loans have been provided to Fraser Papers by each of CIT, CIBC and the Province of New Brunswick. Brookfield has guaranteed certain of these loans. In addition, Brookfield has provided Fraser Papers with a facility in the notional amount of \$350 million to facilitate the Applicants' foreign currency hedging activities, as discussed above. The amounts owing as at May 2, 2009, the date of the most recent internal financial statements, and the security or guarantees held by each lender are as follows:

<u>Lender</u>	<u>Authorized Principal Amount (Outstanding Amount)</u>	<u>Guarantees or Security Held</u>
CIT	\$115M (\$60M)	Unlimited guarantee from each of the other Applicants; first charge over inventory and accounts receivable of each Applicant. \$25M of the outstanding amount is guaranteed by Brookfield.
CIBC	\$25M (\$25M)	None from the Applicants. \$25M of the amount owing to CIBC is guaranteed by Brookfield
Province of New Brunswick	CDN\$40M (CDN \$29.3M)	First charge over fixed assets in New Brunswick and second charge on inventory and accounts receivable in New Brunswick
Brookfield	\$50M in guarantees above, plus any exposure under hedging facility.	Guarantees and security over all assets granted by each Applicant in favour of Brookfield. Security is subordinate to CIT and Province of New Brunswick.

116. Other than in respect of equipment leases, purchase money security interests or similar arrangements, and specific agreements involving (i) Export Development Corporation for the refund of softwood lumber deposits; and (ii) Royal Bank of Canada in respect of a cash collateral agreement relating to a former employee's pension proceeds, no other parties have a registered security interest against any of the Applicants in Ontario, Quebec or New Brunswick. Summaries of searches conducted under the *Personal Property Security Act* against each of the Applicants in the Provinces of Ontario and New Brunswick and equivalent searches conducted in Quebec are annexed hereto and marked as Exhibit "H".

117. Similarly, other than in respect of equipment leases, purchase money security interests or similar arrangements, no other parties have a registered security interest against any of the Applicants in Delaware, Maine or New Hampshire. Summaries of searches conducted pursuant to the *Uniform Commercial Code* in respect of each of the Applicants in Delaware, Maine and New Hampshire are annexed hereto and marked as Exhibit "I".

118. The amount outstanding under the revolving facility provided by CIT includes approximately \$40 million in letters of credit issued by CIT at the request of the Applicants. These include LCs totalling approximately \$1.7 million in favour of certain trade suppliers, an LC for approximately CDN\$23 million in favour of NB Power for any potential future liquidated damages under the CoGen Agreement, three LCs totalling approximately \$3.7 million to secure environmental obligations in respect of a U.S. landfill site in the State of Wisconsin that the Fraser Group no longer owns (the "Wisconsin Landfill") and \$14.4 million to secure potential workers' compensation obligations in the U.S.

119. As detailed below, Brookfield is prepared to provide DIP Financing (as later defined) to the Applicants during this restructuring process and CIT has also indicated that it is prepared to continue to extend credit to the Applicants to support the Applicants' efforts to restructure through a CCAA proceeding, in each case in accordance with the form of Initial Order sought by the Applicants.

(b) *Other Liabilities*

120. As at May 2, 2009, the most significant liabilities of the Applicants, other than their indebtedness to the lenders described above, are as follows:

	(\$millions)
Trade Creditors	\$74
Environmental Costs (net present value of projected future landfill expenses)	\$11.2
Other Liabilities	<u>\$0.2</u>
	<b>\$85.4</b>

121. In addition, the net obligations associated with the Applicants' Pension Plans, SERPS, and retiree benefit plans as at December 31, 2008 (as determined in accordance with GAAP) total \$218.3 million.

122. The Applicants are unable to pay these liabilities generally as they become due and they are insolvent. In addition, the above schedule does not include amounts relating to termination or severance obligations payable under any statute, collective agreement or otherwise. As certain mills are currently

shutdown and may be for an extended period of time, those liabilities may be substantial and the Applicants have no ability to pay such amounts at this time.

123. Certain of the Applicants are also parties to litigation or arbitration that is pending or has been threatened in Canada and the U.S. The Applicants are not able to estimate the likely outcome or quantum of any potential liability at this time, but will review these matters with the Monitor as part of this proceeding.

**B. Inter-Company Accounts**

124. Due to the manner in which the Fraser Group operates as an integrated business and the existence of a centralized cash management system, there are significant inter-company amounts owing among the various members of the Fraser Group at any given time. The Applicants propose to have the Monitor report on the intercompany amounts as part of this proceeding.

125. The Fraser Group uses intercompany accounts to manage activities between its various locations, and these activities are recorded on a location (rather than a legal entity) basis. For example, the Canadian operations of Fraser Papers consist of five locations (Toronto, Thurso, Edmundston, Plaster Rock and Juniper). General ledgers are maintained for each to record all activity relating to that group. The intercompany activities among the various operations can be broadly grouped as: (i) the purchase of goods (pulp, power, steam, chips and biomass) manufactured by one mill and sold to another; (ii) allocation of services paid by one operation but charged to another; (iii) other miscellaneous activity between locations, and (iv) daily movement of cash between individual mill and corporate bank accounts, as described below.

*Purchase of Goods*

126. The largest intercompany transactions relate to the sale of pulp manufactured by the Edmundston and Thurso pulp mills to the Applicants' U.S. paper mills in Madawaska and Gorham. In addition, the Edmundston mill sells power and steam to the Madawaska paper mill to support its operational

requirements. The Madawaska mill is heavily reliant upon the Edmundston mill for its steam, power and certain kinds of pulp, making the Edmundston facility a critical supplier to the Madawaska mill.

127. The Fraser Group's lumbermills in New Brunswick and Maine generate byproduct chips and biomass in the manufacture of dimension lumber. These byproducts are sold to the Edmundston pulp mill as raw materials to support the production of pulp (chips) and power or steam (biomass).

128. Each month the resulting intercompany receivables and payables are transferred from the local mill ledgers to the corporate ledger maintained for the Canadian and U.S. operations (FPS Canada as agent for Fraser Papers in respect of the Canadian operations and Fraser Madawaska for the U.S. operations). For example, on a monthly basis Edmundston's receivable from Madawaska for the sale of pulp, power and steam is transferred to FPS Canada, which maintains the corporate general ledger for the Canadian operations. Similarly, the Madawaska payable to Edmundston is transferred to the corporate Fraser Madawaska general ledger. The resulting balances between the Canadian and U.S. corporate accounts are cleared monthly, as described below.

#### *Allocation of Services*

129. There are a number of services or costs that are managed centrally by the Fraser Group's head office, which are then allocated to the individual mills to reflect their appropriate share of benefits received. These items are summarized below and are allocated to the mills by way of intercompany charges on a monthly, quarterly or annual basis:

- (i) Insurance – insurance premiums are centrally negotiated and paid and each operation is allocated their share of various insurance policies based on insured values or sales, depending on the nature of the policy
- (ii) Letter of Credit ("LC") – letter of credit standby fees are paid centrally and allocated to each operation based on the issuance of mill specific LCs
- (iii) Pension and OPEB expenses – are calculated centrally and allocated to each operation based on based on plan members and retirees attributable to each operation

- (iv) Workers' compensation – benefits are paid centrally and allocated to the operations based on actual claim payments
- (v) Procurement and research – the costs associated with centralized functions are allocated to mills based on estimated (procurement) and actual (research) time spent on specific mill needs
- (vi) Hedging gains/losses – realized gains or losses on hedging programs (foreign exchange and commodity) are received or paid centrally and are allocated to mills based on their actual Canadian dollar denominated cash flows or lumber shipments as the case may be.

130. In addition, there are services managed at the mill level that benefit one or more other locations. These actual costs are charged or allocated to other mills by way of intercompany accounts and can be summarized as follows:

- (i) services provided by Edmundston to Thurso, Plaster Rock and Juniper
  - certain employee benefits (Blue Cross, workers' health and safety)
  - information technology services
  - medical services
- (ii) services provided by Madawaska to Edmundston and Gorham
  - information technology services
  - medical services (Edmundston only)

*Miscellaneous Charges*

131. There are a number of one-time and recurring charges that are allocated between the various operations to reflect an appropriate allocation of costs. Some of the larger or recurring transactions are as follows:

- (i) Payroll
  - Generally payroll at each location is aligned with staff at that location, but when staff are seconded or transferred to another location, payroll adjustments are corrected by intercompany charges.
  - Edmundston's weekly payroll is funded from the corporate FPS Canada account instead of its local bank account. The cost is allocated to Edmundston through an intercompany charge.
- (ii) Payments

- A number of significant Canadian suppliers request that payment be made by wire transfer. As wire transfers can only be processed centrally, payments are made from the corporate FPS Canada bank account and charged to the respective mill through an intercompany entry.

(iii) Canadian Sales

- To ease administration, paper sales to Canadian customers are transacted as an initial sale by the U.S. paper mill (Madawaska or Gorham) to the Edmundston mill. The Edmundston mill then sells the paper to the customer, but is charged for the purchase of goods through intercompany accounts.

(iv) Temporary transfers of goods and services

- On occasion a mill may provide additional services such as storage or training, or lend equipment to another location on a one-time or temporary basis. To reflect the use of these goods or services, charges are posted to the intercompany accounts of these mills.

***Banking, Clearing and Accounting***

132. Local bank accounts for each mill are "zero balanced" daily and cleared to the corporate head office bank accounts. Under this process, daily mill disbursements are funded by the corporate accounts. Canadian bank accounts are cleared to a Fraser Papers' account and U.S. accounts are cleared to a Fraser Holdings account. The offsets to these transfers are intercompany liabilities between the respective entities. These intercompany balances are not cleared regularly and are allowed to accumulate as described below.

133. Cash requirements of the U.S. operations are funded by the Intercompany Note Agreement between Fraser Papers and Fraser Holdings, as described above. As such, if net cash is required by one of the U.S. subsidiaries to pay third party suppliers or pay Canadian purchases from the previous month, it is borrowed by Fraser Holdings from Fraser Papers through the Intercompany Note Agreement. Fraser Papers, as needed, will borrow the necessary funds from its revolving facility with CIT.

134. Monthly mill balances are transferred to the corporate ledgers maintained by FPS Canada (for the Canadian operations) and Fraser Madawaska (for the U.S. operations). Balances due and from operations within each respective country are not paid but allowed to accumulate, subject to infrequent clearing. The

balances among the Canadian operations are effectively offset, as they are all owned by the same legal entity. As the U.S. operations are owned by separate legal entities, they are not offset but effectively eliminated when consolidated financial reporting is prepared for the Fraser Group.

135. Balances due between Canadian and U.S. operations as a result of the purchases of goods or services are paid in cash monthly in the month following the date of the transaction.

136. Intercompany balances are presented in the Applicants' internal financial reporting as balances due between related parties, which eliminate upon consolidation.

### C. Causes of Insolvency

137. The Applicants have not generated positive cashflow from operations for three consecutive years. Negative cash flow from operations (prior to changes in non-cash working capital) equalled \$65.4 million and \$55.5 million in 2007 and 2008 respectively, combined with a further shortfall of \$9.7 million in the first quarter of 2009.

138. During the first quarter of 2009, the Company funded its cash flow shortfall through the reduction in working capital of \$34.2 million, principally through the sale of finished goods inventory. The Company no longer has the ability to finance its cash flow shortfall.

139. The aforementioned cash flow shortfalls are being driven by a sharp deterioration at the Company's pulp operation at Thurso, Quebec, continuing losses from its lumber operations and are only partially offset by the turnaround in its specialty papers business. In particular:

- (a) a collapse in demand and the market price for hardwood pulp led to EBITDA losses of \$10.7 million in 2008 from a break-even situation in 2007. In the first quarter of 2009, the Company lost a further \$8.7 million in EBITDA at its pulp mill in Thurso, Quebec. On June 1, 2009, the Company indefinitely closed the Thurso pulp mill. The outlook for hardwood pulp remains poor and the situation has been exacerbated by the impact of the black liquor tax credit, referred to above;

- (b) continuing operating losses in the Company's four lumbermills of \$22.0 million and \$13.2 million in 2007 and 2008 respectively, reflect market conditions for dimension lumber used in housing construction and renovation. In the first quarter of 2009 these lumbermills had a further operating loss of \$4.1 million. As the outlook for the U.S. home building industry remains poor, the Company does not expect an improvement in the demand or price for its lumber. The Company's four lumbermills produced at only 16% of capacity during the first quarter of 2009; and
- (c) improvements in the financial results at the Company's specialty papers business have not been able to offset losses in its pulp or lumber operations. In the first quarter of 2009, the Company reported EBITDA of \$1.7 million from its specialty paper operations, following losses of \$9.7 million and \$19.7 million in 2008 and 2007, respectively. These improvements reflect achievements in product development and sales mix, operating efficiency and productivity, and energy efficiency.

140. Under the current collective agreement, two severance payments of \$3.9 million each to unionized employees at the Thurso pulp mill are due on November 9, 2009 and December 21, 2009 following the mill's closure on June 1, 2009. The Applicants have no ability to pay these amounts at this time.

141. As at June 16, 2009 the Applicants have a total of \$66.7 million of loans outstanding: \$15.8 million drawn and utilized under a revolving working capital facility with CIT (not including \$40.8 million in LC's issued at the request of the Applicants), \$25.9 million borrowed under the N.B. Loan and \$25 million under a term loan with CIBC. The Applicants are required to repay or refinance the \$25 million term loan in September 2009 and they have no ability to do so at this time.

142. As described above, the Applicants' accrued pension benefit obligations in its five Pension Plans and SERP's exceed the value of the Pension Plan assets by approximately \$171.5 million as at December 31, 2008, as determined in accordance with GAAP. The Applicants are required to make payments of \$3.5 million by September 30, 2009 and an additional \$10.1 by December 31, 2009. Average annual payments of approximately \$34.7 million per year for the years 2010 to 2013 are expected to be required

to fund the Pension Plans. The Applicants' efforts to obtain a one-year funding holiday to address the deficit have not been successful. Without a funding holiday or another funding formula, the Applicants have no ability to meet these funding obligations.

143. Collective bargaining agreements at Plaster Rock, New Brunswick and Thurso, Quebec to which Fraser Papers is a party have expired. Similar agreements at Edmundston, New Brunswick and Madawaska, Maine expire on June 30, 2009 and October 31, 2009 respectively, and negotiations concerning Fraser Papers' request for terms and conditions required to achieve a successful restructuring of the Applicants' business have not led to any resolution to date.

144. The Applicants currently owe trade suppliers in excess of \$10 million beyond normal credit terms and owe an additional \$7.7 million in outstanding property taxes to six municipalities.

#### **D. Efforts to Restructure**

145. Over the past three years the Applicants have taken steps to address the challenges facing them and the industry generally, by implementing a number of initiatives to grow their specialty papers business, reduce their exposure to hardwood pulp and lumber markets and lower operating costs through reductions in highest cost capacity, process efficiencies, higher productivity and energy conservation, as described in further detail below.

146. In 2006, the Applicants permanently shut their 250,000 ton per year hardwood pulp mill in Berlin, New Hampshire that was integrated with the Gorham paper mill; increased shipments of specialty papers by 9%; and sold timberlands in New Brunswick while retaining a long term supply agreement. Proceeds of the sale of the timberlands were used to reduce debt by \$57 million and fund pension obligations of \$37 million.

147. In 2007, the restructuring initiatives included a major rebuild of the recovery boiler at the Edmundston sulphite mill to expand its productive capacity and lower costs; the closure of the two

smallest and highest cost paper machines at the Madawaska mill, representing 15% of the manufacturing capacity; the closure of an oil fired boiler and turbine at Edmundston and the closure of one paper machine representing 20% of the capacity at Gorham. In response to a deterioration in the lumber markets, mill operations at the four locations were curtailed by 50% over levels in 2006 once a supply of softwood chips was secured from alternative sources.

148. During 2008 the Applicants grew the value added paper business by increasing shipments of specialty packaging papers by 11% and high-bright groundwood papers by 35%. Higher paper prices were secured and the Fraser Group achieved a 7% increase in the average realized price of its paper products. This generated an additional \$34 million in revenue. In addition, the Applicants' pipeline of new products under development was expanded in 2008 to include approximately 50 new projects at various stages of development from concept to commercial launch. The Applicants estimate that the combined benefit from the product mix improvements added \$13 million to the Fraser Group's bottom line for 2008. In 2008 the Fraser Group also increased productivity and throughput by 6% at the paper mills, and capital projects at the Edmundston pulp mill provided a similar 6% improvement in throughput.

149. Despite these significant initiatives undertaken by the Fraser Group, the Applicants experienced significant uncontrollable cost pressures from fibre, energy and chemical pricing and Canadian/U.S. foreign exchange, which totalled \$52.4 million in 2008 compared to the prior year, and led to negative EBITDA of \$34 million in 2008.

#### *Recent Mill Shutdowns*

150. On June 1, 2009 the pulp mill at Thurso, Quebec was indefinitely closed due to the market conditions that have led to unsustainable cash losses. The Thurso facility will remain closed until market conditions improve or a solution can be found to mitigate the cash drain on the Applicants.

151. On June 8, 2009, a complete facility shutdown was undertaken at Edmundston involving the (i) groundwood paper mill; (ii) sulphite pulp mill; and (iii) CoGen Facility. The CoGen Facility and

groundwood mill are scheduled to undergo annual maintenance. The CoGen Facility restarted operations on June 12, 2009 and the groundwood mill is expected to restart on or about June 18, 2009. The re-start of the sulphite pulp mill is dependent upon whether the Applicants are able to lower operating costs at the sulphite pulp mill, including reaching new terms and conditions under a collective agreement with the unions representing the employees at that mill, as discussed below.

152. At this time the Applicants' paper mills in Madawaska, Maine and Gorham, New Hampshire will continue to operate, although at capacity rates that will be dependent on customer orders and the Applicants' ability to source an adequate fibre supply.

*Negotiations with Stakeholders*

153. The Applicants have approached the Ministry of Economic Development, Innovation and Export of the Quebec Government with a proposal requesting \$45 million of equity and debt financing for a new subsidiary company that would own and operate the Thurso pulp mill. The financing requested would be sufficient to fund future operating losses, capital expenditure requirements and pension funding obligations and allow the mill to re-start. At the same time, the Applicants have begun negotiations with their unionized employees at Thurso toward a new collective agreement with terms and conditions that would involve wage and benefit concessions necessary to attract the necessary financing. Discussions with the Quebec Government and the unionized employees are continuing.

154. The Applicants have requested the Ministry of Natural Resources in New Brunswick ("MNR") to agree to an additional allocation of Crown fiber in proportion to their size and share in the provincial forest products industry. The Company currently has approximately 400,000 cubic meters of crown sawlogs, pulplogs and chips and has requested additional crown fibre in various forms. The Applicants believe that the right to access crown fibre that allows it to utilize economies of scale is a critical piece to its long term competitive position, and is fair and reasonable in the circumstances. On June 5, 2009, the MNR provided the Applicants with an increase from 9% to approximately 20% of the crown allocation in

the Province. This increase in allocation is conditional upon the Company achieving cost reductions at its operations in New Brunswick.

155. The Applicants have approached NB Power with respect to an amendment to the terms and conditions under the CoGen Agreement that would provide a more appropriate index for changes in the price paid for biomass fuel, a more favourable price for the renewable power produced by the CoGen Facility and a number of other material changes that would either lower the cost of operation of the CoGen Facility or increase the price of electricity sold from it. While no final agreement has been reached, the parties have agreed that the Company can include power produced from an additional, more efficient turbine generator under the CoGen Agreement, providing the opportunity for Fraser Papers to generate electricity more efficiently using less biomass. This change should also reduce the requirement to operate one additional boiler during the winter months in Edmundston.

156. In February 2009, the Applicants received an extension in the amortization schedule of its pension funding obligations in New Brunswick from five years to ten years. This relief was retroactive to 2008 and reduced the pension funding required for 2009 by approximately \$5.0 million.

157. In April, 2009 the Applicants requested a one year pension funding holiday from the pension regulators in New Brunswick and Quebec. These requests were denied. Discussions have continued with the New Brunswick Government on a pension funding solution and the Applicants understand that the New Brunswick Government is studying the situation on a broader level.

## **V. FILING FOR PROTECTION**

### **A. Overview of Restructuring Plan**

158. The Applicants intend to immediately prepare the framework of a restructuring plan that will form the basis of a formal plan to be presented to creditors as soon as possible. Key criteria will be new arrangements for crown allocation of timber in New Brunswick, re-establishing a competitive energy

position with respect to electricity and steam, and achieving lower operating costs at both Edmundston and Madawaska. In addition, the economic relationship with unionized employees will have to be brought to a level that allows Fraser Papers' products to be produced at a cost that is competitive. It is anticipated that certain operations or mills that are considered non-core to this business may be sold or otherwise discontinued as part of a restructuring of the Fraser Group as a whole.

#### **B. Cash Flows**

159. The Applicants' have prepared estimated cash flow forecasts for the period June 18, 2009 to July 17, 2009 on a consolidated basis (the "Cash Flow Forecast"). As described above, the factors influencing the Cash Flow Forecast are both volatile and variable. A copy of the Cash Flow Forecast is attached as Exhibit "J" to this Affidavit.

160. The proposed Monitor in this proceeding, PricewaterhouseCoopers Inc. ("PwC"), has reviewed the Cash Flow Forecast. The Cash Flow Forecast indicates that, in the absence of any DIP Financing, the Applicants will have insufficient cash with which to operate after June 30, 2009. The Applicants' need for protection is immediate and urgent.

161. The Cash Flow Forecast contemplates payment of current pension funding obligations only, as the terms of the DIP Financing prohibit the payment of any special payments including as it relates to the solvency deficit or going-concern deficit.

#### **C. DIP Financing**

162. Due to the insolvency of the Applicants, the Fraser Group will require additional funding in order to implement this restructuring. Brookfield and CIT have both agreed to provide debtor in possession financing ("DIP Financing") to the Applicants up to the aggregate amount up to \$46 million, subject to the Applicants obtaining an Initial Order in this proceeding on the terms requested granting Brookfield and CIT a charge over all property, assets and undertaking of the Applicants in priority to all creditors except CIT in respect to its existing security, to secure the DIP Financing. Term sheets describing the

amount, priority, terms and conditions of the DIP Financing to be provided by Brookfield and CIT are annexed hereto and marked as Exhibits "K" and "L", respectively.

163. I understand that Section 5.7(d) of Multilateral Instrument 61-101 "Protection of Minority Security Holders in Special Transactions" under the *Securities Act* (Ontario) requires that Fraser Papers seek minority approval of its security holders before completing the DIP Financing transaction, by virtue of Brookfield's majority interest in Fraser Papers. I also understand that Multilateral Instrument 61-101 provides an exemption from the minority approval requirement where the transaction is subject to court approval under applicable bankruptcy or insolvency law and the court is advised of the minority approval requirement.

164. The Applicants seek a provision in the Initial Order confirming the disclosure by the Applicants of this requirement and dispensing with the need for compliance.

165. Brookfield provides existing financial support to the Applicants in various forms. In addition to the guarantees it has provided to the Applicants' lenders, as described above, Brookfield and Fraser Papers are party to a paper supply agreement dated January 29, 2009 (the "Paper Supply Agreement") whereby Brookfield purchases paper inventory from Fraser Papers that it then sells to third party customers. A copy of the Paper Supply Agreement is annexed hereto and marked as Exhibit "M".

166. Under the terms of the Paper Supply Agreement, Fraser Papers receives payment for the sale of paper to Brookfield within approximately two business days, whereas Brookfield receives payment from its customers approximately 15 to 60 days thereafter. Fraser Papers acts as collection agent for Brookfield and all receivables relating to Brookfield's sale of paper are collected by Fraser Papers and remitted to Brookfield. The Paper Supply Agreement also includes terms with respect to the payment and reimbursement of freight and warehousing costs as between Brookfield and Fraser Papers.

167. In view of the availability of DIP Financing to be extended by Brookfield and in accordance with the terms and conditions precedent to such funding, by agreement of the parties Brookfield's obligation to purchase paper inventory from Fraser Papers from and after the date of the Initial Order will terminate, with all other terms and conditions continuing to apply. Fraser Papers will continue to collect on Brookfield's behalf the outstanding receivables in respect of paper sold under the terms of the Paper Supply Agreement (for which Fraser Papers will have already received payment from Brookfield) and will remit the proceeds to Brookfield. Fraser Papers will also continue to make payments for freight and warehousing costs incurred while inventory was being purchased by Brookfield, for which it will be reimbursed by Brookfield. The Initial Order sought by the Applicants includes a provision authorizing these arrangements in accordance with the terms of the DIP Financing and the Paper Supply Agreement.

168. The Monitor will provide oversight and will report to the Court with respect to the Applicants' actual results relative to the estimated Cash Flow Forecast during this proceeding. The Applicants' existing accounting procedures will provide the Monitor with the ability to track the flow of funds among the various Applicants, and the non-priming intercompany charges to be created among the Applicants, as described below, will ensure that no creditor of an Applicant is prejudiced by any inter-company activity during the continuation of this proceeding.

**D. Chapter 15 Proceeding in the U.S.**

169. As the U.S. subsidiaries are incorporated under the laws of Delaware and Maine, and because the Fraser Group has operations in the U.S., the Applicants will be seeking recognition of these proceedings as the foreign main proceeding by the U.S. Bankruptcy Court. Accordingly, if an initial CCAA order and a stay of proceedings are granted, the Applicants intend to immediately commence auxiliary proceedings under Chapter 15 of the U.S. *Bankruptcy Code* pursuant to which they will seek to have the CCAA proceedings and this Court's order recognized and enforced in the U.S. as a foreign main proceeding. This will include an immediate request for a temporary restraining order granting provisional relief under

the U.S. *Bankruptcy Code* and preventing any steps from being taken that would impair the Applicants' ability to carry on its business operations in the U.S., pending further order of the Court.

170. The Chapter 15 Petitions to be filed will name Fraser Papers as the Foreign Representative in respect of each Applicant.

**E. The Initial Order**

171. Fraser Papers' Board of Directors is comprised of five directors, representing a diverse base of business skills and experiences. These directors have considerable knowledge and experience in dealing with the business of the Fraser Group, and have provided direction to management on several key initiatives undertaken over the past several years. The Applicants are of the view that the continued participation of the existing directors and officers will be a key element to a successful restructuring.

172. I am concerned that certain of the directors and officers may receive advice to resign if they are not granted the protection of a Directors' Charge as provided for in the draft Initial Order. I also believe that, given their experience in the affairs of the Applicants, the services of the directors and officers are essential to a successful proceeding and that the Directors' Charge over all the assets of the Applicants should therefore be granted.

173. Management estimates that the priority payables in respect of which the directors have personal liability at any point in time during the CCAA process is approximately \$20 million, taking into account approximately 2,400 employees. This amount does not include any termination or severance payments that may at any time be owing. The Applicants therefore request a Directors' Charge in the amount of \$30 million to secure such obligations. The Applicants have sought guidance from the Monitor in respect of comparable CCAA filings in suggesting this number.

174. The Directors' Charge requested in the Initial Order will be in addition to the existing directors' and officers' insurance policies (collectively, the "D&O Policies"). The primary policy has a limit of \$25

million and there is an excess policy for \$25 million. In addition, Endorsement 10 of the D&O Policy is a reinstatement endorsement whereby if the \$50 million in coverage is exhausted, the primary insurer will reinstate for an additional \$25 million in coverage.

175. The Applicants also request that the Court grant a charge in favour of the Applicants' counsel and in favour of the Monitor and its counsel, to secure the payment of fees and expenses incurred in connection with this proceeding. The Applicants seek an Administration Charge in the amount of \$750,000, to secure payment of the fees and expenses of the Applicants' counsel, the Monitor and its counsel.

176. As described above, due to the integrated manner in which the Fraser Group operates, on occasion cash is advanced to or charges are incurred by one Applicant on behalf of another Applicant. The Applicants propose to maintain their existing cash management and accounting system during this proceeding under the oversight of the Monitor, which is acceptable to their operating lender CIT. The Applicants also want to ensure that no creditor of any individual Applicant is prejudiced by the inter-company flow of funds or incurring of liabilities from and after the date of filing. It is proposed that to the extent one Applicant advances money to or incurs a cost on behalf of another Applicant, they will obtain a non-priming secured charge from the recipient Applicant for that amount. The intercompany charge will attempt to maintain the relative priority and value of each Applicant's estate and ensure that one Applicant does not fund, at the expense of its stakeholders, the operations of another Applicant. As inter-company amounts are settled on a monthly basis and this proceeding is being commenced mid-month, it is proposed that the inter-company charge sought as part of the Initial Order cover the current month of intercompany transactions.

177. I have reviewed the model form of Initial Order that is used for proceedings before the Commercial Court in Toronto under the CCAA (the "Model Order"). Certain amendments to the model

form of Initial Order are requested to be made, all of which are necessary to the Applicants' ability to continue business operations in order to effect a successful restructuring.

178. The Applicants currently owe realty tax arrears to various municipalities for the facilities located in those jurisdictions. Some of these facilities (or individual mills located on the facilities) are expected to form part of the restructured business operations of the Applicants upon successful emergence from this proceeding, while other facilities or individual mills may not. In consultation with the Monitor, the Applicants will be reviewing each of the mills and facilities in developing a restructuring plan. In view of their limited cash resources, the Applicants do not believe it is prudent to utilize proceeds of the DIP Financing to pay realty tax arrears on facilities that will not form part of their future operations, or that may be sold or abandoned. The Applicants therefore seek a term in the Initial Order providing discretion as to payment of realty tax arrears on a case by case basis. Current realty taxes on all facilities that are being utilized by the Applicants will continue to be paid from and after the commencement of this proceeding.

179. The Applicants also seek a clarification to the Model Order to confirm that their renewal rights as it relates to certain existing insurance policies are unaffected by the commencement of this proceeding. The Applicants have two insurance policies that are due to expire June 30, 2009 covering: (i) property; and (ii) Canadian fleet insurance on vehicles owned by Fraser Papers. The Applicants have included an amount in the Cash Flow Forecast representing the annual premium payment plus a four percent increase, based on prior years' expenses for insurance. If the Applicants were unable to obtain a renewal of coverage under the property insurance policy from their present insurer on the same or similar terms, it is unlikely that they would be able to secure alternate coverage from a new insurer on terms that would be financially feasible, resulting in a potential shutdown of the facilities.

180. The Applicants provide certain volume rebates to customers that will be important to maintain notwithstanding the commencement of this proceeding. The forest products industry is rapidly

contracting and is highly competitive. If the Applicants do not have the ability to honour rebates earned by customers seamlessly throughout the period prior to and after the date of filing, those customers may quickly move their business to a competitor who can continue to offer volume-related incentives. The Applicants intend to review all such programs with the Monitor.

181. Due to the nature of the business of the Fraser Group, the Applicants have goods in transit at any point in time. The Applicants have requested a provision in the Initial Order to ensure that there is no disruption to the business relating to non-payment of amounts owing to freight forwarders, customs brokers or similar agents who are critical to the Applicants' operations, whether in respect of the period prior to or after the date an Order is issued. In addition, with the Monitor's consent and subject to the terms of the DIP Financing, the Applicants request that they be permitted to make payments to particular suppliers up to a certain capped amount, if it is determined that such suppliers are critical to the Applicants' ongoing business operations, and the inability to pay such amounts may jeopardize their ability to achieve a successful restructuring.

182. As outlined above, certain LC's are outstanding in connection with a landfill located in the State of Wisconsin. The Wisconsin Landfill was originally owned by a predecessor to Fraser Papers, was subsequently owned by Fraser Madawaska and was then sold to Smart Papers LLC in 2005. Fraser Papers agreed to leave LC's in place totalling approximately \$3.5 million to facilitate the sale of the mill to Smart Papers LLC, to support closure and post-closure care obligations assumed by the purchaser on closing. Smart Papers LLC paid certain costs associated with the Wisconsin Landfill following the closure of the mill, but subsequently filed for protection under Chapter 11 of the U.S. *Bankruptcy Code* in 2007. As part of that proceeding Smart Papers LLC paid a small amount to the Wisconsin Department of Natural Resources ("DNR") and obtained a release from any further liability in connection with the Wisconsin Landfill. Smart Papers ultimately became bankrupt.

183. Smart Papers LLC sold the paper mill, but not the Wisconsin Landfill, and accordingly the Wisconsin Landfill continues to be owned by a bankrupt entity in respect of which LC's issued at the request of Fraser Papers remain outstanding. In 2007, the DNR advised Fraser Papers that it intended to draw down the LC's, spend as much as was necessary in their view to close and care for the Wisconsin Landfill, and then sue all prior owners including the Company. The Company believed that it could close and care for the Wisconsin Landfill for an amount that was less than the aggregate amount of the outstanding LC's, and persuaded the DNR to allow the Company to proceed in this manner.

184. Since that time, Fraser Papers has completed the closure obligations and has continued to pay post-closure care amounts. It is in the process of applying for the release of a portion of the LC's totalling approximately \$700,000 to \$800,000. The Company believes that it is in the best interests of their stakeholders that it be permitted to complete the necessary post-closure work on the Wisconsin Landfill, to facilitate the return of the outstanding LC's. The Cash Flow Forecast prepared by the Applicants include these payments.

185. An amendment to the Model Order as it relates to payment of pension and benefits is also requested, as outlined above in respect of the Cash Flow Forecast. The requested amendments make it clear through the use of mandatory language that all employees who are continuing to provide a service to the Applicants from and after the date of the Initial Order will continue to receive all health, dental, insurance and related benefits to which they were entitled immediately prior to filing. The Applicants will also continue to pay all current pension funding obligations.

186. The Applicants also request to not make any special payments in respect of their pension obligations (including obligations under its SERP plans) after the date of filing, in particular as it relates to funding the solvency deficit or the going-concern deficit, and they are prohibited from doing so under the terms of the DIP Financing.

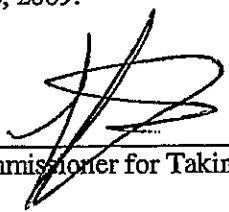
187. As outlined in the draft Initial Order sought by the Applicants, the Applicants seek a provision in the Initial Order providing them with the discretion to pay health, dental, insurance and related benefits on behalf of retirees or any other non-active employees up to a certain amount per month in accordance with the terms of the DIP Financing, without obligating them to do so. It is intended that these payments will continue to be made following the issuance of the Initial Order, with the Applicants having the discretion to stop making such payments at any time thereafter on notice to the affected parties if it is determined that it is not feasible to continue doing so.

**F. The Monitor**

188. The Applicants propose that PwC be appointed Monitor for this proceeding. PwC is not the auditor for the Applicants. PwC has consented to act as Monitor and its written consent is being filed with this Honourable Court.

189. I swear this affidavit in support of the Applicants' request that an Initial Order be granted under the CCAA in the form annexed to the Notice of Application herein, and for no other or improper purpose.

SWORN before me at the City of Toronto,  
in the Province of Ontario, this            day of  
June, 2009.



\_\_\_\_\_  
Commissioner for Taking Affidavits

Gloria Kalkounis, a Commissioner, etc.,  
City of Toronto, for ThomsonGruetFinigan LLP,  
Barristers and Solicitors,  
Expires August 27, 2010.



\_\_\_\_\_  
J. PETER GORDON

**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 PROPOSED PLAN OF COMPROMISE OR  
ARRANGEMENT WITH RESPECT TO FRASER PAPERS INC., FPS CANADA INC.,  
FRASER PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER PAPERS  
LIMITED, FRASER N.H. LLC

Applicants

**FIRST REPORT TO THE COURT  
SUBMITTED BY PRICEWATERHOUSECOOPERS INC.  
IN ITS CAPACITY AS PROPOSED CCAA MONITOR  
OF THE APPLICANTS**

JUNE 18, 2009

**INTRODUCTION**

1. PricewaterhouseCoopers Inc. ("PwC" or the "Proposed Monitor") understands that Fraser Papers Inc. ("FPI"), FPS Canada Inc. ("FPSC"), Fraser Papers Holdings Inc. ("Fraser Holdings"), Fraser Timber Ltd., Fraser Papers Limited and Fraser N.H. LLC (collectively, the "Fraser Group" or the "Applicants") intend to make an application to the Ontario Superior Court of Justice (the "Ontario Court") seeking certain relief under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA"), and appointing PwC as monitor ("Monitor").
2. PwC has consented to act as Monitor and has prepared this report in its capacity as the proposed Monitor (the "Proposed Monitor.>").
3. The Proposed Monitor also understands that the Applicants have prepared petitions for recognition under Chapter 15 of the United States Bankruptcy Code.

4. The purpose of this Report is to provide this Honourable Court with information concerning:
  - i) Background information about the Applicants
  - ii) The reasons for the CCAA proceedings
  - iii) The contemplated insolvency process, including:
    - (a) The proposed restructuring strategy of the Applicants
    - (b) The Applicants' COMI and the Chapter 15 filing
    - (c) The terms of the debtor-in-possession ("DIP") facilities
    - (d) Overview of the 5 week Cash Flow Forecast
    - (e) The request of the Applicants to pay certain pre-filing amounts owed to critical suppliers
    - (f) Payment of ongoing landfill costs
    - (g) Cash management systems
    - (h) Inter-company transactions and the Inter Company Charge
    - (i) Treatment of the Pension Plans
    - (j) Insurance
    - (k) Directors' and officers' charge
  - iv) The Applicants' relationship with Brookfield Asset Management Inc.
  - v) The Proposed Monitor's conclusions
5. Unless otherwise stated, all monetary amounts contained herein are expressed in United States Dollars, the Applicants' reporting currency.

6. Capitalized terms used herein not otherwise defined are as defined in the affidavit as sworn by the CEO, Mr. J. Peter Gordon (the “**Gordon Affidavit**”) and the draft Initial Order.
7. In preparing this Report, the Proposed Monitor has relied upon unaudited financial information, the Applicants’ books and records, the financial information prepared by the Applicants and discussions with management of the Applicants and their legal advisors. The Proposed Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information and, accordingly, PwC expresses no opinion or other form of assurance on the information contained in this Report. Future oriented financial information included in this Report is based on the Applicants’ assumptions regarding future events, and actual results achieved will vary from this information and the variations may be material.
8. The Proposed Monitor was retained by the Applicants on May 26, 2009 to assist the Applicants and their professional advisors in analyzing options available to refinance and restructure their operations. Since being retained, PwC has been reviewing the Applicants’ available financial information to gain knowledge of the business and financial affairs of the Applicants and, more recently, has been preparing for the Applicants’ anticipated CCAA application.
9. Assuming the Applicants are granted protection under the CCAA, and assuming that PwC is appointed monitor by this Honourable Court, PwC, in such capacity, intends to make copies of certain material documents pertaining to the Applicants’ CCAA proceedings available on its website at [www.pwc.com/car-fraserpapers](http://www.pwc.com/car-fraserpapers).
10. The Proposed Monitor does not act as auditor to FPI or any of the other Applicants.

## BACKGROUND

11. Detailed information concerning the background of the Applicants, their creditors and their financial status form part of the Gordon Affidavit. Key to the Fraser Group's ability to carry on its business operations as usual, is the ongoing multi-dimensional support provided by Brookfield Asset Management Inc. ("BAM", the Fraser Group's principal shareholder), as detailed in paragraphs 68 to 78 below.
12. In brief, the Fraser Group is a specialty paper company with integrated paper, pulp and lumber operations. The operations of the Applicants comprise two paper mills, one market pulp mill, two internal pulp mills, a biomass cogeneration power plant, and four lumbermills in New Brunswick, Quebec, Maine and New Hampshire. Appendix A contains a more detailed overview of the Applicants operations.
13. The Fraser Group operates largely as an integrated business. While the Applicants' operations include the above-noted locations in both Canada and the U.S., each location provides to or receives product from another location creating an integrated nature to the business.
14. For fiscal 2008, the Applicants had consolidated net sales of approximately \$688.6 million and suffered a net loss of \$71.9 million. For the four months ended May 2, 2009, the Applicants recorded a net loss of \$22.1 million on consolidated net sales of \$202.8 million.

15. The Fraser Group's debt structure and approximate current amounts outstanding is as follows (excluding any amounts in respect of pensions, post-employment benefits, guarantees, potential exposure under foreign exchange hedging contracts and potential environmental liabilities):

Lender/Type of debt	Outstanding Amount US\$million
CIT – secured	56
NB Loan – secured	29
CIBC – unsecured	25
3 <sup>rd</sup> party trade creditors – Canadian entities *	43
3 <sup>rd</sup> party trade creditors – US entities *	30
Intercompany payable to FPI – US entities *	32

\* Balances as at May 2, 2009

16. FPI is the borrower under the CIT facility. The CIT facility is guaranteed by all of the other Applicants. CIT has a first charge over inventory and accounts receivable of each of the Applicants. BAM has also guaranteed \$25 million of the outstanding amount under this facility.
17. The Province of New Brunswick has a fixed charge over the fixed assets in New Brunswick and a second charge on inventory and accounts receivable in New Brunswick in connection with FPI's indebtedness to it (the "NB Loan").
18. FPI is the borrower under the unsecured CIBC facility. BAM has guaranteed \$25 million of the outstanding amount under this facility.
19. The two BAM guarantees noted above are secured by guarantees of each of the Applicants and a general security agreement over all of the Applicants' assets, which security is subordinate to the CIT and NB Loan security.
20. FPI is listed on the Toronto Stock Exchange under the symbol FPS. As of June 17, 2009, the shares closed at a price of \$0.14.

## REASONS FOR THE CCAA PROCEEDINGS

21. Based on discussions with management, the principal causes of the need for the CCAA filing include:
- i) The poor economic conditions of the past few years, resulting in significant operating losses and a severe working capital shortfall;
  - ii) The impact of the US “black liquor tax credit”, which the Applicants are not entitled to receive, which has further lowered the price of pulp;
  - iii) The uncertainty associated with negotiating new collective bargaining agreements and obtaining concessions under the existing collective bargaining agreements with certain of its unions; and
  - iv) The recent stock market crash which has resulted in material funding deficiencies in the Applicants’ defined pension benefit plans and will require a significant increase in pension funding over the next five years, and the Applicants inability to obtain the necessary relief in respect of these pension funding obligations; and
  - v) The continued poor outlook for the housing, lumber and pulp markets.
22. In addition, the Proposed Monitor has been advised by the Applicants that it does not have the liquidity required to meet the following near term obligations:
- i) the ongoing losses associated with the pulp and lumber operations;
  - ii) the repayment of the \$25 million CIBC term loan which matures in September 2009;
  - iii) \$7.8 million of severance payments related to the temporary shutdown at the Thurso pulp mill, due for payment in two equal amounts in November 2009 and December 2009. Should the shutdown become permanent, \$9.5 million of additional severance (i.e. in addition to the \$7.8 million noted

above), would be payable six weeks after the date the permanent shutdown is announced;

- iv) the approximate amount of \$10 million required to bring their overdue supplier balances back to normal credit terms; and
- v) the approximate amount of \$7.7 million owing to various municipalities for property taxes.

## **CONTEMPLATED INSOLVENCY PROCESS**

### **THE PROPOSED RESTRUCTURING STRATEGY OF THE APPLICANTS**

- 23. As set out in the Gordon Affidavit, a comprehensive operational and balance sheet restructuring is to be pursued by the Applicants and, in that respect, the Applicants have already commenced dealing with the numerous issues that are currently negatively impacting the profitability of its various business units.
- 24. However, significant additional time is required in order to be able to meet with all of the relevant parties, attempt to negotiate revisions to contract terms, determine which parts of the business are viable based on these contract revisions, update business plans, arrange exit-financing and develop a plan of arrangement and compromise for consideration by the Applicants' creditors.
- 25. The Proposed Monitor understands that the negotiations will take place throughout the summer and management will present a plan to creditors as soon as possible. Once the Fraser Group's business has been stabilized, the Applicants and the Proposed Monitor will update this Honourable Court with respect to the Fraser Group's restructuring activities and alternatives.

### **THE APPLICANTS' COMI AND THE CHAPTER 15 FILING**

- 26. Based on the Proposed Monitor's understanding of the Applicants' structure, discussions with management and, as set out in paragraphs 23 and 27 of the

Gordon Affidavit, the Proposed Monitor concurs with the Applicants' view that their COMI is Ontario.

27. Based on the Proposed Monitor's understanding of the integrated nature of the Applicants' management, operations and financing as between the Canadian and US Applicants, the poor liquidity situation of the US Applicants which have no separate borrowing facilities, and our view that the Applicants' COMI is Ontario, the Proposed Monitor concurs with the Applicants commencing auxiliary proceedings under Chapter 15 of the US Bankruptcy Code.
28. The Applicants' survival is predicated upon a centralized, efficient, restructuring proceeding. The CCAA and Chapter 15 proceedings will provide an environment to stabilize the Fraser Group's business and provide for the continuation of going concern operations.
29. The Proposed Monitor understands that FPI seeks to be appointed as the Applicants' Foreign Representative with respect to the Chapter 15 proceedings and has retained Delaware counsel in this respect. The Monitor has been advised that FPI will keep the Proposed Monitor apprised of developments in respect of the Chapter 15 proceedings.

#### THE TERMS OF THE DIP FACILITIES

30. As detailed in the Gordon Affidavit, the Applicants have received two term sheets in respect of the provision of DIP financing – one from BAM and one from CIT (as defined below), the Applicants' existing revolving credit lender (collectively the "**DIP Facilities**"). If approved, the DIP Facilities will provide additional liquidity to the Applicants during the restructuring.
31. The principal terms of the BAM DIP financing (the "**BAM DIP Financing**") are:
  - i) FPI is the borrower under the BAM DIP Financing and each of FPI's subsidiaries is a guarantor;

- ii) subject to the terms of the BAM DIP Financing term sheet, an aggregate amount of \$15 million is immediately available to FPI, which is increasable up to a maximum of an additional \$5 million, upon request by FPI and approval by the BAM DIP Financing lenders;
- iii) the BAM DIP Financing will be used for working capital and for other general corporate purposes;
- iv) up to \$7 million of the BAM DIP Financing amount may be assigned to the Province of New Brunswick (the “GNB Tranche” and “GNB”, respectively, both as defined in the BAM DIP Financing term sheet), which amount shall only be used to finance the Applicant’s Plaster Rock facility in New Brunswick. Additional terms and conditions may be imposed by GNB at its sole discretion in respect of the GNB Tranche;
- v) unless terminated sooner or extended, the BAM DIP Financing matures 12 months following the closing date of the BAM DIP Financing;
- vi) once the condition precedents have been satisfied and assuming there are no events of default, there is no availability calculation with respect to the quantum that can be borrowed;
- vii) the interest payable on the BAM DIP Financing is payable monthly in arrears under one of the following two bases, at the option of FPI:
  - 1. Base Rate (which is subject to an interest rate floor of 3%) plus 1.75% per annum; or
  - 2. LIBOR (which is subject to an interest rate floor of 3%) plus 1.75% per annum.
- viii) FPI will pay primary commitment, structuring, closing and sponsor upfront fees totaling 4.41% of the committed amount on closing, plus a 1% per annum standby fee for any part of the BAM DIP Financing that is committed but not drawn. In addition, all professional and advisory fees and expenses of BAM related to these proceedings and the BAM

DIP Financing are payable by the Applicants, as well as an exit fee of 1%;

- ix) the term sheet contains restrictions on the uses of the BAM DIP Financing unless approved by the BAM DIP Financing lenders, including that it may not be used to pay any amounts to non-active employees, past-service or special pension payments or repayment of pre-filing indebtedness except in respect of the CIT Pre-Filing Amount, as defined below;
- x) the BAM DIP financing imposes a dollar limit on the amount that can be paid for retiree benefits, limited also to a period of 6 months from the Closing Date;
- xi) mandatory prepayments are generally required on the sale of any property or assets of FPI or its subsidiaries (other than in the ordinary course of business), upon the receipt of insurance proceeds on account of loss or damage to any property or assets of FPI or its subsidiaries, and upon the incurrence of indebtedness for borrowed money by any of FPI or its subsidiaries;
- xii) the BAM DIP Financing has a super-priority claim over all assets of FPI and its guarantor subsidiaries, except in respect of (i) CIT Pre-Filing Amount, in respect of the Existing CIT Collateral (each as defined below); (ii) the CIT DIP Portion (defined below); and (iii) the Carve Out (i.e. claims subject to the CCAA Administrative Charge).

32. CIT Business Credit Canada Inc. ("CIT") currently extends credit to Fraser Papers under an amended and restated financing agreement dated as of May 2, 2008 between FPI and CIT (as amended from time to time, the "CIT Financing Agreement"). The Applicants and CIT have negotiated amendments to the CIT Financing Agreement to permit CIT's revolving credit facility to continue to revolve and to address the

provision by BAM of the BAM DIP Financing. Some of the principal terms of the amendments to the CIT Financing Agreement include as follows:

- i) FPI is the borrower and all of FPI's subsidiaries are guarantors;
- ii) the principal amount of the credit facilities under the CIT Financing Agreement will be reduced to U.S. \$80 million, made on a revolving basis;
- iii) the total availability under the amended CIT Financing Agreement is subject to the existing CIT Financing Agreement borrowing base calculation;
- iv) the credit extended to FPI by CIT as at the commencement of the CCAA and Chapter 15 proceedings (the "**Pre-Filing Amount**", estimated to be approximately \$56 million) will continue to be secured by all of the present and future inventory, accounts receivable and certain other assets and proceeds thereof of the Applicants (the "**Existing CIT Collateral**");
- v) any credit extended to FPI under the amended CIT Financing Agreement after the commencement of the Proceedings (the "**CIT DIP Portion**") will also be secured by the Existing CIT Collateral. CIT will now also have a super-priority security interest and charge over all present and future real, personal and mixed property and assets of the Applicants (including fixed assets) to secure \$24 million of the total CIT advances;
- vi) all post-filing accounts receivable collections are to first be applied against the Pre-Filing Amount;
- vii) as of the filing date, the amended CIT Financing Agreement is expected to provide the Applicants with approximately \$8 million of

additional financing, based on the latest available borrowing base calculation;

- viii) amounts advanced under the amended CIT Financing Agreement are to be used to pay transaction costs, fees and expenses incurred in connection with these proceedings, for working capital, and for other general corporate purposes;
- ix) mandatory prepayments are generally required on the sale of any property or assets of FPI or its subsidiaries (other than in the ordinary course of business), upon the receipt of insurance proceeds on account of loss or damage to any property or assets of FPI or its subsidiaries, and upon the incurrence of indebtedness for borrowed money by any of FPI or its subsidiaries;
- x) the interest payable on the CIT DIP Portion is payable monthly in arrears at the rate of Base Rate (which is subject to a floor of 3%) plus 2% per annum, provided that upon an event of default, an additional 2% per annum will be payable on demand. The interest rate on the CIT Pre Filing Amount remains at the pre-filing rate;
- xi) the Borrower will pay a commitment fee of 1% on the CIT DIP Portion on closing, plus a 1% per annum standby fee for any part of the CIT Financing amount that is committed but not drawn. In addition, all professional and advisory fees and expenses of CIT related to these proceedings and the amended CIT Financing Agreement are payable by the Applicants, as well as an exit fee of 1%;
- xii) CIT must be satisfied with the terms of the BAM DIP Financing;
- xiii) CIT must also receive within 15 days of the closing date, written evidence that each of BAM and the Province of New Brunswick

("NB") shall have consented to the amended CIT Financing Agreement security arrangements; and

xiv) CIT's right to receive payment of the credit extended to FPI under the CIT Financing Agreement will rank senior to the BAM DIP facility, as to the Pre-Filing Amount, solely in respect of the Existing CIT Collateral, and as to the CIT DIP Portion, in respect of all collateral.

33. The two DIP Facilities have super-priority charges and would be in priority to the existing charges granted to NB in respect of its advances to fund capital expenditures in NB.
34. The Proposed Monitor has inquired into the marketing process for the DIP financing arrangements, and has been advised by management of the company that the DIP financing requirement was not marketed externally to other potential lenders given the nature of the industry and the willingness of the existing lenders to fund ongoing operations.
35. Management has advised the Proposed Monitor that the two DIP Facilities term sheets represent the only alternative available to the Applicants to ensure the continuation of the Applicant's operations at this time.
36. The Proposed Monitor has not been involved in the marketing or negotiation of the terms of either DIP Facilities' term sheets, and both DIP Facilities term sheets were only finalized in the evening of June 17, 2009. As a result, the Proposed Monitor has had a limited period of time within which to assess the two DIP financing term sheets. The Proposed Monitor has compared the principal financial terms of the two DIP financing arrangements to a number of other recent debtor in possession financing packages in the forestry, pulp and paper sector with respect to pricing, loan availability and certain security considerations. Based on this comparison, we are of the view that the financial terms of the DIP Facilities' term sheets appear to be commercially reasonable and consistent with current market transactions.

#### OVERVIEW OF THE 5-WEEK CASH FLOW FORECAST

37. The Applicants have prepared a cash flow forecast for the five week period from June 18, 2009 to July 17, 2009 (the “June 18 CFF”), a copy of which is attached hereto as Appendix B.
38. The June 18 CFF shows a net cash out flow of \$15.6 million, made up of total receipts of \$34.7 million and total disbursements of \$50.3 million, resulting in a net usage of the DIP Financing as at July 18, 2009 of \$15.6 million and a peak usage in the week commencing June 29, 2009 of \$16.8 million.
39. The principal assumptions utilized in the June 18 CFF include:
  - i) Mills – Only the Edmunston, Madawaska, Goreham and Masardis mills are operational and the following mills remain closed: Plaster Rock, Juniper, Thurso and Ashland;
  - ii) Receipts – amounts are assumed to be collected based on past collection history and future revenues expected;
  - iii) Disbursements – pre-filing amounts are assumed stayed and post-filing amounts are forecast to be impacted by reduced credit terms as a result of the CCAA Proceedings;
  - iv) Input pricing and other assumptions – no significant changes in input prices (e.g. paper, lumber, pulp or oil prices) or foreign exchange rates are assumed;
  - v) The DIP financing is available immediately;
  - vi) Severance and termination payments – any such payments due to be made during the period covered by the June 18 CFF are stayed;
  - vii) Pension obligations – current obligations post-filing are being paid in the normal course of operations, but no payments on account of past service or funding deficiencies are forecast to be paid;

- viii) Interest payments – interest is paid to CIBC, CIT and BAM, pursuant to the various loan agreements as described above;
- ix) Legal and Professional fees – fees associated with the CCAA Proceedings relating to Applicants’ US and Canadian legal counsel and the Monitor and its legal counsel have been included.

**THE REQUEST OF THE APPLICANTS TO PAY CERTAIN PRE-FILING AMOUNTS OWED TO CRITICAL SUPPLIERS**

- 40. The Proposed Monitor has been advised that the Applicants’ operations depend on ready supply of key materials and continued provision of essential services. Accordingly, the Proposed Monitor understands the draft Initial Order contemplates that the Applicants will be able to pay to a maximum amount of \$12.3 million, subject to approval by the Monitor and the terms of the DIP Financing arrangements, pre-filing amounts to certain suppliers who, in the Applicants’ opinion, are critical to the Applicants’ ongoing operations.

**PAYMENT OF ONGOING LANDFILL COSTS**

- 41. The Applicants are contractually liable for the ongoing maintenance costs of a landfill site in the United States, which they previously owned but had sold to a third party who subsequently went bankrupt. The Proposed Monitor understands that the Applicants intend to continue making the required payments, while they negotiate the return of some portion of two letters of credit that they had issued to support their liability for the ongoing maintenance costs. The Proposed Monitor understands that the total amount forecast still to be spent is considerably less than the amount of the letters of credit that are expected to be returned.
- 42. The June 18 CFF includes payments in respect of these ongoing maintenance costs.

#### CASH MANAGEMENT SYSTEMS

43. As described in the Gordon Affidavit, the Applicants operate a large interconnected and complex cash management system (with 30 bank accounts), designed to minimize the group's net borrowings and interest charges and simplify the usage and repayment process for the CIT Credit facility.
44. The Proposed Monitor understands that the draft Initial Order provides that the Applicants can continue to use the existing cash management system and bank accounts.
45. Based on discussions with management, the Proposed Monitor understands that the Applicants account for all these transactions through intercompany accounts (as described in more detail in the next section of this report) in an accurate and timely manner
46. BAM and CIT have indicated that they support the continued operation of the existing cash management system during the CCAA proceedings.
47. The Proposed Monitor has reviewed the cash management system with the Applicants and believes that using the existing cash management system will minimize any disruption to the business operations of the Applicants as it seeks to restructure its affairs. The Proposed Monitor will monitor the CCAA Applicants' cash management system, including intercompany and cash flow activities, on a weekly basis and report to this Honourable Court on a periodic basis with respect to its findings.

#### INTERCOMPANY TRANSACTIONS AND INTERCOMPANY CHARGE

48. There are a number of intercompany transactions that occur between the Applicants in the normal course of business, the most significant being:
  - i) Purchase of goods – on a daily basis; allocation of centrally incurred costs – on a monthly, quarterly or annual basis; and miscellaneous charges –

one time or recurring charges as incurred (collectively the “**Intercompany Goods and Services Transactions**”); and

- ii) Movement of cash between mill and corporate accounts, as detailed above – on a daily basis (the “**Intercompany Funding Transactions**”).
49. As the Intercompany Goods and Services Transactions and the Intercompany Funding Transactions (collectively the “**Intercompany Transactions**”) between the entities are incurred in the normal course and are essential for the continued operation of the businesses, the Applicants propose the continuation of these transactions as outlined in the Gordon Affidavit, which the Proposed Monitor understands is acceptable to CIT and to BAM. The Proposed Monitor understands the Applicants record these transactions on an accurate and timely basis using intercompany accounts, on a location by location basis.
50. The Proposed Monitor understands that the Applicants will settle the net intercompany balances on at least a monthly basis.
51. In lieu of daily settlement of these intercompany transactions, the Applicants have proposed the granting of a subordinated secured Inter-Company Charge (i.e. subordinated to the CIT Security, the Administration Charge, the CIT DIP Charge, the DIP Lenders Charge and the Directors’ Charge) in order to ensure that no creditor of any individual Applicant is prejudiced by the settlement timing differences or the incurring of liabilities by one of the Applicants on behalf of another.
52. The Proposed Monitor understands that the Inter-Company charge is to cover the Intercompany Funding Transactions from and after June 18, 2009, the date of filing. The Proposed Monitor understands that the Inter-Company charge is also to cover the Intercompany Goods and Services Transactions from and after the date of June 1, 2009 on the basis that, without this charge, it would be unfairly prejudicial to creditors of the parties providing the goods or services and create unnecessary disruption to operations in the immediate post-filing period.

53. As many of these transactions are between the US and Canadian entities, we understand the Applicants will seek recognition of the Inter-Company Charge in the Chapter 15 Proceedings.
54. The Proposed Monitor is of the view that the continuation of the intercompany transactions and the Inter-Company Charge appears appropriate and reasonable in the circumstances, given the highly integrated nature of the Applicants, as set out below. The Inter-Company Charge will allow the Applicants to continue to ensure prompt payment of post-June 1, 2009 Intercompany Goods and Services Transactions and post June 18, 2009 Intercompany Funding Transactions. It will also ensure that each individual Applicant will not fund, at the expense of its stakeholders, the operations of another entity.
55. To change all the existing integrated processes and systems would be very disruptive to the Applicants in their efforts to stabilize their business and develop a restructuring plan on a timely basis:
- i) The Applicants operate as a single integrated business;
  - ii) The cash management system is centralized;
  - iii) The intercompany accounts have been used to manage activities between locations, regardless of locale, for an extended period of time;
  - iv) There are very frequent large intercompany transactions between the Edmunston and Thurso pulp mills and the Madawaska and Gorham paper mills related to the sale of pulp, power and steam, and between the New Brunswick and Maine lumber mills and the Edmunston pulp mill related to the sale of byproduct chips and biomass;
  - v) The pulp and energy operations in Edmunston and Madawaska, (Fraser Group's largest paper manufacturing facilities) are physically connected, with pipelines joining the two plants across the international border between New Brunswick and Maine; and

- vi) There is a significant amount of shared services allocated amongst the Applicants on a mill by mill basis.

#### **PENSION PLANS AND BENEFITS**

- 56. As at December 31, 2008 Fraser Papers employed approximately 2,400 people at its eight manufacturing locations in Canada and the U.S. Approximately 70% of these employees are represented by labour unions.
- 57. The Applicants sponsor five defined benefit pension plans in three jurisdictions: two registered in the Province of New Brunswick (an hourly and salaried plan), two registered in the Province of Quebec and one in the U.S. (collectively, the "Pension Plans"). The Proposed Monitor understands there are 2,997 retirees and 1,412 active employees who are members of the Pension Plans.
- 58. In addition, the Applicants have one non-registered, unfunded, Supplemental Employee Retirement Pension Plan ("SERP") in Canada and two unfunded SERPs in the U.S. The obligations under these SERPs are "pay-as-you-go". The Applicants also sponsor a registered defined contribution pension plan in Canada and one in the U.S.
- 59. As at December 31, 2008, the latest date actuarial information is available for, the Proposed Monitor understands that Applicants' accrued pension benefit obligations in respect of the Pension Plans and SERPs exceed the value of the related plan assets by approximately \$171.5 million.
- 60. The Applicants are required to pay \$3.3 million and \$0.1 million in 2009 on account of normal cost contributions to the Pension Plans and SERP, respectively. The Applicants are also required to make special payments in respect of unfunded going concern and solvency liabilities with respect to the Pension Plans and SERP in the amount of \$13.5 million and \$0.6 million in 2009, respectively, and \$34.7 million in each of the years 2010 through to 2013. Due to liquidity and DIP financing constraints, Fraser Papers intends to suspend the remittance of normal

cost contributions to the SERP and special payments to the Pension Plans and SERP during these CCAA proceedings.

61. Pursuant to the terms of the draft Initial Order, the Applicants will be required to continue to provide all health, dental, insurance and related benefits to Active Employees and will also continue to pay all current pension funding obligations.
62. With respect to retirees and non-active employees, the Applicants' current intention is to continue to pay these amounts, while the restructuring plan is being developed and subject to a total expenditure restriction imposed by the DIP financing agreements.
63. Pursuant to the terms of the proposed Initial Order, the Proposed Monitor further understands that the Applicants will also be seeking authority not to make special payments in respect of their pension obligations, including obligations under its SERP plans, after the date of filing. The Applicants are prohibited from funding the solvency deficit or going-concern deficit in respect of these plans under the terms of the DIP financing arrangements.

#### REALTY TAXES

64. The Monitor understands that the Applicants currently owe realty taxes to various municipalities, some amounts of which are in respect of facilities or mills that will not form part of the restructured business operations of the Applicants. The Applicants do not believe it prudent to use any DIP funds to finance realty tax arrears in respect of facilities that may be sold or abandoned and are seeking discretionary authority as to payment of such realty tax arrears on a facility by facility basis.

#### INSURANCE

65. The Applicants have three insurance policies that are due to expire June 30, 2009 covering: (i) property; (ii) employee flight insurance and (iii) trucks owned by Fraser Papers. As of the date of filing, the Applicants' have not received any

renewal documents. If the Applicants were unable to obtain a renewal of coverage under the property insurance policy from their present insurer on the same or similar terms, it is unlikely that they would be able to secure alternate coverage from a new insurer on terms that would be financially feasible, resulting in a potential shutdown of the facilities. In order to avoid this situation, the Applicants have sought an order requiring the insurers to renew the existing policies on the same or similar terms and pricing.

#### **DIRECTORS' AND OFFICERS' CHARGE**

66. The Applicants propose to indemnify their directors and officers by way of the Directors' Charge, for liabilities incurred by the Applicants that result in post-filing claims against the directors and officers in their personal capacities.
67. The amount of the Directors' Charge is US\$30 million and was estimated by management taking into consideration the hourly and salaried payroll costs, unremitted employee source deductions, other employment related liabilities that attract liability for directors and officers, outstanding sales commissions, vacation pay, sales taxes and potential "super-priority" pension contribution amounts.

#### **CREDITOR NOTIFICATION**

68. The draft Initial Order provides for the notice of the CCAA proceedings to only be sent to known creditors, excluding employees, who are owed more than C\$1,000.
69. In lieu of this notice being sent to each of the Applicants' approximately 2,400 employees, the Proposed Monitor understands the Applicants will convene employee meetings on the day the Initial Order is granted at each location where operations are continuing to advise the employees of the CCAA filing. The Proposed Monitor shall require that a notice (substantially in the form attached as Appendix C) will be posted prominently in several places at each of the Applicants' locations.

**THE APPLICANTS' RELATIONSHIP WITH BROOKFIELD ASSET MANAGEMENT INC.**

70. As at April 4, 2009 BAM owned, directly or indirectly, approximately 70.5% of the outstanding common shares of Fraser Papers and, as a result, is the predominant shareholder of the Fraser Group. Historically, the Applicants have been dependent on the financial support of BAM and as a result, the Applicants have a number of financial arrangements with BAM which management advises are on commercially reasonable terms and beneficial to the Fraser Group, all as detailed in the Gordon Affidavit and summarized below.

**1. FOREIGN EXCHANGE CONTRACTS FACILITY**

71. As noted in the Gordon Affidavit, BAM has provided the Fraser Group with a \$350 million foreign exchange facility to hedge the group's exposure to the US dollar. As at April 4, 2009, Fraser Papers had \$170.2 million in net forward exchange contracts outstanding.

**2. FUNDING SUPPORT**

72. During 2008, the Applicants obtained \$110 million of additional funding directly or indirectly as a result of BAM:

- i) raised \$60 million of equity capital from a rights offering to shareholders that was fully underwritten by BAM;
- ii) obtained expanded availability under the existing revolving term facility with CIT Business Credit Canada Inc. ("CIT") of \$25 million which increase was guaranteed by BAM, and
- iii) obtained a \$25 million loan under a new one year term facility with Canadian Imperial Bank of Commerce ("CIBC") that was also guaranteed by BAM.

### **3. INVENTORY PURCHASE PROGRAM**

73. As a means of providing additional liquidity to the Applicants, starting in February 2009, BAM purchased paper inventory from Fraser Papers that was then sold to third party customers by BAM. Under the terms of the Paper Supply Agreement, Fraser Papers receives payment for the sale of this paper to BAM within approximately 2 business days and acts as a collection agent for BAM, as well as coordinating and paying for the shipping and delivery costs of these shipments. As such, Fraser Papers may hold cash that it has collected but not yet remitted to BAM at any point in time, as well as having outstanding supplier amounts payable (in BAM's name) in connection with these sales.
74. The Applicants and BAM have agreed to terminate the Paper Supply Agreement effective June 12, 2009 - however, until all of BAM's third party receivables have been collected, Fraser Papers will continue to act as BAM's collection agent for all inventory sales to BAM prior to June 12, 2009. As such, the Applicants will continue to remit to BAM any amounts received from customers.
75. The Paper Supply Agreement also provides for Fraser Papers to be reimbursed for all freight and warehousing costs incurred by Fraser Papers in respect of these sales. As a result, we understand the Applicants will continue to make payments after the date of the Initial Order for freight and warehousing costs incurred in the period immediately prior to the filing, for which they will then be reimbursed by BAM – the quantum of these amounts is not expected to be significant.

### **4. PURCHASES FROM BAM AND ITS AFFILIATES/SUBSIDIARIES**

76. Fraser Paper purchases electricity for its Gorham paper mill from BAM. During the first quarter of F2009, Fraser Paper purchased approximately \$1.0 million of electricity.
77. On January 31, 2006 Fraser Papers entered into a 20 year fibre purchase agreement with Acadian Timber Income Fund ("Acadian"). Brascan US Holding Inc., a wholly owned subsidiary of BAM, owns 45.3% of Acadian's issued and

outstanding units. During the first quarter of F2009, Fraser Papers purchased \$9.7 million of fibre from Acadian, of which \$1.5 million remained in accounts payable as of April 4, 2009.

#### **5. MANAGEMENT OF KATAHDIN SERVICES COMPANY LLC**

78. Fraser Madawaska is the sole member of Katahdin Services Company LLC (“Katahdin Services”) which, on behalf of the Fraser Group, manages (but does not fund) the Maine paper mill operations of Katahdin Paper Company LLC (“Katahdin Paper”), an indirect, wholly owned subsidiary of BAM. The investment earns a preferential cumulative distribution of 5% per annum. Cumulative distributions accrued on this investment amounted to \$2.7 million as of April 4, 2009.
79. During the first quarter of 2009, Fraser Papers earned a management fee of \$0.9 million from Katahdin Papers which was included in accounts receivable as of April 4, 2009. During the same period, Fraser Papers also sold \$0.2 million of goods and services to Katahdin Paper. As of April 4, 2009, there was no balance in accounts receivable related to these sales.

#### **6. DIRECTORS**

80. The Board of Directors of Fraser Papers is currently comprised of five directors. Three of the directors are non-independent, as defined by the Ontario Securities Act, National Policy 58-201, given their relationship to the Applicants’ major shareholder, BAM. The other two directors are independent.

#### **CONCLUSIONS**

81. The Proposed Monitor is of the view that a restructuring and continuation of the Applicants’ operations as a going concern is currently the best option available for all stakeholders for a variety of reasons, including:
- i) the Applicants qualify for and require protection under the CCAA due to their liquidity issues and financial position;

- ii) without the proposed DIP financing arrangements in place, the opportunity to stabilize the Applicants' business and restructure the Applicants would not be available;
- iii) the only prospect of preserving the going concern value of the Fraser Group is for there to be a centralized insolvency proceeding. For the reasons discussed above, Ontario is the appropriate jurisdiction in which to commence such proceeding;
- iv) a restructuring will preserve the going concern value of the Applicants, whereas a wind-down of the operations and liquidation of the assets in today's poor market, would likely result in a substantial diminution in realizable value that would reduce or eliminate creditors' recoveries; and
- v) a wind-down and liquidation of the Applicants would eliminate a significant number of jobs, some of which may be preserved if a successful restructuring is effected.

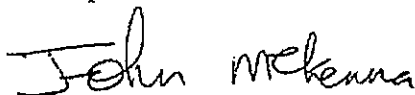
82. As such, the Proposed Monitor supports the Applicants' motion for CCAA protection.

83. The proposed DIP Facilities provide the Applicants with the necessary funding in order to continue to develop their restructuring plan.

The Proposed Monitor respectfully submits to the Honourable Court this, its First Report.

Dated at Toronto, Ontario this 18th day of June, 2009.

**PricewaterhouseCoopers Inc.**  
In its capacity as Proposed Monitor of  
Fraser Papers Inc., et al



John McKenna  
Senior Vice President

# Fact Sheet

JUNE 2009

# FraserPapers

Fraser Papers is an integrated paper company that produces a broad range of specialty packaging, label, converting and publishing papers. Our paper is known for performance and is backed by a high level of customer service and technical support.

## FULLY INTEGRATED OPERATIONS BETWEEN CANADA AND THE U.S.

### Canadian Assets

- Sulphite pulp mill, groundwood pulp mill and biomass cogeneration power plant in Edmundston, New Brunswick
- Hardwood pulp mill in Thurso, Québec
- Dimension lumbermill in Juniper, New Brunswick and dimension lumbermill in Plaster Rock

### U.S. Assets

- Paper mill in Madawaska, Maine
- Paper mill in Gorham, New Hampshire
- Two lumbermills in Ashland, Maine and one lumbermill in Masardis, Maine

### Energy

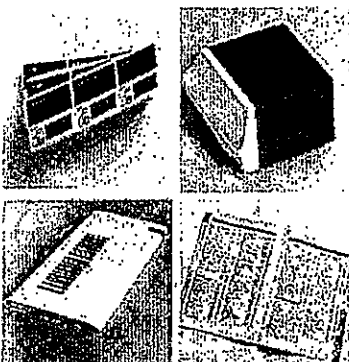
- Cogeneration facility on Edmundston site built in 1995 at a cost of \$120 million
  - ▶ Processes 800,000 tons of biomass annually
  - ▶ Steam used by the Madawaska paper mill
  - ▶ Electricity sold to NB Power



*Madawaska, Maine paper mill in the background and Edmundston, New Brunswick pulp mill in the foreground, connected by cross-border pipelines.*

### Employees

- Approximately 2,400 employees at year end 2008
- About 70% employees represented by labour unions



### Products

- Paper
  - ▶ Specialty Packaging
  - ▶ Specialty Printing
  - ▶ Specialty high-bright groundwood
  - ▶ Commodity freesheet
  - ▶ Commodity groundwood
  - ▶ Towel
- Pulp
- Lumber, wood chips, bark

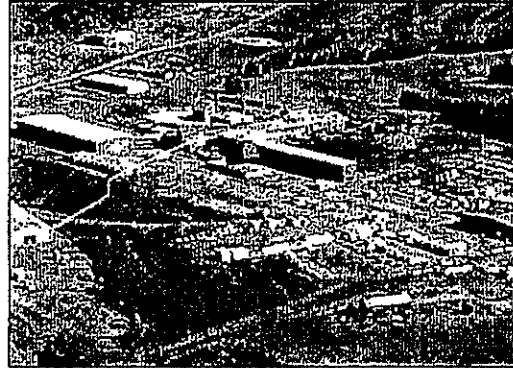
# FraserPapers

Publicly traded on the Toronto Stock Exchange since July 5, 2004

- Formerly a wholly-owned subsidiary of forestry company Nexfor Inc.
- Issued and outstanding capital consists of 50.2 million common shares, of which 70.5% are owned by Brookfield Asset Management

## Financial Results

- Cash flow from operations:
  - ▶ \$(65.4) million in 2007
  - ▶ \$(55.5) million in 2008
  - ▶ \$(9.7) million for Q1 2009
- \$34.2 million reduction in working capital in Q1 2009
- \$60 million rights offering and \$50 million in additional debt served to fund the deficits



*Plaster Rock, New Brunswick lumbermill*

## RESTRUCTURING EFFORTS

Since 2006 the Company has been proactive in turning around its operations:

- Permanent shutdown of the Berlin, New Hampshire pulp mill
- Efficiency improvements
- Operating cost reductions
- Energy conservation
- Rebuild of the recovery boiler at Edmundston, New Brunswick sulphite mill
- Closure of the two smallest paper machines (PM#1, PM#2) in Madawaska and two additional machines in Gorham
- Increased production of value-added specialty papers

### More recent initiatives:

- Indefinite closure of paper machine (PM#6) in Madawaska
- Indefinite shutdown of Thurso, Quebec pulp mill



*Thurso, Québec pulp mill*

## CONTACT INFORMATION

Glen McMillan, Chief Financial Officer  
 Fraser Papers  
 tel. 416.359.8635  
 email, gmcmillan@toronto.fraserpapers.com

**Fraser Papers Inc. and Subsidiaries**  
**Unaudited Combined 5 Week Cash Flow for the Period**  
**Notes and Assumptions**

- 1 Third Party Trade Receivables consist of receipts from the Paper and Pulp and Lumber operations. The timing of receipt collections are based on historical collection rates and have been adjusted for the Company's filing for court protection on June 18, 2009.
- 2 Collection of Other Accounts Receivable primarily includes the collection of a quarterly management fee paid by Katahdin Paper Company LLC ("Katahdin"), an affiliate of Brookfield, for the management of Katahdin's facilities.
- 3 Raw material costs represent materials required for production, primarily fibre and chemicals costs. The raw material costs are based on historical costs and expected required purchases throughout the 5 week period. Forecast payment for raw materials have been adjusted for reduced credit terms.
- 4 Productions Overhead Costs primarily represent supplies and consumables, repairs and maintenance, and property taxes. These costs are based on forecast production levels, historical costs incurred on a mill level and expected costs based on the forecast operations of each of the mills. The paper mills are expected to remain operational throughout the restructuring period. The other operations may be subject to shutdowns during part or all of the restructuring period.
- 5 Selling, General and Admin costs primarily represent shipping and freight, general and admin fees, insurance payments and legal and professional fees in respect of the CCAA process. Costs are based on historical expenses, with forecast increases for insurance payments. Restructuring professional fees of the Applicants' legal advisors, the Monitor and its legal counsel are based on advice from those advisors.
- 6 Employee costs represent salaries, wages, vacation pay, current service pension contributions and other post-employment benefits. Hourly payroll, salary costs and benefits are based on forecast headcount required at a mill level. Pension disbursements are in respect of current service costs only.
- 7 Interest charges are based on CIBC, CIT and Province of New Brunswick interest and fees.
- 8 Dip Interest and Fees are based on the BAM DIP Financing agreement and the CIT Financing Agreement.
- 9 Hedging Gains and Losses are based on contractual payments resulting from expiring hedging positions, assuming the actual foreign exchange rate is US\$1=C\$0.90
- 10 Capital Expenditures primarily represent forecast maintenance expenditures at the Applicants' East Papers operation.
- 11 Other expenses primarily represent costs associated with closed landfill sites and regular general and administrative costs pertaining to each mill.
- 12 DIP Loan Advances represent advance funds received by the Applicants pursuant to the DIP Financing agreement and the CIT Financing Agreement.
- 13 The Consolidated 5 Week Cash Flow is denominated in USD. A foreign exchange rate of \$0.90 has been assumed throughout the 5 Week Cash Flow Forecast.

# NOTICE TO EMPLOYEES OF FRASER PAPERS

## FRASER PAPERS COMMENCES FORMAL RESTRUCTURING PROCESS

On June 18, 2009, Fraser Papers Inc. and its subsidiaries (collectively, "Fraser Papers") filed for protection from its creditors under the *Companies' Creditors Arrangement Act* (the "CCAA"). The CCAA is a Canadian statute available to insolvent companies who wish to restructure their business within the context of a court-supervised proceeding.

Fraser Papers also commenced a similar proceeding in the United States pursuant to Chapter 15 of the U.S. *Bankruptcy Code* (the "U.S. Proceeding"). The U.S. Proceeding is necessary because Fraser Papers and its subsidiaries have assets, operations, employees and other stakeholders that need to be protected in that jurisdiction.

Pursuant to the Initial Order obtained in the Canadian Proceeding and an interim Order obtained in the U.S. Proceeding, Fraser Papers has been granted a "stay of proceedings". This gives Fraser Papers an opportunity to stabilize its operations and cash flow for a period of time so that it can develop a restructuring plan that will allow Fraser Papers to remain in operation and be profitable in the future.

PricewaterhouseCoopers Inc. has been appointed by the Canadian Court as the "Monitor" in the Canadian Proceedings. The Monitor is a court officer who acts independently from Fraser Papers for the purpose of considering the interests of all stakeholders and reporting any relevant information to the Court. The Monitor also assists Fraser Papers as it seeks to restructure its affairs. During this time, Fraser Papers remains in full possession and control of its assets.

Fraser Papers has many challenges to overcome in the near future and the court proceedings that have been commenced provide Fraser Papers with the appropriate framework for resolving these challenges and building a stronger enterprise.

Fraser Papers, together with the Monitor, will take all steps necessary to keep employees and all stakeholders fully informed during the Canadian and U.S. Proceedings. The primary methods for keeping stakeholders informed are as follows:

- Communications to stakeholders will be posted regularly on the restructuring page of the Fraser Papers website: [www.fraserpapers.com](http://www.fraserpapers.com).
- Fraser Papers has established an email address and telephone line for general employee-related enquiries. Please direct your email questions to [Restructuring@fraserpapers.com](mailto:Restructuring@fraserpapers.com) and your telephone calls to the following number: 1-877-374-3834.
- Fraser Papers intends to hold an information meeting. The information meeting will be chaired by the Monitor with key management of Fraser Papers in attendance. Details regarding this meeting will be announced by separate notice.
- Communications to stakeholders will be posted regularly on the Monitor's website: [www.pwc.com/car-fraserpapers](http://www.pwc.com/car-fraserpapers). Additionally, all Court documents filed in the Canadian and U.S. Proceedings will be filed on the Monitor's website.

## **Tab 4**

**Second Report to the Court submitted  
by PricewaterhouseCoopers Inc. in its  
capacity as Court-Appointed Monitor  
of the Applicants**

**TO BE FILED**

# Tab 5



1. THIS COURT ORDERS that the time for service of the Notice of Motion and Motion Record herein be abridged such that this Motion is properly returnable today, that all parties entitled to notice of the Motion have been duly served with notice, that no other parties are affected by the proposed Order and that any requirement for service of the Notice of Motion and the Motion Record upon any other party other than the parties served is dispensed with and that the service of the Notice of Motion and the Motion Record is validated in all respect;
2. THIS COURT ORDERS that all capitalized terms referred to in this Order and not otherwise defined, are as defined in the Order of Mr. Justice Morawetz in this proceeding dated June 18, 2009 (the "Initial Order").
3. THIS COURT ORDERS that, notwithstanding any other provision of this Order, the Applicants shall not make any past service contributions or special payments to fund any going concern unfunded liability or solvency deficiency of the Pension Plans during the Stay Period, pending further Order of this Court.
4. THIS COURT ORDERS that none of the Applicants or their respective officers or directors shall incur any obligation, whether by way of debt, damages for breach of duty, whether statutory, fiduciary, common law or otherwise, or for breach of trust, nor shall any trust be recognized, whether express, implied, constructive, resulting, deemed or otherwise, as a result of the failure of any Person to make any contribution or payments other than Current Contributions during the Stay Period, that they might otherwise have been required to make to any Pension Plans maintained by any of the Applicants.

5. THIS COURT ORDERS that if any claim, lien, charge or trust arises as a result of the failure of any Person to make any contribution or payment (other than Current Contributions in accordance with Sections 81.5 and 81.6 of the *Bankruptcy and Insolvency Act*) during the Stay Period that such Person might otherwise have become required to make to any Pension Plans but for the stay provided for in the Initial Order, no such claim, lien, charge or trust shall be recognized in these proceedings or in any subsequent receivership, interim receivership or bankruptcy of any of the Applicants as having priority over the claims of the CCAA Charges as set out in the Initial Order.
6. THIS COURT ORDERS AND DECLARES that nothing in this Order shall be taken to extinguish or compromise the obligations of the Applicants, if any, regarding payments under the Pension Plans.
7. THIS COURT HEREBY REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States, to give effect to this Order and to assist the Applicants, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Applicants and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, in any foreign proceeding including a proceeding commenced by the Applicants pursuant to Chapter 15 of the United States *Bankruptcy Code*, or to assist the Applicants and the Monitor and their respective agents in carrying out the terms of this Order.

8. THIS COURT ORDERS that each of the Applicants and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order.
  
  9. THIS COURT ORDERS that any interested party (including the Applicants and the Monitor) may apply to this Court to vary or amend this Order on not less than seven (7) days notice to any other party or parties likely to be affected by the order sought or upon such other notice, if any, as this Court may Order.
-

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO FRASER PAPERS INC., FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER PAPERS LIMITED and FRASER N.H. LLC (collectively, the "Applicants")

Court File No.: CV-09-8241-00CL

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

Proceedings commenced at Toronto

**ORDER**

**ThorntonGroutFinnigan LLP**  
Barristers and Solicitors  
Suite 3200, P.O. Box 329  
Canadian Pacific Tower  
Toronto-Dominion Centre  
Toronto, ON M5K 1K7

**Robert I. Thornton** (LSUC# 24266B 1B)  
**Michael E. Barrack** (LSUC# 21941W)  
**D.J. Miller** (LSUC# 34393P)

Tel: 416-304-1616  
Fax: 416-304-1313

Lawyers for the Applicants

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO FRASER PAPERS INC., FPS CANADA INC., FRASER PAPERS HOLDINGS INC., FRASER TIMBER LTD., FRASER PAPERS LIMITED and FRASER N.H. LLC (collectively, the "Applicants")

Court File No.: CV-09-8241-00CL

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

Proceedings commenced at Toronto

**MOTION RECORD**

**ThorntonGroutFinnigan LLP**  
Barristers and Solicitors  
Suite 3200, P.O. Box 329  
Canadian Pacific Tower  
Toronto-Dominion Centre  
Toronto, ON M5K 1K7

**Robert I. Thornton** (LSUC# 24266B 1B)  
**Michael E. Barrack** (LSUC# 21941W)  
**D.J. Miller** (LSUC #34393P)

Tel: 416-304-1616

Fax: 416-304-1313

Lawyers for the Applicants