

**Receiver's First Report
RE: CIC Pulp Ltd. operating as
Meadow Lake Limited Partnership and
Meadow Lake Pulp Ltd.**

RSM Richter Inc.
Calgary, December 10, 2008

CANADA)
PROVINCE OF SASKATCHEWAN)

IN THE QUEEN'S BENCH
JUDICIAL CENTRE OF REGINA

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 ARRANGEMENT FOR
THE CREDITORS OF CIC PULP LTD. in its capacity as a general partner of
MEADOW LAKE PULP LIMITED PARTNERSHIP and
MEADOW LAKE PULP LTD. in its own capacity as agent and nominee for
Meadow Lake Pulp Limited Partnership

BETWEEN:

CIC PULP LTD., operating as MEADOW LAKE PULP LIMITED PARTNERSHIP
and MEADOW LAKE PULP LTD.

APPLICANTS

- and -

HSBC BANK CANADA, INVESTMENT SASKATCHEWAN INC.,
101069101 SASKATCHEWAN INC., GUSCO HANDEL G. SCHARFELD & CO.,
MILLAR WESTERN INVESTMENTS (SASKATCHEWAN) LTD.,
MILLAR WESTERN HOLDINGS (MEADOW LAKE) LTD.
and MILLAR WESTERN INDUSTRIES LTD.

RESPONDENTS

Receiver's First Report
December 10, 2008

1.0 INTRODUCTION

- 1.1 This report is filed by RSM Richter Inc. ("Richter") in its capacity as Receiver and Manager ("Receiver") of CIC Pulp Ltd. operating as Meadow Lake Pulp Limited Partnership and Meadow Lake Pulp Ltd. (collectively "MLPLP") pursuant to an Order of the Court of Queen's Bench of Saskatchewan ("Court") made on October 1, 2007 ("Receivership Order").

- 1.2 Richter was previously appointed monitor (the “Monitor”) of MLPLP pursuant to an Order of the Court made on December 28, 2005 granting MLPLP protection under the *Companies’ Creditors Arrangement Act* (“CCAA Order”).
- 1.3 On October 29, 2007, the Court made an Order terminating the stay of proceedings against MLPLP pursuant to the CCAA Order and discharging the Monitor.
- 1.4 The purpose of this report is to:
- Provide an update on developments since September 26, 2007, the last date the Monitor reported to the Court; and
 - Respectfully recommend the Court approve the Release and Settlement Agreement among 101069101 Saskatchewan Ltd. (“101”), Meadow Lake Mechanical Pulp Inc. (“MLMP”), Elite Shine Investments Limited (“Elite”) and MLPLP.

2.0 UPDATE

Sales Summary

- 2.1 The following is a brief historical overview of the events in respect of the sale of MLPLP’s assets to MLMP:
- In December 2006, MLPLP accepted an offer to purchase from MLPLP the pulp mill (the “Mill”) and certain of its assets;
 - On January 11, 2007, the Court approved the sale of the Mill to MLMP. MLMP did not purchase, inter alia, MLPLP’s accounts receivable or finished goods inventory (the “Non-Purchased Assets”) and certain of MLPLP’s land (the “Non-Acquired Lands”);
 - On January 23, 2007, the sale transaction closed. The proceeds realized on the sale were \$38.5 million, subject to certain closing adjustments. Twenty percent (20%) of the purchase price was paid to MLPLP by way of the issuance of Class “A” common shares in MLMP (which shares are held by 101 as nominee for MLPLP) and the issuance of a promissory note in the amount of \$2.7 million to 101 as nominee for MLPLP (“Promissory Note”). The remaining eighty percent (80%) of the purchase price (\$30.8) million was paid in cash;
 - The closing adjustments related mainly to unfunded future reforestation fees owed by MLPLP to Mistik Management Ltd. (“Mistik”), the company that harvested wood for the Mill. An audit of the reforestation fees owed to Mistik was conducted following the closing of the sale to quantify the actual amount owed. The closing adjustment totalled \$2,008,568 in favour of MLMP. Consistent with the Purchase and Sale Agreement (“PSA”), this purchase price adjustment was paid 80% (\$1,606,854) by way of cash

and 20% (\$401,714) by way of a reduction in the Promissory Note. The cash component of the adjustment was paid from funds held by the Monitor;

- As a result of the closing adjustments the proceeds realized were reduced from \$38.5 million to \$36,491,432 as summarized below:

		Amount CDN\$
Cash	\$30,800,000	
Purchase price adjustment	<u>(1,606,854)</u>	\$29,193,146
Promissory Note	\$2,700,000	
Purchase price adjustment	<u>(401,714)</u>	2,298,286
Common Shares		5,000,000
		<u>\$36,491,432</u>

- The Monitor distributed cash to HSBC Bank Canada (on account of its operating loan), the Rural Municipality of Meadow Lake (on account of its property tax arrears) and to Investment Saskatchewan Inc. (“ISI”) to be applied against the DIP Facility. ISI directed and authorized the Monitor on ISI’s behalf to forward \$1.8 million to MLMP as a loan made by 101 to MLMP. Two additional advances were authorized by ISI to MLMP and were made; \$1.0 million on February 28, 2007 and \$200,000 on April 5, 2007 such that the advances directed and authorized by ISI total \$3.0 million. A total of \$2.082 million has been paid against the Dip Facility.

Buy Out of 101

- 2.2 The PSA contemplated various agreements including a pulp purchase agreement (the “Off-Take Agreement”) and a unanimous shareholder agreement (the “USA”) among 101, MLMP, and Elite. Elite is the owner of eighty percent (80%) of the Class A common shares of MLMP.
- 2.3 The USA contemplated, inter alia, a “Take-Out Price” (the purchase price amount to be paid to MLPLP for its common shares of MLMP and the Promissory Note, calculated pursuant to a formula set out in the USA) in respect of 101’s ownership in MLMP. The Receiver understands that the parties to the Off-Take Agreement (including MLMP) wished to make certain amendments thereto. Pursuant to the USA, MLMP is not permitted to agree to or permit any amendment to the Off-Take Agreement without the prior written consent of 101. 101 consented to the amendments to the Off-Take Agreement on condition that Elite purchase 101’s interest in MLMP prior to October 1, 2008. 101 has extended the time for its interest in MLMP to be so purchased.

- 2.4 101 and Elite have negotiated in good faith and arrived at a total purchase price of \$9,322,829 for 101's Class "A" common shares (\$6,386,999) and the Promissory Note (\$2,935,830).

Non Purchased Assets

- 2.5 The realization on the Non-Purchased Assets is complete, with the exception of the recovery of approximately \$400,000 relating to an outstanding deposit that was placed with CN Rail ("CN") at the commencement of the CCAA proceedings, to ensure continued supply of CN's services during the CCAA process. There also remains a dispute between MLPLP and CN with respect to outstanding invoices totalling approximately \$28,000 relating to demurrage charges. The Receiver has contacted CN on several occasions to attempt to settle the dispute and obtain the return of the deposit. The Receiver has been unsuccessful and has recently requested the assistance of its legal counsel to attempt to bring this matter to conclusion.

3.0 ENVIRONMENTAL ISSUES

Landfills

- 3.1 MLPLP continues to own the Non-Acquired Lands and MLPLP's landfills are located on these lands. A Phase I Environmental Site Assessment ("ESA") was obtained by MLPLP in January, 2007 which indicated that there were environmental issues associated with the Non-Acquired Lands. Accordingly, a Phase II ESA was subsequently commissioned to determine the extent of the environmental contamination associated with MLPLP's landfills. Based on the Phase II ESA work conducted, it was not possible to determine the extent, if any, of environmental contamination associated with the Non-Acquired Lands.
- 3.2 The environmental firm that conducted the ESA's, SLR Consulting (Canada) Ltd. ("SLR"), recommended additional steps be undertaken that would take several months to complete, in order to conclude the Phase II environmental assessment. The Phase II ESA was finished and SLR provided a report to the Receiver on February 15, 2008. The Phase II ESA concluded that there was environmental contamination caused by the landfill site, although the impact was considered to be low, that the landfills needed to be capped and that a long-term program should be established to monitor the landfill site and the attendant environmental contamination.

- 3.3 Covering the landfills with specially designed covers will limit potential future contamination. SLR was engaged to design the landfill caps. A long-term monitoring program has been developed. SLR has completed the landfill cover design and it will be provided to the Saskatchewan Ministry of Environment (“SMOE”) in the next week for its review and approval. A detailed budget to construct the covers is being developed but is not yet available; however, preliminary estimates place the costs of addressing the landfill contamination at \$4.0 million.

Water Recovery Pond

- 3.4 The Mill uses a water recovery pond (the “Recovery Pond”) in connection with its pulp production process. The water held and circulated in the Recovery Pond has a significant elevated salt content compared to fresh ground water in the Meadow Lake area. It was MLPLP’s view that the Recovery Pond’s liner was breached and it was leaking, perhaps contaminating MLPLP’s property and nearby ground waters.
- 3.5 The PSA addressed this issue by providing for MLPLP to take steps to repair the Recovery Pond. MLMP obtained cost estimates to repair the Recovery Pond. It would take several months to drain it, assess any contamination, remove any contaminated soil and replace the liner. The Recovery Pond is an integral component of the Mill’s production process and to repair the pond would entail constructing a complicated bypass system so as not to interrupt the Mill’s production process. Shutting down the Mill’s operations for several months to effect repairs would be even more costly than constructing a bypass system.
- 3.6 SLR was engaged by the Receiver to conduct several soil samples around the Recovery Pond. It was not possible to obtain a soil sample directly underneath the Recovery Pond without draining it. Based on the soil samples that could be obtained; however, SLR concluded that there does not appear to be significant leakage from the Recovery Pond, but there does appear to be contamination associated therewith. The Receiver; therefore, requested that SLR review MLMP’s cost estimate to repair the Recovery Pond for reasonability. Based on the cost estimates to repair the Recovery Pond (which includes the impact on the Mill’s operations and consideration for the removal of any

contaminated soil) an agreement has been reached, subject to Court approval, that MLPLP will pay to MLMP the sum of \$2.0 million (from the funds currently held by the Receiver) in settlement of this matter. A Release and Settlement Agreement, the form of which is attached as Exhibit “A”, provides that MLMP, in return for the \$2.0 million, agrees to:

- As soon as reasonably practicable, commence to develop a plan for the remediation of the Recovery Pond;
- Consult with 101 in respect of its remediation plan and keep 101 apprised as to the finalization and implementation of such plan; and
- Use its best efforts to complete the remediation of the Recovery Pond within two (2) years from the date of the agreement.

3.7 SMOE has been regularly consulted with the proposed remediation of the landfill sites and environmental issues in respect of the Recovery Pond. The Receiver, through SLR, intends to continue to consult with SMOE with respect to implementation of the landfill capping and monitoring program and understands that MLMP will consult with SMOE in connection with the development and implementation of the Recovery Pond remediation plan.

3.8 On May 24, 2007 the Court made an Order permitting the net funds, after costs, generated from the realization on the Non-Purchased Assets to be deposited with the Monitor pursuant to an agreement made among the Monitor, ISI and MLPLP. The Monitor transferred the funds it held to the Receiver subsequent to the issuance of the Receivership Order. As at December 8, 2008, the Receiver holds and has invested \$42,583,386 from the recovery on the Non-Purchased Assets payable to 101 and ISI. The funds can only be distributed in accordance with an Order or Orders of this Honourable Court. The \$2.0 million to be paid to MLMP is to be paid from the funds held by the Receiver.

3.9 The Receiver understands that 101 and ISI agree that the remaining funds will continue to be held by the Receiver until the costs associated with the capping of the landfill sites and long term monitoring program are known, at which time 101 and ISI envisage making a Court application for the distribution of the funds held by the Receiver.

4.0 Other

4.1 Millar Western Forest Products Ltd. (MWF”) provided marketing and other services to MLPLP pursuant to a Marketing Services Agreement (“MSA”) and an Administrative Services Agreement (“ASA”). MWF assisted MLPLP in the realization process on the Non-Purchased Assets. The ASA was terminated effective June 25, 2007. By or about September 15, 2007 all remaining pulp inventory had been sold and the MSA effectively terminated on that date.

4.2 Addressing the environmental matters as aforementioned in this report, in the Receiver’s opinion, should be acceptable to MWF.

5.0 Conclusion and Recommendation

5.1 The environmental issues facing MLPLP are being addressed in consultation with SMOE. They are costly; however, funds are available to remediate the contamination in an appropriate fashion. The PSA contemplated that MLPLP would address environmental contamination associated with the Recovery Pond and the Release and Settlement Agreement with MLMP addresses that issue. The Receiver, therefore, respectfully recommends that the Court approve the Release and Settlement Agreement and the payment of \$2.0 million to MLMP.

All of which is respectfully submitted this 10th day of December, 2008.

**RSM RICHTER INC.
IN ITS CAPACITY AS RECEIVER AND MAMAGER
OF CIC PULP LTD. OPERATING AS
MEADOW LAKE PULP LIMITED PARTNERSHIP
AND MEADOW LAKE PULP LTD.**



per: Robert J. Taylor, CA, CIRP

DRAFT
December 1, 2008

RELEASE AND SETTLEMENT AGREEMENT

This Release and Settlement Agreement (the "Agreement"), dated as of [◆, 2008], is made and entered into between 101069101 SASKATCHEWAN LTD. ("101"), MEADOW LAKE MECHANICAL PULP INC. ("MLMP"), MEADOW LAKE PULP LIMITED PARTNERSHIP, by its receiver and manager RSM RICHTER INC. (the "Partnership"), MEADOW LAKE PULP LTD., by its receiver and manager RSM RICHTER INC. ("MLP"), and ELITE SHINE INVESTMENTS LIMITED ("ELITE") (collectively, the "Parties").

WHEREAS, MLMP and King Paper Source International Trading (Shanghai) Co., Ltd. ("KPS") are parties to a pulp purchase agreement dated as of January 23, 2007 (the "Off-Take Agreement");

WHEREAS, MLMP and KPS wish to make certain amendments to the Off-Take Agreement as more particularly described in the first amending agreement dated January 31, 2007 and the second amending agreement dated February 5, 2008 (the "Amending Agreements");

WHEREAS, Pursuant to the unanimous shareholders agreement dated January 23, 2007 made between 101, Elite and MLMP, MLMP is not permitted to agree to or permit any amendment of the terms of the Off-Take Agreement without the prior written consent of 101;

WHEREAS, 101 has agreed to consent to the amendments contemplated by the Amending Agreements on a conditional basis, subject to the terms and conditions set out in a conditional delivery agreement dated as of July 21, 2008 (the "Conditional Delivery Agreement");

WHEREAS, one of the conditions set out in the Conditional Delivery Agreement is that 101 and MLMP agree on a final resolution satisfactory to both of them with regards to the remediation of the water recovery pond as required by the 101 Agreement dated January 23, 2007 made between 101, MLMP, Investment Saskatchewan Inc. ("ISI") and Meadow Lake Pulp Ltd. (the "101 Agreement");

WHEREAS, the Parties desire to terminate the 101 Agreement as well as the securities pledge and assignment agreement (the "Securities Pledge and Assignment Agreement") and the landfill lands use agreement (the "Landfill Lands Use Agreement") both entered into in connection with the 101 Agreement and both dated as of January 23, 2007 and release each other from all obligations, past and future, owing to one another thereunder;

NOW, THEREFORE, IN CONSIDERATION OF the mutual covenants and agreements set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

1. Definitions: All capitalized terms not otherwise defined herein have the means ascribed to them in the 101 Agreement.

2. Payment: The Partnership shall pay no later than the close of business, Central Standard Time, on ♦, 2008 (the “Stipulated Payment Time”), to MLMP, the amount of \$2,000,000 CDN (the “Payment”). MLMP agrees to use the Payment for the sole and express purposes of the fulfillment of its obligations pursuant to section 6 below.

3. Condition Precedent: This Release and Settlement Agreement is subject to the condition precedent that the Partnership obtain an Order of the Saskatchewan Court of Queen’s Bench authorizing the Payment. If for any reason, the Partnership has not obtained the Order described in the preceding sentence or MLMP has not received the Payment within 5 days of the Stipulated Payment Time, the Parties agree that the condition precedent shall not have been satisfied and this Agreement shall be null and void and of no force or effect.

4. Release: Upon the fulfillment of Article 2 and Article 3 of this Release and Settlement Agreement by the relevant Party, the Parties agree that the 101 Agreement, the Securities Pledge and Assignment Agreement and the Landfill Lands Use Agreement shall be terminated and the Parties shall unconditionally release, acquit, and discharge each other, as well as their respective successors, assigns, shareholders, direct or indirect parents, subsidiaries and affiliates, and each of their respective officers, directors, employees, representatives, subcontractors, agents, insurers and attorneys from and against any and all claims, suits, causes of action (whether in law or equity), rights, obligations, indemnities, undertakings, debts, agreements, liabilities, or damages whatsoever that either of the Parties, their respective successors, assigns, shareholders, direct or indirect parents, subsidiaries and affiliates, their respective officers, directors, employees, representatives, subcontractors, agents and attorneys once had, now have or could assert in the future against each other or any other party in connection with the 101 Agreement or a breach thereof.

5. Return of Security: Upon the fulfillment of Article 2 and Article 3 of this Release and Settlement Agreement by the relevant Party, Elite shall return to 101 the Pledged Notes and the certificate representing the Pledged Shares delivered to Elite pursuant to the 101 Agreement and the Securities Pledge and Assignment Agreement.

6. Use of Payment: MLMP agrees to use the Payment solely for the purposes of remediating the MLPLP Pond Environmental Contamination and, to that end, agrees as follows:

- (a) MLMP shall as soon as reasonably practicable following its receipt of the payment commence with the development of a plan for the remediation of the MLPLP Pond Environmental Contamination;
- (b) MLMP shall consult with 101 in the development of its remediation plan and shall keep 101 apprised as to the finalization and implementation of such plan;
- (c) MLMP shall exercise its best commercial efforts to complete the remediation of the MLPLP Pond Environmental Contamination within two years of the date of this Agreement.

7. **All Claims Are Barred**: Except for such actions as may be necessary or appropriate to enforce the terms of this Agreement, the Parties irrevocably covenant to refrain from making any claim or demand, or causing to be commenced, any suit, action or proceeding of any kind or character whatsoever against each other arising out of, resulting from or in any way related to the 101 Agreement, the Securities Pledge and Assignment Agreement or the Landfill Lands Use Agreement.

8. **Entire Agreement**: This Agreement constitutes the complete understanding between and among the Parties. No modification of this Agreement shall be binding, unless evidenced in writing and signed by an authorized representative of each of the Parties.

9. **Enurement**: This Agreement shall be binding on and inure to the benefit of each of the Parties, their successors, representatives, agents, officers, directors, employees and assigns.

10. **Proper Authority**: The persons executing this Agreement on behalf of the Parties each represent and warrant that they have full and complete authority to do so, and to make and give the promises, releases, and covenants set forth in this Agreement. The Parties each represent and warrant that the claims released by each of them pursuant to this Agreement have not been assigned.

11. **Governing Law**: The terms of this Agreement shall be governed, construed and enforced in accordance with the internal laws of the Province of Saskatchewan, without regard to Saskatchewan conflict of laws provisions.

12. **Counterparts and Facsimile Execution**: This Agreement may be executed in identical counterparts and by fax signature, and each such counterpart shall be deemed an original but such counterparts shall nevertheless together constitute one and the same instrument.

(The next page is the signature page)

IN WITNESS HEREOF, the undersigned certify their assent to the terms of this Agreement.

101069101 SASKATCHEWAN LTD.

By: _____
Name:
Title:

By: _____
Name:
Title:

MEADOW LAKE PULP LIMITED PARTNERSHIP, by its receiver and manager RSM RICHTER INC.

By: _____
Name:
Title:

ELITE SHINE INVESTMENTS LIMITED

By: _____
Name:
Title:

By: _____
Name:
Title:

MEADOW LAKE MECHANICAL PULP INC.

By: _____
Name:
Title:

By: _____
Name:
Title:

MEADOW LAKE PULP LTD., by its receiver and manager RSM RICHTER INC.

By: _____
Name:
Title:

(Signature page to Release and Settlement Agreement)