

Court File No. 08-CL-7819

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)
IN BANKRUPTCY AND INSOLVENCY**

IN THE MATTER OF THUNDER BAY FINE PAPERS INC.

FIRST REPORT OF THE INTERIM RECEIVER AND RECEIVER

January 26, 2009

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I. Introduction

1. By Order of the Honourable Mr. Justice Campbell dated October 29, 2008 (the “Initial Order”), Deloitte & Touche Inc. was appointed interim receiver and receiver (the “Receiver”), without security, over all of the assets, undertakings and properties of Thunder Bay Fine Papers Inc. (“TBFP” or the “Debtor”) pursuant to section 47(1) of the *Bankruptcy and Insolvency Act* (“BIA”) and section 101 of the *Courts of Justice Act*. A copy of the Initial Order is attached hereto as Exhibit “A”.
2. The Initial Order empowered the Receiver to market and to sell any or all of the property of the Debtor (the “Property”). The Receiver undertook a sales and marketing process (the “Sales Process”) and has accepted an offer to purchase substantially all of the Property, subject to approval by this Honourable Court. The Receiver considers it advisable to inform this Honourable Court as to the status of matters since the appointment of the Receiver; to seek approval of its activities to date; and to seek approval with respect to the recommendations set out in this, the Receiver’s first report (the “Report”).

II. Summary of Recommendations

3. Based on the matters set out in this Report, and subject to the advice and directions of this Honourable Court, the Receiver recommends the following and seeks from this Honourable Court an order:
 - i. approving the activities carried out by the Receiver since its appointment on October 29, 2008;
 - ii. approving the Sales Process carried out by the Receiver;
 - iii. approving the Agreement of Purchase and Sale entered into by the Receiver in connection with the sale of the Property, which is more fully described in the Receiver’s Supplemental Report;
 - iv. granting a Vesting Order vesting all of the Debtor’s rights, title and interest in the Property free and clear of all liens, claims and encumbrances; and
 - v. approving the Receiver’s cash receipts and disbursements for the period October 29, 2008 to January 23, 2009.

III. Background to Receivership

4. TBFP owns a fine paper mill in Thunder Bay, Ontario (the "Mill"). The Mill was originally built in 1917 and has been operated by several owners. The most recent owner prior to TBFP was Cascades Fine Papers Group Inc. ("Cascades"), which operated the Mill from 1997 until January 2006, when the Mill was closed because it was unprofitable. TBFP purchased the Mill from Cascades in December 2007 with a view to restarting the Mill and producing high-grade glossy paper and card inserts for sale to printers of magazines and similar publications.
5. To finance the restart, TBFP arranged financing from several sources: new equity, a \$4,000,000 grant from Cascades, term loans from CIT Business Credit Canada Inc. ("CIT") of up to \$12,700,000 guaranteed by the Province of Ontario, and a further loan of up to \$1,500,000 from the Northern Ontario Heritage Fund Corporation. CIT also agreed to provide a revolving line of credit under a credit agreement following the restart.
6. TBFP restarted operations at the Mill in May 2008. The business operated for a short period of time but was not able to generate sales as quickly as had been forecast and incurred higher than forecast expenses in refurbishing the Mill. The Mill was shut down again in mid-July because of excess inventories and a lack of cash.
7. During the period from mid-July to mid-October 2008, TBFP was able to sell some of the inventory of fine paper it produced while it was in operation. TBFP was unable to obtain additional financing and by the end of October 2008, it had no cash to complete the refurbishing of the equipment or to pay its other obligations. On October 29, 2008 pursuant to an application by CIT, the Initial Order was made appointing the Receiver.

IV. Receiver's Activities to Date

Possession and Control

8. Immediately following its appointment, the Receiver attended at TBFP's head office located at 550 Shipyard Rd. in Thunder Bay, Ontario. Initial meetings were conducted with key management employees to address critical issues.
9. Along with TBFP management, the Receiver reviewed the roles of the TBFP employees that were still on payroll to determine who should be retained to assist the Receiver. Key suppliers, such as utilities and security services, were contacted to facilitate the safeguarding of assets.

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10. The Receiver entered into an arrangement with Safety Net Security Ltd., to provide security 24 hours per day, including weekends. A list of employees who were retained was provided to security to allow clearance through the gate. All visitors, including former employees, required pre-approval by the Receiver for entry to the Mill.
 11. A local locksmith was contracted to change the locks at the office building. Keys were provided to specific personnel, where necessary.
 12. The Receiver instructed the Debtor's bankers to freeze the Debtor's local bank accounts and arrangements were made to transfer existing funds to new trust accounts in the Receiver's name. Arrangements were made to transfer any future receipts of TBFP accounts receivable from the Debtor's lockbox account to the new trust accounts.
 13. Immediately prior to the receivership, the supply of natural gas to TBFP had been terminated for lack of payment. As a result, the Debtor was unable to start up its heating system. Heat to the Mill was considered critical to safeguard the Debtor's chemical inventories, and prevent damage to the machinery and equipment, water lines, and sprinkler system. On October 30, 2008, the Receiver negotiated with representatives of Union Gas to set up a new account, to allow for the unlocking of the gas meters and re-supply of gas. Shortly afterwards, the boiler was able to be restarted and heat to the Mill was restored.
 14. TBFP's finished paper inventory was stored at the Mill, and at two offsite leased locations nearby in the city of Thunder Bay. The Receiver contacted the landlords and negotiated payment arrangements to ensure that access to TBFP's paper inventory would not be interrupted.
 15. The Debtor's property and liability insurance policy premiums were fully paid until December 21, 2008. Since then, the Receiver has paid premiums to continue the same insurance coverage on a monthly basis.

Employees

16. Pursuant to paragraph 13 of the Initial Order, "...all employees of the Debtor remain employees of the Debtor until such time as the Receiver, on the Debtor's behalf, may terminate the employment of the employees". There were approximately 60 employees of the Debtor on the receivership date. On behalf of the Debtor, the Receiver terminated 38 employees. The remaining 22 employees continue to be employed by the Debtor.
17. In addition, when needed, the Receiver has employed a number of former employees of the Debtor to assist with the shipping of inventory sold by the Receiver.

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18. Records of employment were prepared and provided to Service Canada for all terminated employees.
 19. The Debtor was unable to fund the payroll for its employees for the two week period ending on the date of the receivership. While the majority of the unpaid wages would be eligible for payment under the Wage Earner Protection Program (the "WEPP"), with the consent of CIT, the Receiver advanced payment of the priority amount due under the WEPP as well as any amounts owed for the pre-receivership payroll in excess of the WEPP priority payment limit to the retained employees.
 20. As required pursuant to the WEPP, the Receiver prepared and filed the prescribed information for 271 qualifying employees of TBFP through the Service Canada website. As well, a notice and proof of claim were sent to the qualifying employees to explain the process for them to make WEPP claims. The Receiver continues to respond to inquiries from former employees and Service Canada regarding the WEPP application process.

Third Party Property

21. The Receiver coordinated on-site visits to allow former employees to pick up personal belongings. The Receiver inspected and approved all items that were removed from the premises in order to ensure they were personal in nature and signed receipts were obtained.
22. A number of property claims have been received from third parties for the return of their equipment. Each claim has been reviewed by the Receiver and arrangements were made to release the equipment where such third parties provided satisfactory evidence of their claim.
23. In some cases, the Receiver agreed to allow claimants to leave their equipment at the Mill until the sales process had concluded.

Current Assets

24. The Receiver has collected the majority of the Debtor's accounts receivable. The remaining accounts are not significant and further collections are unlikely.
25. Since the commencement of the receivership, the Receiver has continued selling TBFP's inventories of raw materials and finished paper.
26. The Receiver retained the services of TBFP's former sales manager on a commission based arrangement to sell the finished paper inventory. As at the date of this Report, all of the

Company's finished goods inventory has been sold. Approximately 3,800 tons of paper remains to be shipped. The shipping of the remaining paper is expected to be complete by mid-March.

27. The Receiver has sold and shipped TBFP's entire inventory of raw poplar logs.

28. The Receiver continues to offer TBFP's chemical inventory for sale.

Environment

29. TBFP operations are subject to a Certificate of Approval (the "CA") issued by the Ontario Ministry of Environment (the "MOE"). The Debtor's environmental manager, informed the Receiver of the required environmental monitoring and testing of the water and sewage discharged into the water treatment lagoon, which pursuant to the CA, should be continued notwithstanding the shutdown of Mill operations. The Receiver has ensured that testing of the effluent, as required by the CA, has continued throughout the receivership.

30. A letter dated November 10, 2008 (the "November 10th Letter"), summarizing the MOE's environmental concerns at the Mill was received by the Receiver. A copy of the November 10th Letter is attached hereto as Exhibit "B".

31. Shortly after receipt of the November 10th Letter, the Receiver met with representatives of the MOE to discuss the outstanding environmental issues related to the Mill, to ensure that the MOE was satisfied with the Receiver's plans to continue with the testing as required by the CA, and to confirm that the Receiver could direct inquiries relating to environmental issues from potential purchasers to the MOE. The representatives of the MOE confirmed that they were satisfied with these arrangements. Since that meeting, the Receiver has kept the MOE regularly informed as to the status of the receivership and the Sales Process.

32. The Receiver was made aware that there existed 26 radioactive materials in storage at the Mill. These radioactive materials were required as part of the process for producing paper. TBFP holds a license with the Canadian Nuclear Safety Commission ("CNSC") for the storage and use of such radioactive materials (the "License").

33. On November 7, 2008 the Receiver received a notice from the CNSC advising that the License was not transferable to the Receiver.

34. On November 28, 2008, the Receiver entered into a contract with Stuart Hunt & Associates Ltd. ("Stuart Hunt"), a licensed radiation safety services provider, to safely remove all of TBFP's radioactive materials. Under the agreement with Stuart Hunt, the Receiver has six months to decide whether to retrieve or dispose of the materials. Should this option not be exercised by the

end of the six month period, the materials will be disposed of by Stuart Hunt. The CNSC has been advised that the radioactive materials have been removed. The License has been cancelled.

Notices to Creditors

35. On November 4, 2008, the Notice and Statement of the Receiver (“Receivership Notice”), prescribed by sections 245(1) and 246(1) of the BIA, was sent by regular mail to all creditors on record with TBFP. A copy of the Receivership Notice is attached hereto as Exhibit “C”.

V. Sales Process

36. The Receiver prepared a detailed sales information package containing details of the following:

- Sales Process
- Timeline summary
- Terms and conditions of sale
- Introduction and General Description of the Business
- Description of Assets Available for Sale
- Offer Form
- Agreement of Purchase and Sale

37. A copy of the Sales Information Package dated November 10, 2008 (the “Sales Information Package”) is attached as hereto as Exhibit “D”.

38. The Sales Process can be summarized as follows:

- Offer due date: On or before 5 pm (Toronto time) Friday November 28, 2008 (the “Offer Due Date”)
- Notice of Accepted Offers: On or before Friday December 5, 2008
- Closing Date: On or before Monday December 8, 2008
- Removal of Assets Date (if applicable)- No later than 5 pm (Toronto time) Wednesday December 31, 2008

39. With the assistance of TBFP management, the Receiver compiled a listing of potential buyers based on industry research, knowledge of competitors, suppliers, customers, and identified

interested parties. In addition, several machinery and equipment liquidators were included in the list of potential buyers.

40. The Receiver also prepared an announcement inviting offers to purchase the business and/or the assets of TBFP (the "Offer Invitation"). Due to the specialized nature of the paper industry, the Receiver did not believe it would be effective to place advertisements for the sale of the assets of TBFP in general newspaper publications. In addition, the deadlines for advertising in bi-weekly or monthly releases of paper industry magazines could not be met. Instead, the Receiver contacted relevant pulp and paper industry websites, and arranged for the Offer Invitation to be listed. The Receiver listed the Offer Invitation on the websites of Pulp and Paper Canada and RISI, in the United States. A copy of the Offer Invitation is attached hereto as Exhibit "E".
41. Identified potential buyers and equipment dealers were contacted during the week of November 3, 2008. Distribution of the Sales Information Package via e-mail occurred on and subsequent to November 11, 2008 to those parties that requested the information. The Receiver promptly responded to any related inquiries from such parties. Confidentiality agreements were signed by parties prior to the release of any further information.
42. The Receiver arranged for on-site visits for potential buyers, with the first visit occurring on November 7, 2008. The Receiver ensured that TBFP personnel, who were familiar with the equipment and Mill operations, provided a tour of the Mill.
43. A total of 75 parties were contacted by the Receiver. As a result of the Offer Invitation, several inquiries were received from Canada, the United States and India.
44. The Sales Information Package was requested by and sent to 37 parties. In total, 9 parties attended at the Mill to inspect the assets.
45. By the Offer Due Date, the Receiver had received expressions of interest from five parties, consisting of two offers to purchase substantially all of the Property, and three offers to liquidate all or some of the equipment. None of the offers presented by the Offer Due Date were accepted by the Receiver as none of the offers were on terms which the Receiver was prepared to recommend. The Receiver has kept the major secured creditors, CIT and the Province of Ontario (collectively, the "Secured Creditors"), fully informed as to the details of offers received.
46. Following the expiry of the Offer Due Date the Receiver continued to negotiate with the two parties which had provided offers to purchase substantially all of the Property. No additional offers other than a few offers to purchase specific equipment were received.

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47. In the week commencing January 19, 2009 the Receiver requested that the two remaining interested parties submit their highest and best unconditional offer for consideration. Two final offers were received as at January 20, 2009, including the offer from Seaway Metals Recycling Corp. (“Seaway”) which is the offer being recommended by the Receiver for approval by this Honourable Court.
48. Following receipt of the remaining two offers, Aird & Berlis LLP, legal counsel to the Receiver, sent email requests to both potential purchasers acknowledging receipt of their “final and best offer”, requesting each party to ensure that their deposits were paid forthwith and requesting evidence from each purchaser of their financial ability to close the transaction. Such evidence was requested to be received by noon on January 22, 2009, in order that the Receiver could consider the evidence prior to the expiry of the Seaway offer. Each party provided their deposits. Seaway also provided satisfactory documentary evidence to the Receiver, as further described in the confidential supplement to this Report, of their ability to close the transaction. The other offering party did not.
49. On the afternoon of January 22, 2009 the Receiver reviewed each of the offers with the Secured Creditors.
50. The Seaway offer was believed to be superior for the following reasons:
- The Receiver believed that there was far less closing risk associated with the Seaway offer.
 - Seaway provided evidence of access to sufficient capital to complete the transaction.
 - The other interested party had submitted many prior offers which were conditional on financing, and after several months remained unable to show any evidence of having secured financing to complete the transaction.
 - On a review of all of the terms of each offer, which are more specifically set out in the confidential supplement to this Report, the Receiver believed that the Seaway offer would generate a greater net recovery to the Secured Creditors. Neither offer was sufficient to generate any recovery beyond the claims of the Secured Creditors.
 - The Seaway offer was on terms fully acceptable to the Receiver, while certain terms of the alternative offer would require further negotiation.

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- The closing date of the Seaway offer was earlier than the alternative offer, which not only impacted the net value of each offer, but as well decreased the risk to the Receiver of unanticipated additional costs.
51. Based upon the above analysis the Receiver recommended that the Seaway offer be accepted and signed back prior to its expiry. The Secured Creditors concurred with the Receiver's recommendation, and shortly before 5:00 p.m. on January 22, 2009 the Receiver accepted the Seaway offer (the "Accepted Offer"), subject to the approval of this Honourable Court. A copy of the Accepted Offer in redacted form, essentially deleting any reference to the purchase price, is attached as Schedule "F" to this Report.
 52. The Receiver believes that the terms and conditions and the amount of the Accepted Offer should be kept confidential until the closing of the transaction as disclosure of such details could prejudice future sale efforts should the Accepted Offer not close for any reason.
 53. The Receiver will be submitting a Supplemental Report to this Honourable Court which will provide a summary of the Receiver's analysis of the process that led to the Accepted Offer. The Receiver respectfully requests that this Supplemental Report be sealed by this Honourable Court until after the sale transaction closes. A copy of the Accepted Offer in unredacted form is filed with the Supplemental Report and is therefore being filed with this Honourable Court in a sealed envelope pending the Receiver's request for a Sealing Order.
 54. Seaway has advised that, on closing, title to the Property being purchased will be directed in favour of Republic Development Holdings (Canada) Corp. which is a company incorporated under the laws of the Province of Ontario

VI. Cash Receipts and Disbursements

55. A copy of the Receiver's statement of cash receipts and disbursements, as at January 23, 2009 is attached hereto as Exhibit "G". The cash balance in the receivership accounts as at January 23, 2009 was \$737,990.65 before the deposit received from Seaway.

VII. Conclusion

56. The Receiver respectfully requests that this Honourable Court grant an Order which provides for the following:

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- a) approving the activities carried out by the Receiver since its appointment on October 29, 2008;
 - b) approving the Sales Process carried out by the Receiver;
 - c) approving the Agreement of Purchase and Sale entered into by the Receiver in connection with the sale of the Property, which is more fully described in the Receiver's Supplemental Report;
 - d) granting a Vesting Order vesting all of the Debtor's rights, title and interest in the assets free and clear of all liens, claims and encumbrances; and
 - e) approving the Receiver's cash receipts and disbursements for the period October 29, 2008 to January 23, 2009.

All of the foregoing is respectfully submitted to this Honourable Court as of this 26th day of January, 2009.

Deloitte & Touche Inc.

In its capacity as Interim Receiver and Receiver
of Thunder Bay Fine Papers Inc.
and not in its personal capacity



Robert J. Bougie, CA • CIRP
Senior Vice-President