

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

**FRASER PAPERS INC., FPS CANADA INC.,
FRASER PAPERS HOLDINGS INC., FRASER
TIMBER LTD., FRASER PAPERS LIMITED,
FRASER N.H. LLC**

**MONITOR'S THIRD REPORT TO THE COURT
July 14, 2009**

ONTARIO SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT WITH
RESPECT TO FRASER PAPERS INC., FPS CANADA INC., FRASER PAPER HOLDINGS
INC., FRASER TIMBER LTD., FRASER PAPERS LIMITED, FRASER N.H. LLC

Applicants

THIRD REPORT TO THE COURT
SUBMITTED BY PRICEWATERHOUSECOOPERS INC.
IN ITS CAPACITY AS MONITOR
OF THE APPLICANTS

INTRODUCTION

1. On June 18, 2009, 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**") made an application under the *Companies' Creditors Arrangement Act* (the "**CCAA**") and an initial order (the "**Initial Order**") was granted by the Honourable Mr. Justice Morawetz of the Ontario Superior Court of Justice (Commercial List) (the "**Court**") granting, *inter alia*, a stay of proceedings against the Applicants until July 17, 2009 (the "**Stay Period**") and appointing PricewaterhouseCoopers Inc. as monitor (the "**Monitor**"). The proceedings commenced by the Applicants under the CCAA will be referred to herein as the "**CCAA Proceedings**".
2. On June 19, 2009, the Applicants sought and obtained recognition and provisional relief in an ancillary proceeding pursuant to Chapter 15 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

3. On June 26, 2009, the Applicants also sought and were granted an Order stating that the Applicants shall not make past service contributions or special payments to fund any going concern unfunded liability or solvency deficiency of the Pension Plans during the Stay Period. The Monitor filed its second report on June 25, 2009 to provide the Court with pertinent information with respect to the Applicants' pension plans.
4. The purpose of this, the Monitor's third report (the "**Third Report**"), is to provide the Court with information pertaining to the following:
 - (A) The Applicants' operations during the Stay Period;
 - (B) The Monitor's activities during the Stay Period;
 - (C) The status of the Chapter 15 Proceedings;
 - (D) The Applicants' receipts and disbursements for the period June 18, 2009 to June 28, 2009 (the "**Period**"), including a variance analysis of actual cash flows as compared to forecast cash flows;
 - (E) The Applicants' revised and extended weekly cash flow forecast for the 16 week period from June 29 to October 18, 2009 (the "**16 Week CFF**");
 - (F) Amendments to the DIP Financing provided by BAM and CIT (as defined later in this report), including revisions related to additional DIP Financing to be provided by the Province of New Brunswick;
 - (G) Modifications being sought by the Applicants to the Initial Order;
 - (H) The Applicants' proposed claims process;

And to support the request of this Honourable Court for approval of:

- (I) An extension of the Stay Period to October 16, 2009;
- (J) Amendments to the Initial Order;
- (K) Amendments to the DIP financing term sheets of BAM and CIT;

- (L) An amendment of the existing credit facility with the Province of New Brunswick, including a super-priority financing component; and
 - (M) The Claims Process (as defined later in this report).
5. Unless otherwise stated, all monetary amounts contained herein are expressed in U.S. Dollars. Capitalized terms used herein not otherwise defined are as defined in the Initial Order, the Monitor's First Report and in the affidavit of J. Peter Gordon sworn July 10, 2009 (the "**July 10 Gordon Affidavit**").
 6. The Monitor has not audited, reviewed, or otherwise attempted to verify the accuracy or completeness of such information and, accordingly, the Monitor expresses no opinion or other form of assurance in respect of such information contained in this Report. Some of the information referred to in this Report consists of forecast and projections. An examination or review of the financial forecast and projections, as outlined in the Canadian Institute of Chartered Accountants ("**CICA**") Handbook, has not been performed. Future-oriented financial information referred to in this Report was prepared by the Applicants based on Management's estimates and assumptions.
 7. Readers are cautioned that, since these projections are based upon assumptions about future events and conditions, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.

ACTIVITIES OF THE COMPANY

8. Since June 18, 2009, the Applicants have worked diligently to stabilize their operations and have been able to maintain operations (as they were in the period leading up to June 18, 2009), being the operations at the Edmundston pulp mill (in New Brunswick), the Madawaska and Gorham paper mills (in Maine and New Hampshire, respectively) and the Masardis lumber mill (in Maine).
9. The Applicants have continued to sell products to their customers and have obtained the necessary goods and services from their suppliers, necessary to continue operations, without a significant disruption in supply. There have been no significant changes in the

Applicants' workforce and the Applicants have secured the necessary financing, through the DIP Financing, to continue operations while they attempt to restructure.

10. The Applicants executed a comprehensive communication plan subsequent to the issuance of the Initial Order (as described in more detail in the Communication Plan section of this report below) to address the information needs of suppliers, customers, employees and retirees.

Suppliers

11. As a result of the filing, the Applicants have expended significant energy and resources in order to notify trade suppliers affected by the filings and negotiate acceptable payment terms for ongoing supply with all suppliers. While there have been numerous issues to resolve with suppliers for goods and services, the Applicants have, for the most part, maintained the continuity of supply of goods and services to their various businesses.
12. The Monitor understands the Applicants have also renewed their property insurance, with only a modest increase in premiums which is payable in an upfront annual instalment.

Customers

13. The Applicants have provided the majority of their customers with information surrounding the CCAA Proceedings. Management has advised the Monitor that key customers have continued regular purchasing patterns and that, in general, customers have expressed a desire to continue to purchase goods from the Applicants. The customers have been generally supportive of the Applicants in this respect thus far, accordingly, cash inflows during the Period have been better than Forecast.
14. As of the date of this Report, the Monitor is not aware of any significant customer disruption or order cancellation due to the commencement of the CCAA Proceedings.

Employees & Retirees

15. The Applicants are continuing to hold discussions with unions at various locations. The discussions are focussed on modifications to existing collective bargaining agreements

(“CBAs”) and are being carried out between Senior Management and senior members of the various unions.

16. The Monitor understands that the Applicants have negotiated the principal terms of a new five-year CBA with the Thurso pulp mill unionized employees, which is conditional upon receiving a financing commitment from the Quebec Government. It is the intention to seek ratification of the new CBA once a term sheet has been received from the Quebec Government (as expanded upon in more detail below).
17. The Monitor also understands that the Applicants have presented a final proposal of a new four-year CBA to the unionized employees of the Edmundston mill. These employees are to vote on this new CBA on Tuesday, July 14, 2009. Management has advised that if this new CBA is approved, the Edmundston sulphite pulp mill could be re-started as early as late July 2009.
18. As noted in more detail below, the Applicants and the Monitor have conducted employee information meetings at all operating locations in Canada and the United States to inform employees about the restructuring process and respond to employees’ questions.
19. The Monitor understands that the Applicants are developing an employee incentive plan designed to ensure that the Applicants provide recognition and incentive to individuals critical to the successful restructuring of the Applicants.

Communication Plan

20. The Applicants have implemented a comprehensive communication plan to advise its various stakeholders of the CCAA Proceedings, including:
 - (a) On June 18, 2009 the Applicants issued a press release advising of the CCAA Proceedings and advising the various stakeholder groups of the websites established by the Applicants and the Monitor to answer enquiries;
 - (b) The Applicants also sent letters to suppliers, customers, regulators, employees, retirees and community leaders to inform them of the CCAA Proceedings and direct them to the Applicants’ and Monitor’s websites for further information;

- (c) The Applicants also set-up a restructuring hotline (1-877-374-3834) for all interested parties to leave messages regarding the restructuring, as well as a dedicated email address (restructuring@toronto.fraserpapers.com) for questions to be tabled by email. The Monitor has been reviewing these messages and emails and the Applicants have been responding to all parties on a timely basis.
21. In accordance with paragraph 50 of the Initial Order, on June 30, 2009 the Applicants sent by prepaid ordinary mail a notice of these proceedings to all known creditors to which the Applicants owed more the \$1,000. A copy of the notice is included as Appendix A to this report.
 22. In addition, on June 19, 2009, the Applicants' U.S. attorneys sent the Chapter 15 pleadings, included as Appendix B in this report, to all U.S. creditors of the Applicants.
 23. On or before June 19, 2009, the Applicants also posted the Employee Letter at each of the operating mills in several prominent positions.
 24. On or before June 23, 2009, the Applicants mailed or e-mailed an employee letter (the "Employee Letter") to their approximately 2,400 employees. The Employee Letter (included as Appendix C to this Report) identifies the filings for court protection pursuant to the CCAA in Canada and pursuant to Chapter 15 of the Bankruptcy Code in the United States. The letter also advises employees that they could stay informed of the insolvency proceedings' updates, via the Monitor's Website, phone hotline and email, and via the Applicants' website, phone hotline and new dedicated restructuring email.
 25. On or before June 23, 2009, the Applicants issued English or French notices to retired participants of registered pension plans sponsored by the Applicants. The notices advised that the Order permits the Applicants to continue making payment to retirees for health, dental and similar benefits including life insurance, but that the payments are subject to a cap and may change as the restructuring plans evolve. The Applicants also advised of their intention to notify the retired participants of the registered pension plans should their decision to continue to make payments change.

26. On or before June 23, 2009, the Applicants issued English and French notices to participants of the Applicants' Supplemental Employee Retirement Plans. The notices advised that the Applicants were no longer obligated or able to make payments in respect of any unfunded, unregistered pension plans. The Applicants advised that they would immediately cease paying benefits to participants currently in receipt of benefits under the plans.

Plaster Rock Lumber Mill Modernization Capital Expenditures

27. The Monitor understands that the Applicants have reached an agreement with the New Brunswick Government ("GNB") to advance up to C\$9 million, pursuant to an existing term loan facility that had been entered into in June 2008 to finance a comprehensive modernization of the Plaster Rock lumber mill. The estimated costs to complete the modernization are C\$8.5 million, net of tax. The Applicants have agreed that any new advances are to be used exclusively for expenditures to complete this project, as discussed in more detail below.

Thurso Pulp Mill Re-Financing

28. The Monitor understands that the Applicants have continued discussions with the Quebec Government's Ministry of Economic Development regarding potential new financing that would fund the re-start of operations at the Thurso pulp mill. The Applicants anticipate receipt of a term sheet in regards to this financing within the next two weeks.

ACTIVITIES OF THE MONITOR

29. To date, the Applicants have provided the Monitor with their full co-operation and unrestricted access to their premises, books and records. The Monitor has implemented procedures for the monitoring of the operations, receipts and disbursements and is assisting the Applicants in their dealings with suppliers.

30. The Monitor has established a website at www.pwc.com/car-fraserpapers (the “**Website**”) which includes all materials filed by the Applicants and Monitor in this Court as well as all orders issued by this Court.
31. The Monitor also established a dedicated hotline at 1-877-332-1688. To date, the Monitor has received and returned in excess of 400 calls and emails to suppliers, customers, employees and retirees.
32. The Monitor chaired two information meetings with employees at each of the Masardis lumber mill on July 8, 2009, the Edmundston pulp mill and Madawaska paper mill on July 9, 2009 and the Gorham paper mill on July 10, 2009. At each meeting, the Monitor, along with senior management of the Applicants, provided a presentation to each employee group to address the nature and role of a court appointed Monitor, the principal reasons for the CCAA and Chapter 15 filings, an overview of the restructuring process and to answer attendees’ questions.
33. The Monitor has assisted the Applicants deal with a number of their suppliers to ensure the uninterrupted flow of goods and services to the Applicants.
34. The Monitor has also assisted the Applicants in preparing the actual receipts and disbursements analysis for the period to June 28, 2009, detailed below.

STATUS OF CHAPTER 15 PROCEEDINGS

35. On June 19, 2009, the U.S. Court entered a Temporary Restraining Order (“**TRO**”) pursuant to Chapter 15 of the U.S. Bankruptcy Code, recognizing the Applicants’ CCAA Proceedings as a “foreign main proceeding” and enforcing the terms of the Initial Order of the Ontario Court dated June 18, 2009 in the U.S. A copy of the TRO is included as Appendix D of this report.
36. On June 26, 2009 the TRO was converted into a preliminary injunction, a copy of which is included as Appendix E of this report.

37. The Monitor understands that on July 13, 2009, at an uncontested hearing, the U.S. Court approved an order to convert the preliminary injunction into a permanent injunction.

RECEIPTS & DISBURSEMENTS FOR THE PERIOD FROM JUNE 18 TO JUNE 28, 2009

38. The Applicants' actual net cash flow for the period from June 18 to June 28, 2009 (the last date actual receipts and disbursement data were available at the time the Third Report was finalized) was approximately \$16.8 million higher than its forecast cash flow included in the Monitor's First Report to the Court (the "**Initial Forecast**"), as summarized below:

\$000	Actual	Forecast	Variance
			Fav/(Unfav)
Total Receipts	13,573	4,328	9,245
Disbursements:			
Raw Material Costs	6,700	10,398	3,698
Productions Overhead Costs	284	2,169	1,885
Selling, General & Admin Costs	747	2,116	1,369
Employee Costs	4,050	3,307	(743)
DIP Interest & Fees	240	1,122	882
Hedging Gains/Losses	(267)	(275)	(8)
Pre-Filing Debt Interest & Other Bank Charges	17	24	7
Capital Expenditures	-	236	236
Other	205	460	255
Total Disbursements	11,976	19,557	7,582
Surplus/(deficiency)	1,597	(15,230)	16,827
Opening Cash	5,257	1,400	3,857
DIP Loan Advance	7,162	15,230	(8,068)
DIP Loan Repayment	(6,647)	-	(6,647)
Ending Total Cash	7,369	1,400	5,969

39. Comments on the specific variances between the Initial Forecast and actual receipts and disbursements are provided in Appendix F hereto, but in summary, the Applicants cash flow has been better than forecast largely due to:
- (a) Better than forecast receipts due to a forecast slow-down in collections that did not occur; and
 - (b) Lower than forecast disbursements, primarily resulting from timing differences in respect of payments to suppliers and a delay in payment of DIP fees. This positive variance is expected to reverse over the next couple of weeks.

APPLICANTS' CASH FLOW FORECAST FOR THE PERIOD FROM JUNE 29 TO OCTOBER 18, 2009

40. The Applicants have prepared a revised and extended cash flow forecast for the period of June 29 to October 18, 2009, the 16 Week CFF, a copy of which is attached hereto as Appendix G.
41. The Applicants have not previously prepared weekly cash flow forecasts. As a result, the 16 Week CFF is a new forecast that has been prepared by Management on a "bottom-up" basis using the best available information. As with any new forecasting methodology, where there has not been a period of time to verify the assumptions with actual results, it is likely that there will be variances between forecast to actual results.
42. The 16 Week CFF forecasts that the Applicants will incur a net cash out flow of approximately \$23.3 million during this period of time, which is to be funded by the cash on hand and utilization of the DIP Financing.
43. The major changes in assumptions underlying the 16 Week CFF as compared to the Initial Forecast are as follows:
- (a) The discontinuance of the Applicants' cash flow hedging program due to the reduction in its Canadian dollar exposure as a result of the shutdowns of the

Thurso mill and the Canadian sawmills, which is expected to generate net proceeds of approximately \$11.4 million;

- (b) Capital expenditures in respect of the Plaster Rock lumber mill modernization and receipt of funding the Applicants expect to receive under the new Plaster Rock DIP Loan, as defined later in this report; and
 - (c) A change in the US\$/C\$ exchange rate used for the 16 week period, based on the spot rate as of July 10, 2009, of \$0.86.
44. Based on the cash on hand as at June 29, 2009 coupled with the forecast availability under the DIP Financing, the Applicants appear to have sufficient liquidity to fund the net cash out flow during the 16 Week CFF period.

DIP FINANCING

45. As noted in the Monitor's First Report, the Applicants had obtained DIP financing from Brookfield Asset Management ("**BAM**" and the "**BAM DIP Financing**") and CIT Business Credit Canada Inc. ("**CIT**" and the "**CIT DIP Financing**"). The combined DIP financing authorizes borrowing up to \$45 million (CIT - \$25 million, BAM - \$20 million), subject to the availability formula associated with the CIT DIP Financing terms and conditions. Notwithstanding \$45 million of authorized DIP financing, the maximum priming DIP charge was limited to \$20 million.
46. As set out in the July 10 Gordon Affidavit, the Applicants have secured the following, which has increased the maximum available amount of DIP financing to approximately \$52 million:
- (a) a C\$9 million (approximately US\$8 million) GNB Plaster Rock lumber mill modernization loan (the "**Plaster Rock DIP Loan**"); and

- (b) consent of GNB, BAM and CIT (the “**Secured Lenders**”) to increase the priming CIT and BAM DIP financing charge to an amount equal to the maximum available borrowings of \$44 million (the CIT DIP Financing was adjusted downwards by \$1 million), but still subject to the CIT DIP Financing availability formula.
- 47. As of June 28, 2009, based on these revisions and the CIT DIP Financing availability formula, the Applicants would have total DIP financing availability of up to approximately \$ 37 million (including the DIP Plaster Rock DIP Loan).
- 48. The principal terms of the agreed amendment to the existing loan agreement between Fraser Papers Inc. and GNB, which requires a corresponding amendment to the Initial Order, are as follows:
 - (a) all advances under the Plaster Rock DIP Loan are to be used exclusively for the completion of the Plaster Rock lumber mill modernization project;
 - (b) CIT and BAM must acknowledge that all advances under the Plaster Rock DIP Loan will be given a super-priority charge over the fixed assets of the Plaster Rock lumber mill; and
 - (c) Advances under the Plaster Rock DIP Loan will incur interest at the rate of 4.7% per annum, as determined in the existing loan agreement, paid monthly.

AMENDMENTS TO THE INITIAL ORDER

- 49. The Applicants also seek modifications to the Initial Order to reflect:
 - (a) Amendments to the CIT and BAM DIP financing agreements to accommodate the Plaster Rock DIP Loan;
 - (b) Consent of the Secured Lenders to effectively increase the priming DIP charge on the DIP financing to approximately \$52 million;

- (c) Agreement amongst the Secured Lenders as to the relative priorities to be afforded to these DIP lenders over various classes of collateral, as outlined in Appendix H;
- (d) Amendments to reflect the order obtained in respect of the Applicant's June 26, 2009 pension motion;
- (e) An increase the Administration Charge from C\$750,000 to C\$850,000 as a result of the need for a claims officer to be retained in respect of the Claims Process, described below, and;
- (f) to include the claims officer as a person who shall be entitled to the benefit of the Administration Charge.

THE CLAIMS PROCESS

- 50. The Applicants are seeking approval of a process for the submission, evaluation and adjudication of claims against the Applicants and past and present directors and officers of the Applicants (the "**Claims Procedure**"). The Monitor, with the assistance of the Applicants, will be responsible for the administration of the Claims Procedure.
- 51. The Claims Procedure is set out in the updated Claims Process Order which we understand is to be filed in Court in time for the July 15, 2009 hearing. Unless otherwise defined, capitalized terms used in this section of this report shall be as defined in the updated Claims Process Order.
- 52. In summary, the major steps of the Claims Procedure are as follows:
 - (A) The Applicants shall provide the Monitor with a complete list of all Known Creditors, showing for each Known Creditor, their name, address and amount owed pursuant to the Applicant's books and records;

- (B) On or before August 14, 2009, Proofs of Claim Document Packages will be sent by the Monitor to all Known Creditors for completion and submission to the Monitor;
- (C) The Monitor shall send a Proof of Claim Document Package to each Creditor with a Restructuring Claim, that arose after the Filing Date but prior to the Restructuring Claims Bar Date, as soon as practicable, and in any event, no later than 21 days prior to the date fixed by the Court for voting on any plan in respect of the Applicants;
- (D) A Notice to Creditors will be published on or before August 12, 2009, in each of (a) the national edition of The Globe and Mail; and (ii) The Wall Street Journal (U.S. Edition), calling for claims against the Applicants in order to identify Unknown Creditors. Unknown Creditors responding to the Notice to Creditors will be provided a Proof of Claim Document Package;
- (E) Copies of the Notice to Creditors, the Proof of Claim Document Package and the Claims Process Order will also be available from the Monitor's Website at www.pwc.com/car-fraserpapers;
- (F) Creditors will be required to file their Proof of Claim with the Monitor by 5:00 pm (Eastern Standard Time) on September 30, 2009, (the **"Claims Bar Date"**);
- (G) Creditors with Restructuring Claims will be required to file their Proof of Claim with the Monitor by 5:00 pm (Eastern Standard Time) on the date 30 days prior to any vote (the **"Restructuring Claims Bar Date"**);
- (H) The Monitor, with the assistance of the Applicants, will review and evaluate Proofs of Claim received and, if not accepted, in whole or in part, the Monitor will issue a Notice of Revision or Disallowance and a blank Dispute Notice to the Creditor by 5:00 pm (Eastern Standard Time) October 23, 2009;

- (I) Creditors may dispute their Claim, as set out in the Notice of Revision or Disallowance, by filing a Dispute Notice with the Monitor and the Applicants by 5:00 pm (Eastern Standard Time) November 6 2009, setting out the reasons for their dispute;
 - (J) Any Creditor who does not serve and file such Dispute Notice within the noted time frame shall be deemed to have accepted the claim as set out in the Notice of Revision or Disallowance;
 - (K) Dispute Notices not consensually resolved through the dispute and review process may be accepted by the Monitor and the Applicants for voting purposes only;
 - (L) Dispute Notices not consensually resolved through the dispute and review process will be sent to a Claims Officer, who shall make a determination as to the quantum of the Creditor's Claim for distribution purposes and, if necessary, for voting purposes;
 - (M) The decision of the Claims Officer shall be final and binding for voting purposes;
 - (N) Adjudication by a Claims Officer of Claims for distribution purposes may be appealed to the Court; and
 - (O) Any Creditor that does not file a Proof of Claim by the Claims Bar Date or the Restructuring Claims Bar Date will be forever barred from asserting a claim against the Applicants and the past and present directors and officers of the Applicants.
53. The Applicants believe that the proposed Claims Process will allow the Applicants to determine the claims against them and proceed with one or more creditor meetings for the purpose of voting in respect of a restructuring plan, which will facilitate their ability to complete the CCAA Proceedings on a timely basis.

54. The Monitor considers the Applicants have proposed an achievable timetable to complete the Claims Procedure. As a result, the Monitor believes that the Claims Procedure is fair and reasonable and respectfully recommends that the Company's request for the approval of the Claims Procedure be granted.

EXTENSION OF THE DEADLINE FOR THE STAY PERIOD

55. Pursuant to the Initial Order, the Stay Period expires on July 17, 2009. In order to allow the Applicants sufficient time to continue the restructuring of its business and operations, including the formulation of a potential plan of arrangement, the Applicants are requesting an extension of the stay period to October 16, 2009.
56. As described earlier in this report, the Applicants have prepared an updated weekly cash flow forecast for the 16 week period ending October 18, 2009, which indicates that the Applicants should have sufficient liquidity to sustain ordinary course operations during the proposed extended stay period.
57. The Monitor is not aware of any material changes to the Applicants' operations in Canada or the U.S. since the commencement of the Stay Period on June 18, 2009.
58. The Monitor believes that, based on the information currently available, creditors would not be prejudiced by an extension of the stay period to October 16, 2009.
59. The Monitor believes that the Applicants are diligently working on formulating a restructuring proposal for presentation to the creditors and court and the Applicants believe such restructuring proposal may be presented before the end of extended Stay Period.
60. The Monitor believes that the Applicants have acted and are acting in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate. The Monitor therefore respectfully recommends that the Applicants' request for an extension of the Stay Period to October 16, 2009, be granted.

The Monitor respectfully submits to the Court this, its Third Report.

Dated at Toronto, this 14th day of July 2009.

PricewaterhouseCoopers Inc.
in its capacity as Monitor of
Fraser Papers Inc. et al

A handwritten signature in black ink that reads "John McKenna". The signature is written in a cursive, flowing style.

John McKenna
Senior Vice President