

**CANFOR PULP INCOME FUND**

**ANNUAL INFORMATION FORM**

February 18, 2010

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## EXPLANATORY NOTES

The information in this Annual Information Form ("**AIF**") is stated as at December 31, 2009, unless otherwise indicated.

Unless otherwise indicated or the context otherwise requires, "**Fund**" refers to Canfor Pulp Income Fund; "**Trust**" refers to Canfor Pulp Trust; "**General Partner**" refers to Canfor Pulp Holding Inc., and "**Partnership**" refers to Canfor Pulp Limited Partnership, and their respective subsidiaries and predecessors.

For an explanation of the capitalized terms and expressions and certain defined terms, please refer to the "Glossary of Terms" at the end of this AIF. Unless otherwise indicated, all dollar amounts are expressed in Canadian dollars and references to "\$" are to Canadian dollars.

## FORWARD LOOKING STATEMENTS

Certain statements in this AIF may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Fund, or industry results, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. When used in this AIF, such statements include such words as "may", "will", "expect", "believe", "plan" and other similar terminology. These statements reflect current expectations regarding future events and operating performance and speak only as of the date of this AIF. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risk Factors". Although the forward-looking statements contained in this AIF are based upon what management of the Fund believe are reasonable assumptions, the Fund cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this AIF, and the Fund assumes no obligation to update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable law.

Forward-looking statements in this AIF include statements made under:

- "Pulp Overview" on page 5, in the last paragraph under that heading;
- "Kraft Paper" on page 15, in the second paragraph under that heading;
- "Capital Expenditures" on page 17, in the second, fifth, seventh and last paragraphs under that heading;
- "Fibre Supply" on page 19, in the second paragraph under that heading;
- "Other Fibre Supply Arrangements" on page 21, in the last paragraph under that heading;
- "Environment" on page 23, in the fourth paragraph under that heading;
- "Secure Fibre Supply" on page 24;
- "Strategic Direction and Opportunities to Increase Cash Distributions" on page 25;
- "The Business of the Fund" on page 26 in the last paragraph under that heading;
- "The Business of the Trust" on page 28 in the last paragraph under that heading;
- "Unitholder Limited Liability" on page 33, in the second paragraph under that heading; and
- "Capital Requirements" on page 36.

Material risk factors that could cause actual results to differ materially from the forward-looking statements are contained under the heading "Risk Factors", on page 28.

## CORPORATE STRUCTURE

### Name, Address and Incorporation

The Fund is an unincorporated open-ended trust established under the laws of Ontario pursuant to a declaration of trust made as of April 19, 2006 (the “**Fund Declaration**”). The Fund was created to indirectly acquire an interest in the Partnership through its holding of units and notes of the Trust (“**Trust Units**” and “**Trust Notes**”, respectively).

The Trust is an unincorporated open-ended trust established under the laws of Ontario pursuant to a trust declaration made as of April 19, 2006 (the “**Trust Declaration**”). All of the Trust Units and Trust Notes are owned by the Fund. The Trust was formed to hold LP Units of the Partnership (the “**LP Units**”) and a corresponding interest in the General Partner.

The Partnership is a limited partnership formed under the laws of Manitoba pursuant to a limited partnership agreement made as of April 19, 2006 (the “**Partnership Agreement**”). The Partnership was formed to hold the Pulp Business.

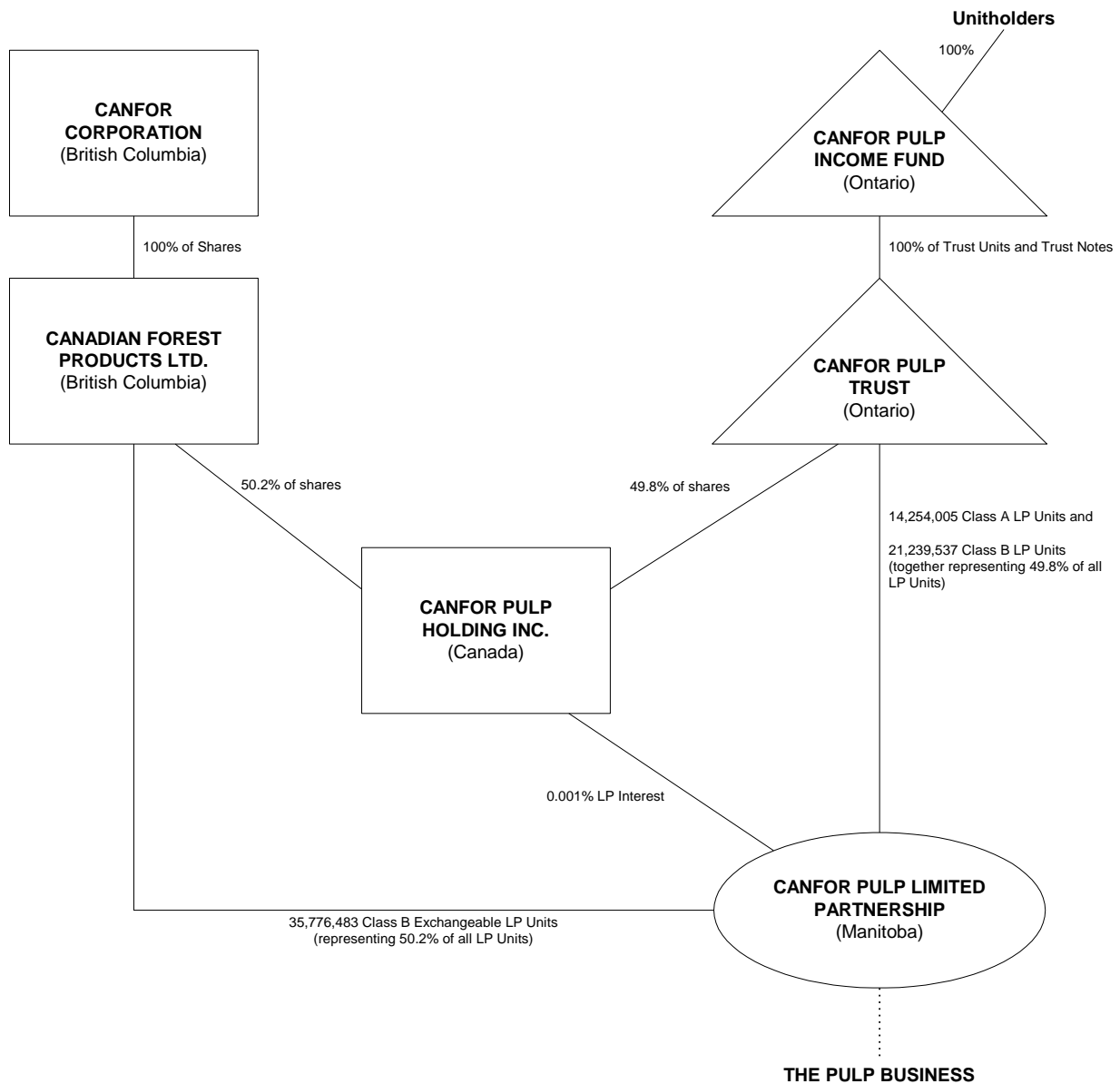
The General Partner is a corporation incorporated under the laws of Canada. The General Partner was formed to act as general partner of the Partnership and to operate the Pulp Business on behalf of the Partnership in its capacity as general partner.

The principal and head office of the Fund, the Trust, the Partnership, and the General Partner is located at 1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia, V6P 6G2.

The registered office of the Fund, the Trust, the Partnership, and the General Partner is: 1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia, V6P 6G2.

## Ownership Relationships

The following chart illustrates, on a simplified basis, the ownership structure of the Partnership (including jurisdiction of establishment/incorporation of the various entities).



## GENERAL DEVELOPMENT OF THE BUSINESS

Under a plan of arrangement effective on July 1, 2006 (the “**Spinout**”), shareholders of Canfor Corporation (“**Canfor**”) received Fund Units representing a 20% indirect interest in Canfor’s NBSK pulp and paper business (the “**Pulp Business**”), primarily consisting of Canfor’s Northwood Pulp Mill, Intercontinental Pulp Mill and Prince George Pulp and Paper Mill (the “**Mills**”). These mills, all located in Prince George, British Columbia, produce over one million air-dried metric tonnes (“**ADMT**”) of softwood market kraft pulp and approximately 140,000 tonnes of bleached and unbleached kraft paper each year. Following the Spinout, Canfor continued to indirectly own the remaining 80% interest in the Pulp Business. The Fund Units commenced trading on the TSX on July 6, 2006 under the symbol “CFX.un”.

On November 30, 2006, Canfor distributed to its shareholders of record on November 15, 2006 an in-kind taxable dividend (the “**November 2006 Dividend**”) of 1.49 Fund Units for every 10 shares of Canfor for a total of 21,239,537 Fund Units distributed. The total amount of Fund Units distributed under the November 2006 Dividend represented a 29.8% indirect interest in the Pulp Business with the result that a total of 35,493,505 Fund Units are now outstanding, representing a 49.8% indirect interest in the Pulp Business. Following the November 2006 Dividend, Canfor continued to own 35,776,483 Class B Exchangeable LP Units, representing a 50.2% interest in the Pulp Business.

No significant acquisitions or dispositions have been completed during the last financial year.

## DESCRIPTION OF THE PULP INDUSTRY

The market and industry data set forth in this section are based on industry publications, market research and publicly available information. Sources for this data are Pulp & Paper Products Council (“**PPPC**”), Pöyry Forest Industry Consulting Inc. (“**Poyry**”), and Resource Information Systems Inc. (“**RISI**”). While management of the Partnership (“**Management**”) believes this information to be reliable, it has not independently verified it.

### Pulp Overview

Pulp is used in the production of paper, paperboard, tissues and paper related products. Pulp is generally classified according to the process used in its production, the degree to which it is bleached and the type of raw material, or fibre, used.

Generally, either a mechanical or chemical process is used to produce pulp. Mechanically processed pulps are produced by using mechanical force to separate the individual wood fibres. Chemically processed pulps are produced by dissolving the lignin, the component of wood that binds individual fibres, through a chemical reaction. The primary advantage of chemically processed pulps – which the Partnership produces – are that they have a higher strength potential, as the chemical pulping process retains the intrinsic fibre properties, such as length and flexibility, better than mechanical pulping.

The majority of chemical pulps are produced by cooking wood chips with a mixture of caustic soda and sodium sulphide. These are called “kraft” pulps. In turn, most kraft pulps are then bleached to increase the brightness and whiteness of the pulp. There are two main types of bleached kraft pulp: softwood kraft, which is made from coniferous tree species (“**Bleached Softwood Kraft**” or “**BSK**”) and hardwood kraft, which is made from deciduous tree species (“**Bleached Hardwood Kraft**” or “**BHK**”).

Bleached Softwood Kraft has longer, more flexible fibres than Bleached Hardwood Kraft and is primarily purchased for its ability to add strength to paper. This ability to add strength to paper is referred to as its reinforcement ability, and Canadian softwood pulps enjoy the reputation of being the worlds Premium Reinforcing Pulps. Bleached Hardwood Kraft contains shorter fibres, and is primarily purchased to improve the printed appearance of paper end products. Most paper end-uses of kraft pulp

use a mix of softwood and hardwood grades to achieve both desired strength requirements and printed appearance of the end product. In 2009, market kraft pulp consumption was approximately 50% bleached hardwood kraft, 44% bleached softwood kraft, with the remainder split between unbleached and sulphite pulp<sup>1</sup>.

In the past five years, Bleached Hardwood Kraft production capacity has grown faster than Bleached Softwood Kraft capacity for a variety of reasons, one of which is cost. The relative production cost advantage recently enjoyed by Bleached Hardwood Kraft mills when compared to Bleached Softwood Kraft mills is a result of lower fibre costs, higher wood yields and, on average, greater economies of scale. Recently however, the substitution of Bleached Hardwood Kraft for Bleached Softwood Kraft has declined due to factors that are increasing the need for higher strength Bleached Softwood Kraft pulps, including:

- significant increases in the size and speed of paper machines which put more stress on the papers being formed by those machines; and
- consolidation and rationalization in the paper business which has resulted in paper companies having fewer production facilities that need to be run with greater efficiency.

These two counteracting forces – the desire to use lower cost pulps versus the need for increased strength – are leading to the development of distinct market segments, which is reducing the direct competition between Bleached Hardwood Kraft and Bleached Softwood Kraft. In commodity papers, such as office or photocopy paper, where low cost is key or in high bulk applications, such as towels, Bleached Hardwood Kraft is dominant. In segments where end products are lightweight or specialized, such as direct mail, magazine papers or premium tissues, or where end products must be strong, such as is the case with abrasive papers, Bleached Softwood Kraft forms a significant proportion of the fibre used in its production.

The Bleached Softwood Kraft market is further segmented into Northern Bleached Softwood Kraft ("**NBSK**") and Southern Bleached Softwood Kraft ("**SBSK**"). NBSK Pulp is only made from trees grown in the Northern Hemisphere - predominantly in Canada, Northern Europe, and Russia. It commands the highest price of any pulp grade as it has the highest reinforcing strength – which is the ability to reinforce paper so it does not break when printed or converted.

Within the NBSK Pulp market segment, there is a significant range of pulp qualities in terms of reinforcing strength. All of the NBSK Pulp produced by the Partnership is in the upper end of the quality spectrum in terms of reinforcing strength. As a result, the Partnership's reinforcing NBSK commands a premium in segments of the market that demand high reinforcing strength. This premium is supported by the higher quality NBSK Pulp's superior reinforcing potential and by limited supply. Supply is limited because the highest quality of premium reinforcing NBSK can only be made from northern spruce or pine fibres, which are only found in Canada and in some areas of Scandinavia and Russia.

In the last 2 years, BSK facilities with annual production exceeding 2 million ADMT (representing approximately 10% of global BSK capacity) have been closed.<sup>2</sup>

Concerning the supply of Premium Reinforcing NBSK pulp, there are currently no confirmed major expansions of existing facilities or new confirmed greenfield projects reported. There is a possibility of more closures of existing premium reinforcing NBSK production facilities, as a number of these facilities are older and not cost competitive.

<sup>1</sup> Source: PPPC World Chemical Market Pulp Global 100 Report, December 2009

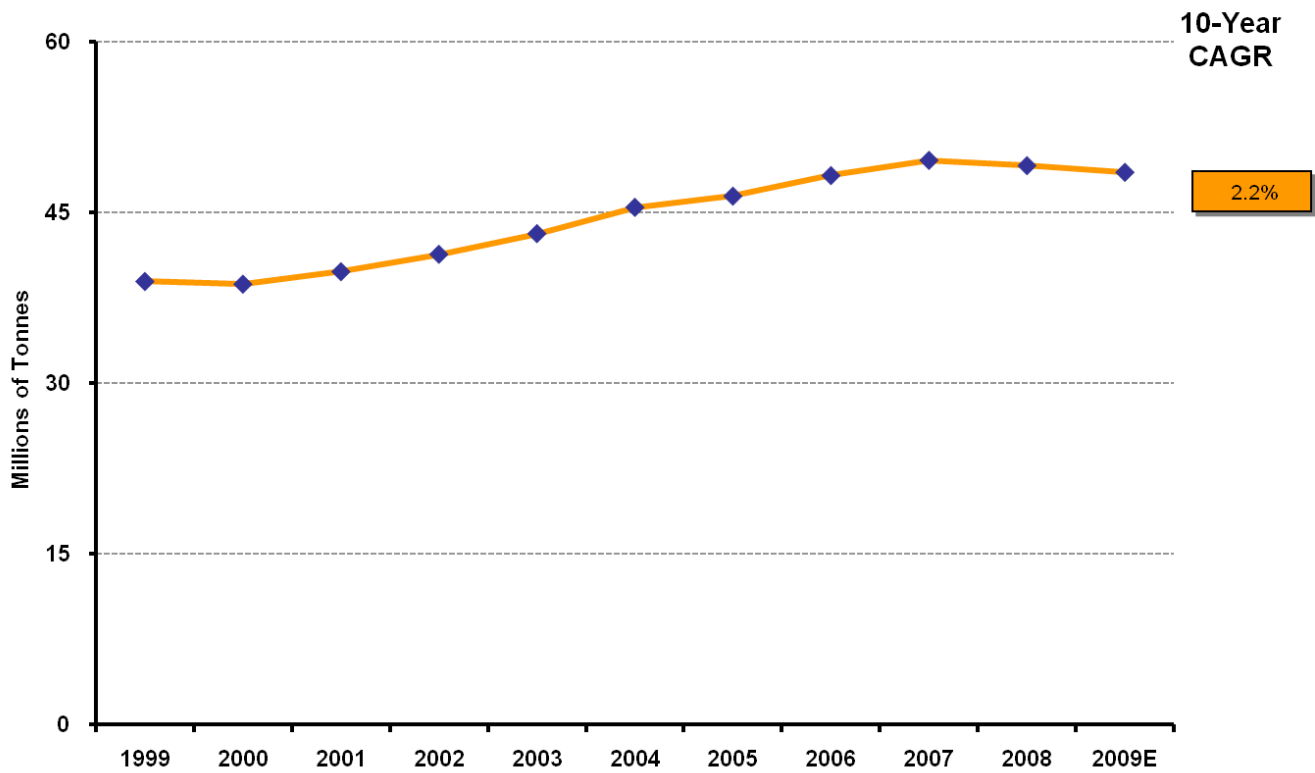
<sup>2</sup> Source: PPPC Chemical Market Pulp Supply and Demand Report, November 2009



## Pulp Markets

In 2009, total worldwide consumption of chemical market pulp was approximately 49 million ADMTs. Although demand is cyclical, global demand for pulp has grown at an average rate of approximately 2% annually from 1999 to 2009. The following chart illustrates the global demand for pulp during the specified period:

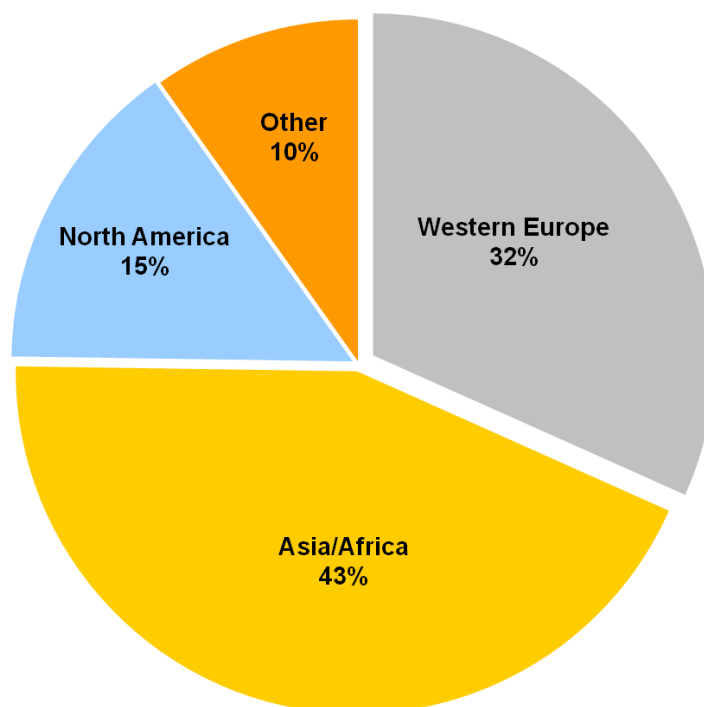
Global Chemical Market Pulp Demand



Source: PPPC - Chemical Market Pulp Supply and Demand Report - November, 2009

In 2009, Western Europe, Asia/Africa, and North America collectively accounted for approximately 90% of global chemical market pulp demand, as illustrated below<sup>1</sup>:

**Global Chemical Market Pulp Demand by Region**



Source: PPPC - Chemical Market Pulp Supply and Demand Report, November, 2009

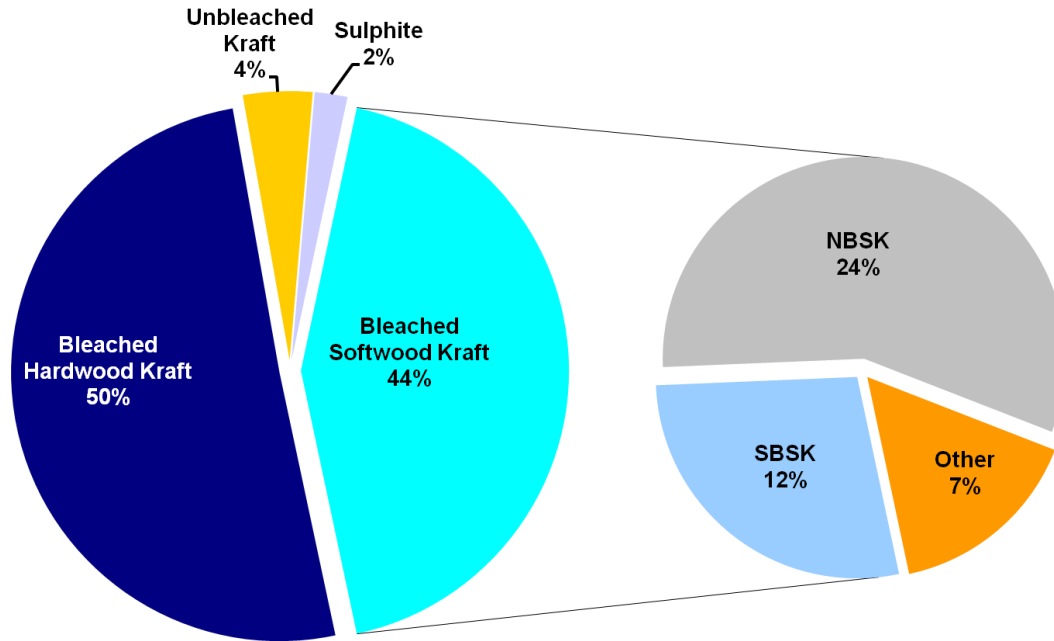
Western Europe is the largest consumer of pulp, and at approximately 15.4 million ADMT accounts for 32% of current global consumption. Asia/Africa consume approximately 21.1 million ADMT accounting for 43% of current global consumption, while North America accounts for approximately 7.2 million ADMT, or 15% of global consumption.

### **NBSK Pulp Markets**

As shown in the following chart, Bleached Softwood Kraft and Bleached Hardwood Kraft are the two predominant types of pulp, together accounting for over 94% of global chemical market pulp consumption. Of the Bleached Softwood Kraft market, NBSK has always been the single largest market segment and is estimated to have accounted for 12.0 million ADMT, or 24% of global chemical market pulp consumption in 2009. As a result, NBSK is referred to as the benchmark grade of pulp when discussing price or relative market conditions.

<sup>1</sup> Source: PPPC Chemical Market Pulp Supply and Demand Report, November 2009

### Global Chemical Market Pulp Shipments



Source: PPPC World Chemical Market Pulp Global 100 Report - December 2009

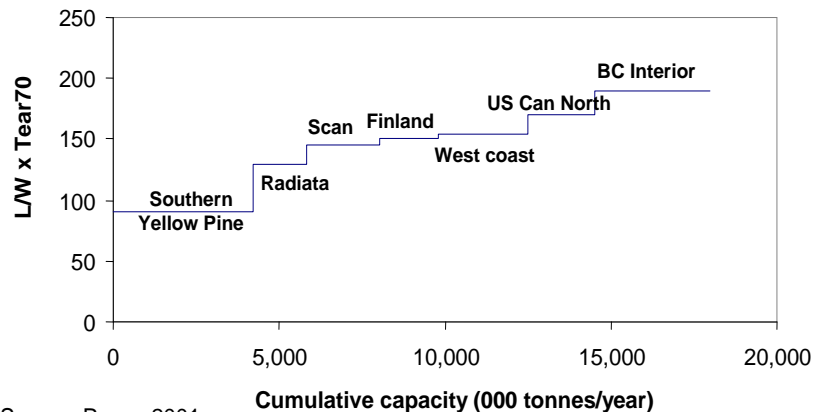
### Premium Reinforcing NBSK

NBSK Pulps differ widely in their strength or reinforcing potential due to differences in the physical characteristics of the fibre used in the production process, such as fibre length, diameter, and cell wall thickness. Longer, more slender and thin walled fibres provide the highest reinforcing potential.

The best fibres for producing premium reinforcing pulps are derived from northern spruce and pine or western red cedar, as they have relatively long and slender fibres, and have the thinnest cell walls. Hardwood species have very short and thick-walled fibres, and therefore have very little strength potential.

The correlation between fibre characteristics and strength potential has been verified through extensive study and sample testing. Poyry completed a study in 2001, comparing the reinforcing potential of different Bleached Softwood Kraft Pulps for producing light weight coated paper, principally used for magazines, and verified that NBSK was stronger than SBSK and that the NBSK produced in the interior of British Columbia was the strongest NBSK.

### Reinforcement Ranking for Light Weight Coated Paper

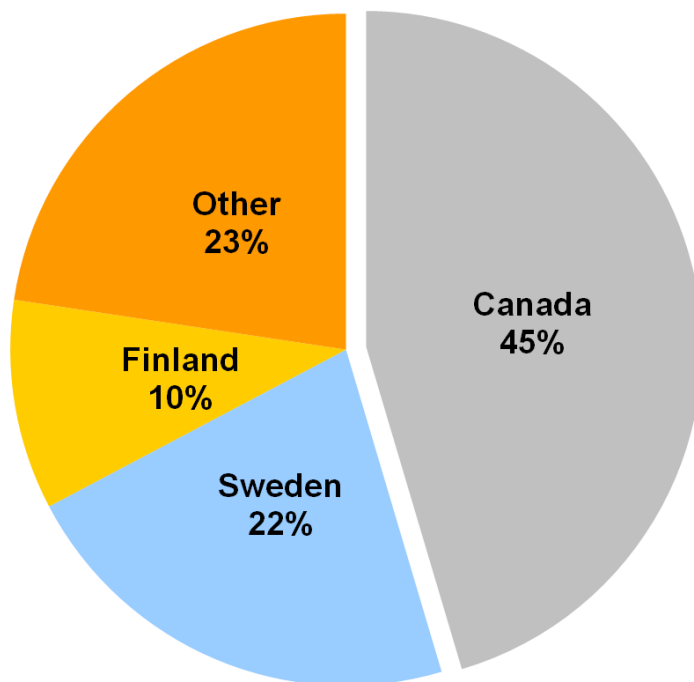


Source: Poyry, 2001

## NBSK Pulp Production

Canada ranks as the largest producer of NBSK Pulp in the world, with a production capacity of approximately 6 million tonnes in 2009, or approximately 45% of worldwide production capacity. Sweden ranks as the second largest producer of NBSK Pulp with a production capacity of approximately 3.0 million ADMT or 22% of global production capacity in 2009.

**Global NBSK Pulp Estimated 2009 Production Capacity by Geographic Region**

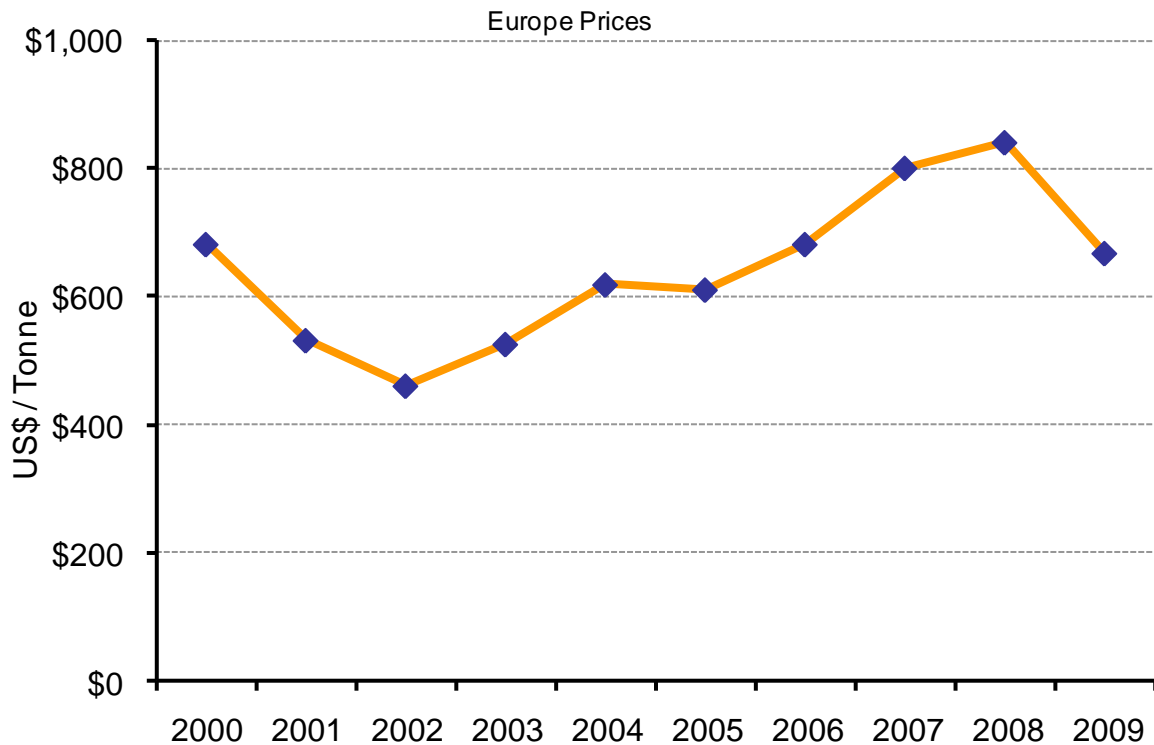


Source: PPPC - Chemical Market Pulp Supply and Demand Report, November, 2009

## NBSK Pulp Pricing

Global economic conditions, changes in production capacity, inventory levels, and currency exchange rates are the primary factors affecting NBSK Pulp list prices. As Northern Europe is the world's largest market and NBSK is the premium grade, Northern European NBSK market pricing is the benchmark used in the industry. The following chart illustrates the average annual Northern Europe list prices for NBSK Pulp for the specified periods:

### Average Annual Northern Europe NBSK Pulp List Prices in US\$



Source: RISI, World Pulp Monthly

The average annual Northern European list price for NBSK Pulp between 2000 and 2009 ranged from a low of US\$460 per ADMT in 2002 to a high of US\$840 per ADMT in 2008. Following a decline in demand in 2001, list prices for NBSK Pulp fell to approximately US\$460 per ADMT in 2002. A weakening US dollar, combined with pulp mill closures had driven the steady growth in market pricing since 2003 until 2008. Prices peaked at another high of US\$900 per ADMT in the first half of 2008, before falling in the latter half of the year to US\$700 in December. Prices recovered steadily in 2009 from a low of US\$575 per ADMT in March to US\$800 per ADMT in December.

## DESCRIPTION OF THE PAPER INDUSTRY

### Paper Overview

Kraft Paper is typically used in the production of paper bags. End uses include single ply grocery bags, multi-ply bags for pet food or cement as well as specialty end uses such as tape and laminate base stock. Similar to pulp, both bleached and unbleached products are produced. However, unlike pulp, the majority of Kraft Paper used to produce bags ("**Sack Kraft**") is unbleached.

Within the market for Sack Kraft, there is a high performance segment that is distinct – based upon its strength. These high performance papers can only be produced with strong northern fibres and post refining – a stage in the paper manufacturing process that refines or increases the bonding strength of the fibres.

## **Kraft Paper Markets**

The size of the global paper bag market has been relatively constant for the past 10 years at approximately 5 million tonnes. The kraft paper market was estimated to be 5.6 million tonnes in 2005. 2005 demand was estimated to be split between North America (31%), Europe (27%), Asia (25%), Latin America (5%), and other countries (12%).<sup>1</sup> Demand for the product is driven by packaged food consumption and the overall economy. It is estimated that in 2009 in North America 58% of all multi-wall bags were used in the agricultural and food industry, 18% were used in the building materials sector, and 24% were used for chemicals, minerals and other industries.<sup>2</sup>

### **Fully Bleached, High Performance Kraft Paper Market**

Although overall market demand for Kraft Paper has been flat, there are two significant market trends occurring: an increase in the demand for both fully bleached paper products, and an increase in demand for high performance paper products. The trend to fully bleached Kraft Paper products is driven by the growth of sales through big box stores and the internet, where the package is no longer manufactured simply for protection but also to advertise the contents. The trend to high performance Kraft Paper products is being driven by simple economics. If a customer can achieve the same performance with two plies as was previously achieved with three, it can substantially reduce its costs. At present, the majority of European Sack Kraft consumption is fully bleached, high performance papers, whereas in the United States only a small, but rapidly growing, segment of the market uses these grades.

### **Kraft Paper Production**

In 2007, approximately 5.1 million tonnes of Kraft Paper were converted into single ply bags and multi-wall paper bags, as well as other specialty paper product end uses around the world.<sup>1</sup> A significant portion of this was produced for internal use by integrated manufacturers. This figure is estimated to be similar for 2009.

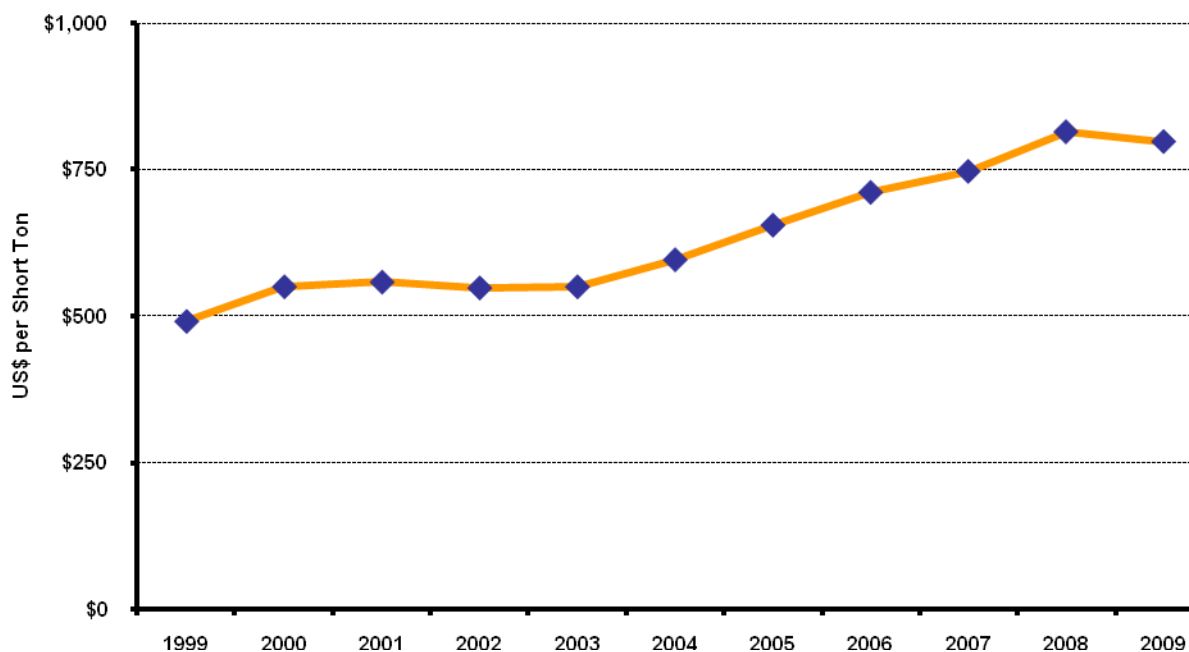
### **Kraft Paper Pricing**

Similar to pulp prices, Kraft Paper prices fluctuate with supply and demand. Unlike pulp however, fluctuations in the US exchange rate do not affect Kraft paper prices, because the majority of the production facilities are located in the USA. The following chart illustrates the average annual US Kraft Paper prices (for 50 pound unbleached flat multi-wall) since 1999:

<sup>1</sup> Source: Poyry, 2007.

<sup>2</sup> Source: Paper Shipping Sack Manufacturers Association Inc.

### Average Annual US Kraft Paper Market Prices



Source: RISI

## THE PULP AND PAPER BUSINESS OF THE PARTNERSHIP

### General

The General Partner operates the Pulp Business on behalf of the Partnership. The Partnership is a leading global supplier of pulp and paper products with operations based in the central interior of British Columbia. The Partnership's strategy is to maximize cash flows and to enhance the value of its assets by: (i) preserving its low-cost operating position, (ii) maintaining the premium quality of its products, and (iii) opportunistically acquiring high quality assets.

The Partnership owns and operates three mills with annual capacity to produce over one million ADMT of northern softwood market kraft pulp, 90% of which is bleached to become NBSK Pulp, for sale to the market and approximately 140,000 tonnes of Kraft Paper. The Mills are among the lowest cost producers in Canada with a first quartile ranking based on average cost of production of NBSK Pulp in the PricewaterhouseCoopers LLP Market Pulp study (2007) of competitive costs of Canadian pulp mills.

### Market Position

The Partnership is the world's third largest producer of NBSK Pulp for sale on the open market, based on global production capacity of existing facilities. Prince George Pulp and Paper ("PGP&P") is the largest producer of its types of bleached high performance Kraft Paper in North America.

## The Mills

Northwood is a two line pulp mill with annual production capacity of approximately 590,000 ADMT of NBSK Pulp, making it the largest NBSK Pulp facility in North America. Northwood's pulp is used to make a variety of products including printing and writing paper, tissue and specialty papers and is primarily delivered to customers in North America, Europe, and Asia.

Intercontinental is a single line pulp mill with annual production capacity of approximately 315,000 ADMT of NBSK Pulp. Intercontinental's pulp is used to make substantially the same product as that from Northwood, and is delivered to the same markets.

PGP&P is an integrated two line pulp and paper mill with an annual market pulp production capacity of approximately 155,000 ADMT, and Kraft Paper production capacity of approximately 140,000 tonnes. PGP&P supplies pulp markets in North America, Europe, and Asia, and its internal paper making facilities. The paper mill supplies primarily North American and European markets, with a wide range of both bleached and unbleached Kraft Paper grades.

## Manufacturing Process

### *Pulp*

In order to transform wood chips into kraft pulp or kraft paper, wood chips undergo a multi-step process involving the following principal stages: chip screening and digesting, and pulp washing, screening, bleaching and drying.

In the initial processing stage, wood chips are screened to remove oversized chips and sawdust and then conveyed to a pressurized digester where they are heated and cooked with chemicals. This process softens and eventually dissolves the phenolic material called lignin that binds the fibres to each other in the wood.

Cooked pulp flows out of the digester and is washed and screened to remove most of the residual spent chemical called black liquor, and any partially cooked wood chips. The pulp then undergoes a series of bleaching stages where the brightness of the pulp is gradually increased. Finally, the bleached pulp is sent to the pulp machine where it is dried. The pulp is then ready to be baled for shipment to customers. Alternatively to produce Kraft Paper, the bleached pulp is sent to the paper machine where the pulp is converted to Kraft Paper, which is then rolled for shipment to customers.

A significant feature of kraft pulping technology is the recovery system, through which chemicals used in the cooking process are extracted and re-used. This reduces chemical costs and improves environmental performance. During the cooking stage, dissolved organic wood materials and black liquor are extracted from the wood chips in the digester. After undergoing an evaporation process that removes excess water from liquor drawn from the digester, the resulting black liquor, which is now rich with combustible organic materials, is burned in a recovery boiler. The chemical compounds of the black liquor are then collected from the recovery boiler and reconstituted into cooking chemicals which are then eventually re-used in the digesting process.

The heat produced by the recovery boiler is used to generate high-pressure steam. Additional steam is generated by a power boiler through the combustion of biomass consisting of hog fuel, residue generated by the effluent treatment system, and purchased natural gas. The steam produced by the recovery and power boilers is used to power turbogenerators to generate electricity, and to also provide heat for the digesting and pulp drying processes.



### *Kraft Paper*

PGP&P produces Kraft Paper from the bleached and unbleached pulp produced at its mill. This process involves the transfer of “slush pulp” (pulp before it is dried and baled) to the paper making machine located adjacent to the PGP&P pulp mill.

## **Products**

### *Pulp*

Different papermaking applications place different demands on their fibre components. The properties of the component pulps, especially their length, coarseness, and collapsibility, strongly influence their paper making potential and the quality of the final paper. Some papers require very high tensile strength properties while others require a very bulky porous structure. Other paper grades need folding endurance, while still others must be strong while light in weight. No one fibre type is ideal for all of these circumstances.

Due to the climate conditions in the central interior of British Columbia, namely cold winters and relatively dry summers, the spruce, pine and fir tree species that make up the fibre supply develop long, slender, and thin-walled fibres which are generally recognized as being one of the strongest in the world. This characteristic allows the Mills to produce a premium reinforcing NBSK Pulp with excellent tensile properties that commands a premium price. The Mills are able to consistently produce a premium reinforcing NBSK Pulp because all of their fibre is sourced from sawmills in the central interior of British Columbia.

Approximately 90% of the market pulp production of the Mills is focused on fully bleached NBSK Pulp in order to meet the demands of the Partnership’s customers. PGP&P also produces speciality varieties of unbleached, semi-bleached, and fully bleached pulp.

The following table shows the pulp production of the Mills for the past three years, classified according to the variety of pulp produced.

#### **Market Pulp Production (ADMT)**

<u>Product</u>	<u>Mill</u>	<u>2009</u>	<u>2008*</u>	<u>2007</u>
Bleached	Northwood	546,110	544,115	589,443
	Intercontinental	309,718	271,592	306,535
	PGP&P	9,678	774	244
Semi-Bleached	PGP&P	12,985	14,249	32,372
Unbleached	PGP&P	<u>128,291</u>	<u>102,036</u>	<u>115,678</u>
Total		<u>1,006,782</u>	<u>932,766</u>	<u>1,044,272</u>

*\*Note: The reduced production in 2008 is a result of increased scheduled maintenance outages, a market curtailment in December, 2008, and the impact of a fire at the Prince George Pulp and Paper Mill in January, 2008.*

### *Kraft Paper*

PGP&P produces both bleached and unbleached Kraft Paper, but since 1995 has emphasized premium product development. This has resulted in a significant change in the paper product mix, moving from lower value unbleached Kraft Paper for use in multi-wall applications, to high performance

papers, high porous bleached and unbleached Kraft Papers, and specialty papers where profit margins are higher.

PGP&P is the only North American producer that has a large paper machine capable of producing fully bleached, high performance Kraft Paper. Its focus on producing and creating a demand for this product has allowed it to increase its production of fully bleached Kraft Paper from 42% of total production in 2003 to approximately 61% of total production in 2009. Management intends to continue this focus with the goal of moving substantially all of PGP&P's production to the higher-margin fully bleached Kraft Paper.

The following table shows the Kraft Paper production of PGP&P for each of the past three years, classified according to the variety of Kraft Paper produced.

<b>Kraft Paper Production (tonnes)</b>			
<b><u>Product</u></b>	<b><u>2009</u></b>	<b><u>2008</u></b>	<b><u>2007</u></b>
Bleached .....	80,499	102,213	94,818
Unbleached .....	<u>50,506</u>	<u>30,364</u>	<u>36,828</u>
Total .....	<u>131,005</u>	<u>132,577</u>	<u>131,646</u>

## **Sales and Marketing**

### ***Pulp***

The Partnership has a sales and marketing department staffed by full time marketing professionals who are responsible for the global sales of all of the NBSK Pulp produced by the Mills, through three regional offices. Customers in the Americas are serviced through the Vancouver office while European customers are serviced through the Brussels office. The third regional office is a joint venture marketing company, called Canfor April Corporation ("**CAPCO**"). CAPCO is owned equally by the Partnership and Asia Pacific Resources International Holdings Ltd. ("**APRIL**"). CAPCO is responsible for selling in Japan market pulp produced by the Mills and by APRIL's Riaupulp mill in Indonesia.

Asian customers (excluding Japanese customers) are generally serviced through third party long-term sales representatives. These sales representatives generally realize a commission of between 1% and 2% of the net sales price of Northern Softwood Kraft (NSK) Pulp, with the fee varying depending on the services provided, and the tonnage sold.

The following table shows pulp sales by the Mills for the last three years, classified by sales region:

<b><u>Year</u></b>	<b><u>Total Sales</u></b>	<b><u>Geographic Region</u></b>		
		<b><u>Americas</u></b>	<b><u>Europe</u></b>	<b><u>Asia</u></b>
2009 .....	1,044,564	367,386 (35%)	201,049 (19%)	476,129 (46%)
2008 .....	905,441	409,822 (45%)	149,384 (17%)	346,235 (38%)
2007 .....	1,023,566	494,736 (48%)	157,670 (16%)	371,160 (36%)

For an arm's-length fee negotiated from time to time with Canfor, Howe Sound Pulp and Paper Limited Partnership (HSLP), the Partnership also markets and sells chemi-thermo mechanical pulp produced by Canfor's Taylor Pulp Mill, and NBSK Kraft pulp produced by HSLP's Howe Sound Pulp Mill.

### *Kraft Paper*

Premium 1 Papers, a sales and marketing partnership owned equally by the Partnership and Tolko Marketing and Sales Ltd. ("**Tolko**") is responsible for marketing all bleached and unbleached Kraft Paper products produced by PGP&P, and Tolko's unbleached Kraft Paper mill in The Pas, Manitoba. Premium 1 Papers has approximately 15 full time marketing professionals.

The following table shows sales of Kraft Paper produced by PGP&P for the last three years, classified by sales region.

**Kraft Paper Sales by Geographic Region (tonnes)**

<u>Year</u>	<u>Total Sales</u>	<u>Geographic Region</u>		
		<u>Americas</u>	<u>Europe</u>	<u>Asia</u>
2009 .....	134,980	102,813 (76%)	20,363 (15%)	11,804 (9%)
2008 .....	124,757	87,679 (71%)	26,585 (21%)	10,493 (8%)
2007 .....	129,494	89,264 (69%)	30,010 (23%)	10,220 (8%)

## **Customers**

### *Pulp*

The Mills have long-standing relationships with the majority of their customers, some for as long as 42 years. The largest customers have evergreen supply agreements with lengthy notice periods and ramp down clauses should either party wish to terminate the agreement.

In 2009, the Partnership's top 10 customers purchased approximately 509,000 ADMT of pulp, or 48% of the Partnership's total pulp sales. No customer accounted for more than 10% of the Partnership's total pulp sales. Due to the high quality of its pulp, the Partnership generally does not have any difficulty in selling all of its production. As a result, its main marketing focus has been on optimizing the technical fit and geographic/customer mix to maximize prices over the business cycle.

The Partnership adopts a conservative approach to extending credit to customers in order to minimize the risk of bad debts. Approximately 81% of the outstanding trade receivables are covered under credit insurance. In addition, the Partnership requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. The Partnership believes that its approach to managing credit risk associated with the collection of outstanding trade accounts receivable is appropriate in the current credit market. Due to the conservative nature of the credit policy applied by the Pulp Business, the Pulp Business has experienced no bad debt expense in its pulp sales over the last 10 years.

### *Kraft Paper*

Similar to the pulp business, the Kraft Paper customer base is characterized by many long-standing relationships with evergreen contracts.

In 2009, the Partnership's top 10 Kraft Paper customers purchased approximately 82,000 tonnes of Kraft Paper, or 61% of the Partnership's total Kraft Paper sales. The Partnership's largest customer accounted for 17% of its total Kraft Paper sales and only one additional customer accounted for more than 10% of the Partnership's total Kraft Paper sales.

The Partnership adopts a conservative approach to extending credit to Kraft Paper customers in order to minimize the risk of bad debts. Due to this conservative credit policy, the Partnership's kraft paper business has experienced no material bad debt expense in its Kraft Paper sales over the last 6 years.

## Human Resources

The Partnership currently employs approximately 1,164 people throughout the organization. Approximately 75% of these employees are hourly employees covered by collective agreements ("the **Labour Agreements**") with the Communications, Energy and Paperworkers Union ("CEP") and the Pulp, Paper and Woodworkers of Canada ("PPWC"). Negotiations with the CEP and the PPWC for the renewal of the agreements covering the pulp and paper operations were successfully concluded and ratified in 2008 for terms of four years expiring on April 30, 2012.

The following table summarizes, for each Mill, the number of employees, collective agreements in effect and the percentage of the workforce governed by these agreements.

<u>Mill</u>	<u>Employees</u>	<u>Union</u>	<u>% Unionized</u>	<u>Agreement Expiry</u>
Northwood.....	458	CEP, Local 603	80%	April 30, 2012
Intercontinental .....	271	PPWC, Local 9	80%	April 30, 2012
PGP&P .....	363	PPWC, Local 9	75%	April 30, 2012
		CEP, Local 1133		
Administration, Sales and Marketing .....	72	N/A	0%	N/A

## Capital Expenditures

Sustaining capital expenditures are additions to, or replacements of, assets required to maintain the operational components of the Mills at their current capacity, and includes expenditures on projects undertaken for incremental increases in productivity or operating capacity and cost reduction.

Management estimates that in order to maintain the Mills in good working order and retain a competitive cost structure, future sustaining capital expenditures will average approximately \$30 million per year, before adjustments for inflation.

Discretionary capital expenditures are major projects that constitute a significant change in the business or operating mode of the Mills. The following table summarizes capital expenditures by the Mills over the past three years.

(unaudited, in thousands of dollars)

	<u>Year Ended December 31,</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Capital Expenditures</b>			
Sustaining .....	13,452	34,670	28,959
Discretionary .....	<u>-</u>	<u>-</u>	<u>559</u>
Subtotal .....	13,452	34,670	29,518
Amount Funded by Insurance .....	<u>28</u>	<u>(9,401)</u>	<u>-</u>
Net Capital Spending .....	<u>13,480</u>	<u>25,269</u>	<u>29,518</u>

In reacting to the weak world economic conditions in 2009, capital expenditures for the year were generally focused on sustaining capital projects required to maintain the Mills.

In 2009, the Partnership was allocated credits of \$122.2 million from the billion dollar Pulp and Paper Green Transformation Program ( "GTP") announced by the Canadian government on June 17, 2009. The GTP is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. The Partnership expects to commence spending under this program in 2010, and credits may be used until the GTP end date of March 31, 2012.

The objective of the GTP is to improve the environmental performance and energy efficiency of Canada's pulp and paper industry by financing capital projects with environmental benefits. Eligible capital projects under the GTP must demonstrate an improvement in performance relating to: energy efficiency, increase production of renewable energy, or other environmental benefit. The Program will enable the advancement of projects at all of the Partnership's facilities that will yield a variety of environmental benefits. The planned improvements include reductions in odour and particulate emissions; reduced fossil fuel and water consumption; and incremental renewable electricity generation.

The Partnership has identified and will be submitting a number of projects for approval under the GTP that demonstrate the Partnership's continued commitment to environmental stewardship. These projects are expected to enhance the long-term sustainability of the Partnership operations and provide benefits to the Fund unitholders, the Partnership's employees, and the local Prince George economy.

The most significant project completed in 2008 was the replacement of the PGP&P mill chip screening system at a cost of \$12.6 million. A fire destroyed the original system in January 2008 and a new system, partially funded with the insurance proceeds, was operational by November 2008.

The PG Cogeneration Project was a strategic discretionary capital expenditure that was undertaken in 2004 and substantially completed in 2005. The total cost of the project was \$115.4 million, less \$45.8 million recovered from BC Hydro under the PG Cogeneration Load Displacement Agreement. The PG Cogeneration Project was expected to provide 390 GWh of electricity annually and operating cost savings of approximately \$21.5 million per year. The original project scope delivered 338 GWh of electricity annually. The Partnership finalized an amended Cogeneration Agreement with BC Hydro effective September 15, 2009 which provides for the sale of power production that exceeds an amended commitment of the original cogeneration project at the Prince George Pulp and Paper Mill. A payment to BC Hydro of \$4.3 million was made to reduce the Partnership's obligation for power production reflecting the cogeneration project's actual output. The obligation to produce power for the remainder of the term of the agreement, extending to August 2020, is reduced to 338 GWh per year from 390 GWh effective September 15, 2009. As a result of further investments by the Partnership, power production in

excess of 338 GWh per year is now available for sale under the terms of our new Energy Purchase Agreement with BC Hydro.

In 2007, an environmental remediation provision was recorded in the financial statements, representing the estimated discounted current value of asset retirement obligations for the Mills landfills, and for Intercontinental's ash settlement pond (see Environment section). The initial provision in 2007 of \$11.4 million was subsequently reduced by \$6.8 million in 2008 based on revised estimates of the useful lives of the landfills, and by \$0.9 million, the difference between the original containment estimate of \$2.4 million, and the actual remediation cost of \$1.5 million for the ash settlement pond. The actual cash expenditures will be made at the end of the useful lives of the related assets. An accretion expense of \$0.2 million was recorded in 2009, updating the estimated present value of these obligations.

The Partnership expects to fund its sustaining capital expenditures out of the operating cash flow of the Partnership and draws under its Credit Facilities, if necessary. The funding of discretionary capital projects will be determined as part of the project evaluation, considering the nature, size and expected return on the project in each case.

## **Fibre Supply**

### *General*

When running at full capacity, the Mills' annual fibre requirements are approximately 2.6 million ODTs of wood chips and 540,000 ODTs of hog fuel. The availability of wood chips for purchase and processing in the central interior of British Columbia is influenced significantly by the timber supply in the Prince George Timber Supply Area ("PGTSA") and by the operating rates of sawmills within the geographic area of fibre supply for the Mills.

Historically, the annual allowable cut levels in the PGTSA and the resulting sawmill production have been sufficient to supply all of the fibre requirements of the Mills. In order to control the mountain pine beetle infestation in the area the Ministry of Forests has increased the annual allowable cut in the PGTSA by approximately 30%. This increase in the AAC is projected to remain in effect for at least the eight to ten years following the implementation of the uplift, resulting in an abundant supply of timber for sawmills and other timber conversion facilities. The timber supply during this forecast period is expected to exceed the requirements of the timber conversion industries (sawmills, board plants, pellet plants, etc.). Excluding the impact of sawmill production curtailments, the Partnership would anticipate this surplus of timber to result in competitive fibre pricing over the short and medium-term. However, in 2008 and 2009 weak North American lumber markets caused by a slowdown in the US housing sector have resulted in closures or reductions in sawmill lumber and residual wood chip production. This reduction in supply of residual wood chips has increased the cost of residual wood chips purchased by the Partnership and has necessitated the purchase of chips from pulp logs (whole log chips). Whole log chips are more expensive than sawmill residual chips. The Partnership expects this fibre availability situation to improve in 2010 due to the closure of the competing pulp mills in the region, and a more normal level of sawmill production in the Mills' fibre supply area due to an improving lumber market.

The wood chip supply for the Mills consists primarily of lodgepole pine and white spruce. The wood chip species percentages are variable by Mill, depending on the supply sources directed to each Mill. Wood chips are stored in co-mingled piles at each of the Mills, with the exception of any wood chips derived from balsam fir, which are stored separately at PGP&P and used principally in the production of unbleached pulp and paper. Wood chips from each species are combined and processed to produce premium reinforcing market NBSK Pulp and for use by PGP&P in producing Kraft Paper.

### *Fibre Supply Agreement*

On July 1, 2006 the Partnership entered into the Fibre Supply Agreement with Canfor under which Canfor supplies the Partnership with agreed annual quantities of the residual wood chips and hog fuel produced at specified sawmills in the Prince George Forest Region.

If Canfor discontinues operation of, or reduces production on a long term basis at, any of the specified sawmills, the Partnership has the right to replace the lost volume from other Canfor sawmills which are closest in terms of transportation efficiency to the Mills. Canfor will have the first right of opportunity to sell to the Partnership any wood chips required by the Partnership in excess of the agreed maximum annual quantity on the same commercial terms including price, as set out in the Fibre Supply Agreement. If the Partnership requires additional annual quantities of wood chips due to an increase in the capacity of the Mills, the Partnership is required to first offer to purchase the additional wood chips from Canfor on the same commercial terms as those set out in the Fibre Supply Agreement. The Partnership will also have the first right to acquire additional wood chips from any sawmill facility subsequently acquired or constructed by Canfor in the Prince George Forest Region, subject to any commitments affecting an acquired facility, which are in effect or required by the vendor as a condition of the acquisition. Canfor has the right, on prior written notice, to require the Partnership to purchase wood chips from Canfor in excess of the agreed maximum annual quantity. If, as a result, the Partnership is required to terminate or cancel other supply agreements in order to take the additional Canfor wood chips, then the price that Canfor is entitled to receive will not be greater than the price paid pursuant to the other supply agreements which were terminated or cancelled.

The price paid by the Partnership for all residual wood chips supplied by Canfor under the Fibre Supply Agreement is a market price determined in relation to the Partnership's Canadian dollar pulp prices.

The price paid by the Partnership is also adjusted for wood chip quality and to reflect any changes in the actual freight cost for delivering the wood chips to the Mills if Canfor elects to supply wood chips from Canfor sawmills other than the Canfor sawmills specified in the Fibre Supply Agreement.

The Partnership is also entitled, upon giving three months prior written notice, to request Canfor to supply the Partnership with pulplogs or other pulpwood harvested by or on behalf of Canfor from its woodlands operations in the Prince George forest region at market prices.

Canfor also supplies the Partnership with agreed annual quantities of hog fuel produced from specified Canfor sawmills located within the Prince George forest region. If Canfor discontinues operations at any of the specified Canfor sawmills, Canfor must use reasonable efforts to supply the Partnership with hog fuel from other Canfor facilities so as to maintain the quantity of hog fuel supplied to the Partnership. Canfor will also have the right, on not less than six months' prior written notice to the Partnership, to reduce the quantity of hog fuel delivered from the specified sawmills. If Canfor exercises this option, the Partnership will be entitled to acquire hog fuel from other Canfor sawmills which are closest in terms of truck hauling to the Mills in order to replace the displaced quantity of hog fuel, to the extent hog fuel is available from the other Canfor sawmills. The price paid by the Partnership to Canfor for hog fuel supplied under the Fibre Supply Agreement is at the prevailing market price.

### *Other Fibre Supply Arrangements*

The Mills currently have short and long term chip supply agreements with 13 different suppliers, other than Canfor, supplying approximately 0.6 million ODTs on an annual basis. These agreements are for periods ranging between one and eighteen years and each agreement permits the Mills to purchase wood chips available at a specified sawmill, subject to certain maximums. These agreements do not

provide for minimum volumes, which protects the Mills from being required to purchase wood chips in excess of their requirements.

Pricing for wood chips purchased under these agreements is based on the same formula as used in the Fibre Supply Agreement, subject to adjustment for chip quality. Similar to other pulp producers, the Mills have chip quality incentive programs for suppliers designed to reduce off-grade pulp. The program is designed to ensure the highest quality of wood chips is supplied by reducing bark and chip fines as well as defining the preferred classification mix of wood chips. These agreements also contain a market adjustment clause similar to the Fibre Supply Agreement, and during 2009, the price paid for wood chips under these other fibre supply agreements increased above the formula price to open market prices for the first nine months.

In addition to the supply of hog fuel under the Fibre Supply Agreement, the Partnership is able to source hog fuel from third party suppliers. Hog fuel has increased in value at the source due to the development of other end-users, coupled with the reduced levels of production from the sawmill industry.

The Partnership expects that the Fibre Supply Agreement, together with supplemental agreements with other parties for the supply of wood chips including the production of whole log chips, will satisfy all of its anticipated fibre requirements to operate the Mills at current or reasonably projected levels of operation.

## **Energy**

### *Northwood*

In 2009, Northwood generated approximately 84% of its electrical power requirements and purchased the remaining 16% from BC Hydro. The Northwood steam production was produced primarily with black liquor from the Kraft pulping process, and hog fuel. Approximately 10% of the steam required was produced from natural gas.

### *Intercontinental*

In 2009, Intercontinental generated approximately 51% of its electrical power requirements, purchased 9% from PGP&P, and purchased the remaining 40% from BC Hydro. The reduction in the total amount of electricity supplied from the PG Cogeneration Project relative to 2008 is a result of the implementation of the new Electricity Purchase Agreement (EPA) with BC Hydro (see below).

The 2009 Intercontinental steam production was primarily with black liquor from the Kraft pulping process and hog fuel. Approximately 3% of the total steam produced was from natural gas.

### *PGP&P*

In 2009, PGP&P self-generated approximately 99% of its internal electricity requirements, and also displaced electricity purchases from BC Hydro at the Intercontinental mill. In 2009, the PGP&P mill also became a power exporter to BC Hydro with the Cogeneration Project. The new exports to BC Hydro reduced the opportunity of the Cogeneration Project to displace electricity purchases from BC Hydro at the Intercontinental mill.

The 2009 PGP&P steam production was primarily with black liquor from the Kraft pulping process and hog fuel. Approximately 3% of the total steam produced was from natural gas.

### *Cogeneration Agreement*

In October 2003 BC Hydro entered into an agreement (the "**Cogeneration Agreement**") under which it agreed to contribute \$45.8 million, through its PowerSmart Program, to construct an electrical



cogeneration facility at PGP&P designed to produce 48 MW of electricity (the "**Cogeneration Project**"). In addition to the construction of the electrical cogeneration facility, the Cogeneration Project included the modification of two of the three boilers at PGP&P and the addition of wood waste and ash handling systems to enable a more efficient use of energy generated from black liquor and significantly higher steam production from hog fuel.

The original Cogeneration Agreement required the Cogeneration Project to be operated for a period of 15 years from its completion at an average annual electricity output of 390 GWh, to supply the electricity requirements of PGP&P and Intercontinental up to a maximum of 1,070 MWh per day.

On September 15, 2009, a new Electricity Purchase Agreement ("**EPA**") with BC Hydro began commercial operation. Several conditions of the original Cogeneration agreement required amendment to integrate with the new EPA. The new EPA has a term of 10 years effective September 15, 2009. The EPA commitment is for the Partnership to export 8 MWh per hour, of 'hourly-firm' electricity from the PG Cogeneration project above the annual amended Load Displacement generating baseline of 338 GWh.

Under the amended Cogeneration agreement, the Partnership agreed to repay BC Hydro \$4.3 million of incentive funding and the load displacement commitment was reduced to 338 gigawatt hours of electricity per year, reflecting the original project output capacity. The amended Cogeneration Agreement also provides that if the Cogeneration Project generates less than 338 GWh in any year, the shortfall can be made up by excess 'non-firm' generation exports assigned to the Load Displacement Reserve account. If the balance in the Load Displacement Reserve account does not make up the shortfall at the annual reconciliation, BC Hydro is entitled to be reimbursed for the difference by an amount equal to the average annual price paid for all energy exported through the EPA.

## **Chemicals**

The Partnership has entered into a long-term supply agreement (the "**Chemical Supply Agreement**") under which it has agreed to obtain all of the Mills' requirements for the principal chemical used in the production of pulp, sodium chlorate, exclusively from Chemtrade, a subsidiary of Chemtrade Logistics Income Fund, whose facilities are located adjacent to the Intercontinental Mill. The long-term supply agreement has a minimum annual purchase requirement of 48,000 tonnes. Sodium chlorate is used for the production of chlorine dioxide, which in turn is used in the bleaching phase of the kraft pulping process. The supply agreement has four years remaining on its initial 10-year term, and is automatically renewed for successive five-year terms unless either party gives notice of termination not less than two years prior to expiry of the then current term. The price payable by the Partnership for sodium chlorate supplied by Chemtrade is subject to a periodic adjustment to reflect the actual costs incurred by Chemtrade for salt, caustic soda, electricity, and steam used in the production of sodium chlorate.

## **Transportation**

The Partnership uses various modes of surface transportation to distribute its pulp and Kraft Paper products. In the case of pulp, nearly all is shipped from the Mills by rail and each of the Mills is serviced by at least one dedicated rail spur. In the case of Kraft Paper, due to the smaller average order size, a much higher percentage is shipped by truck, with the balance being shipped by rail. Products destined for overseas customers are loaded at terminals in Vancouver, and in Montreal, and are then transported by break-bulk cargo vessel for European customers, and either break-bulk or container cargo vessels for Asian customers depending on which mode is most cost effective.

The Partnership's costs of transportation over the past four years have risen due to increasing fuel costs, and as a result of reduced break-bulk capacity. The Partnership is working to minimize the effect of these cost increases by optimizing the Partnership's geographic pulp distribution. Re-directing pulp sales from certain offshore markets to North American markets reduces total transportation costs due to shorter shipping distances.

## Environment

The Mills are subject to a wide range of general and industry-specific environmental statutes, laws, regulations, bylaws, guidelines, policies, directives and other requirements (the "**Environmental Requirements**") governing or relating to among other things: air emissions, wastewater discharge, waste management, landfill sites, pollution prevention, site contamination and hazardous and residual materials. In addition, the Mills have obtained numerous environmental permits, authorizations, and approvals relating to the protection of the environment and operation of equipment. Compliance with the Environmental Requirements requires the Mills to incur expenses and to monitor their operations on an ongoing basis.

The Mills have an Environmental Management System ("**EMS**") that is certified under ISO 14001. Risks to the environment are formally assessed providing the foundation for continuous improvement on a priority basis. This systematic approach ensures optimum utilization of resources. Third party EMS audits and internal audits of the EMS, compliance with legal requirements, company policies, and good industry practice are conducted on a regular basis.

The Mills are actively engaged in the local airshed management program including areas of ambient monitoring and research. Staff serving on air quality committees work to ensure that future airshed plans are guided by sound science.

Future regulations or permits may place lower limits on allowable emissions of all kinds, including air, water, waste, and hazardous materials, and may increase the financial consequences of remaining in compliance with Environmental Requirements or conducting future remediation, if required, of spills. The Mills' EMS and policies have enabled the Partnership to develop and implement effective measures to maintain emissions in material compliance with Environmental Requirements to date. Although Management believes that adherence to and strengthening of the EMS and the policies will enable the Mills to comply with future Environmental Requirements in a cost-effective manner, there can be no assurance that this will be the case.

In October 2006, the Partnership observed dark ponded water in an area on the banks of the Fraser River and reported the dark ponded water to the appropriate regulatory agencies. The consultants engaged by the Partnership concluded that the source was likely a leak from the Intercontinental pulp mill ash pond. In 2007, the Partnership submitted a remedial plan to the regulatory agencies and began the process of implementing that plan. The Intercontinental pulp mill ash pond was decommissioned in the 4<sup>th</sup> quarter of 2007, with remediation work completed in 2008. The cost to remediate the Intercontinental pulp mill ash pond was \$1.5 million. This obligation has been recorded in the 2007 financial statements. Two new ash settling ponds were constructed in 2007 to serve the ongoing ash handling requirements. Groundwater quality will be monitored regularly to ensure that the remediation work has been successful.

The Canfor forest tenures from which the Partnership obtained 63% of its fibre supply in 2009 are certified to the Canadian Standards Association Sustainable Forest Management Standard (CAN/CSA-Z809).

The Mills continue to reduce their reliance on fossil fuels as an energy source. Despite the production and market challenges of 2009, the Mills reduced their emissions of greenhouse gasses by 42% on an absolute basis, and 53% on an intensity basis relative to 1990. The Partnership is committed to continue to reduce its dependence on fossil fuels. Capital spending under the Pulp and Paper Green Transformation Program (GTP) will reduce this dependence even further. The GTP will enable the advancement of projects at all of the Partnership's facilities that will yield a variety of environmental benefits. The planned improvements include reductions in odour and particulate emissions; reduced fossil fuel and water consumption; and incremental renewable electricity generation. For more information on the GTP, please see the capital expenditures section starting on page 17.

## Competition

The pulp industry is highly competitive, with a substantial number of competitors having extensive manufacturing expertise and sales and distribution organizations, some of which are larger than the Partnership's, but none of which is considered to be dominant. The principal competitive factors in the pulp market are price, quality, volume, availability, and reliability of supply, and customer service. Most markets in which the Mills' products are sold are highly competitive and customers have several choices of suppliers. The Partnership's principal competitors in North America are Abitibi-Bowater Incorporated, SFK Pulp Fund, Domtar Inc., West Fraser Timber Co. Ltd., and Tembec Inc. For sales to Europe, the Partnership's principal competitors include Södra Group, Metsa Botnia, Mercer International, Stora Enso Oyj, and British Columbia coastal pulp mills. For sales to Asia, the Partnership's principal competitors are mills located in Chile, Russia, Scandinavia, and British Columbia. Mills located in the southern United States and in South America rarely compete directly with the Partnerships, as Southern mills typically rely upon different species that supply end uses that the Partnership's Mills do not target.

The Partnership's main product line for its Kraft paper business is high performance, bleached paper. The Partnership's main competitors in its sale of Kraft Paper products are two European producers – Bilerud and Frantschach/Mondi – as they are the only companies that can produce high performance bleached papers. Tolko is the only other North American producer with high performance capability, but it produces only unbleached papers.

## Competitive Advantages

Management believes the Partnership has the following competitive strengths and advantages:

- **Market Leadership:** The Partnership is the largest North American and third largest global producer of market NSK Pulp, with an annual production capacity of approximately 1,060,000 ADMTs. The Partnership is the leading global North American producer of fully bleached, high performance Kraft Paper with an annual capacity of 140,000 MT.
- **Low Cost Producer:** According to the most recent PricewaterhouseCoopers LLP Market Pulp study (2007), Intercontinental and Northwood are in the first quartile in terms of manufacturing cash costs among Canadian pulp producers. Though not part of the Market Pulp study, PGP&P's cash conversion costs are also in the first quartile. This cost position has been confirmed by comparing more recent financial statistics extracted from 2008 financial reports for Canadian Public companies.
- **Secure Fibre Supply:** The Partnership has a long-term, secure supply of wood chips through the Fibre Supply Agreement with Canfor. This Fibre Supply Agreement, together with supplemental agreements with other parties, will satisfy the Partnership's anticipated fibre requirements to operate the Mills at current and projected levels. The Mills are located in the central interior of British Columbia, which has an abundant supply of fibre due to the large number of lumber production facilities and whole log chipping opportunities, in the region. In order to control a mountain pine beetle infestation in the region, the Ministry of Forests has increased the AAC by approximately 30% for at least the next seven to ten years. This abundant fibre supply provides the Partnership with a lower fibre cost than any other region in Canada and a significant competitive advantage relative to eastern Canadian pulp producers.
- **Strong, Diverse Customer Base:** The Partnership's customers generally have technical requirements for premium reinforcing NBSK Pulp, are dominant in their field, and are interested in maintaining long-term relationships. Many of the Partnership's customers have long-standing relationships with one or more of the Mills and multiple year supply contracts including notice and/or ramp-down periods prior to termination.

- **Experienced Management:** The Partnership has a strong management team with substantial experience and proven expertise in the forest products sector.

## Strategic Direction and Opportunities to Increase Cash Distributions

Management intends to maximize and grow cash distributions to Unitholders by focusing on the Mills' specific strengths and core business — the production of low-cost and high-quality pulp delivered to market segments providing the best margins.

The Partnership's business focus and strategy are aimed at:

- preserving the Mills' low-cost position through (i) cost reduction initiatives in the areas of chemical usage, energy, fibre and maintenance; (ii) efficiency improvements to increase production through process optimization and control; and (iii) targeted investment in new technologies to improve energy efficiency and environmental performance;
- implementing quality improvement initiatives to better meet customer needs in the areas of pulp strength and product consistency; and
- leveraging its access to public markets and other financial resources and its reputation as a strong business partner to pursue selective and accretive acquisitions of existing high quality assets.

## THE BUSINESS OF THE FUND

The Fund Declaration provides that the Fund's operations and activities are restricted to, among other things:

- (a) acquiring, investing in, transferring, disposing of, and otherwise dealing with securities, including those of the Trust and the Partnership;
- (b) paying the expenses and liabilities of the Fund, paying amounts owing by the Fund in connection with the redemption of any Fund Units or other securities of the Fund and making distributions to Unitholders and temporarily holding cash in interest bearing accounts, short-term government debt or short-term investment grade corporate debt for such purposes;
- (c) issuing Fund Units and other securities of the Fund (including warrants, options or other rights to acquire Fund Units or other securities of the Fund pursuant to the Fund Declaration), including for the purposes of:
  - (i) obtaining funds to conduct the activities described in paragraph (a) above, including raising funds for acquisitions or investments;
  - (ii) implementing Unitholder rights plans, distribution reinvestment plans, distribution reinvestment and Fund Unit purchase plans, incentive option plans or other compensation plans, if any, established by the Fund;
  - (iii) making non-cash distributions to Unitholders as contemplated by the Fund Declaration, including pursuant to distribution reinvestment plans, if any, established by the Fund; and
  - (iv) giving effect to the exercise of the rights of exchange pursuant to the Exchange Agreement;

- (d) issuing debt securities (including debt securities convertible into, or exchangeable for, Fund Units or other securities of the Fund) or otherwise borrowing and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering any of its assets as security, provided that any such mortgage, pledge, charge, security interest or other encumbrance in the applicable Trust Units and Trust Notes will be automatically released upon a redemption of Fund Units if the redemption price is to be satisfied by way of an in specie redemption under the terms of the Fund Declaration;
- (e) guaranteeing (as guarantor, surety or co-principal obligor) the payment of any indebtedness, liability or obligation of any wholly-owned affiliate of the Fund or the performance of any obligation of any wholly-owned affiliate of the Fund, and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering all or any part of the assets of the Fund, including securities issued by the Trust and the Partnership, as the case may be, as security for such guarantee, and, where considered appropriate, postponing or subordinating its rights under the Trust Notes to other indebtedness, provided that any such mortgage, pledge, charge, security interest or other encumbrance in the applicable Trust Units and Trust Notes will be automatically released upon a redemption of Fund Units if the redemption price is to be satisfied by way of an in specie redemption under the terms of the Fund Declaration;
- (f) disposing of all or any part of the assets of the Fund;
- (g) issuing or redeeming rights and Fund Units pursuant to any Unitholder rights plan adopted by the Fund;
- (h) repurchasing securities issued by the Fund, including Fund Units, subject to the provisions of the Fund Declaration and applicable law;
- (i) satisfying the obligations, liabilities or indebtedness of the Fund; and
- (j) undertaking all other usual and customary actions for the conduct of the activities of the Fund in the ordinary course as are approved by the Fund Trustees from time to time, or as are contemplated by the Fund Declaration,

provided that the Fund shall not undertake any activity, take any action or make or retain any investment which would result (or fail to take any action where such failure would result) in the Fund not being considered a "mutual fund trust" for purposes of the Tax Act.

As at the date of this AIF, the Fund does not intend to hold securities other than securities of the Trust or securities held in connection with its short-term cash management.

As at the date of this AIF, no bankruptcy, receivership or similar proceedings were made against the Fund or any of its subsidiaries within the three most recently completed financial years or completed during or proposed for the current financial year.

## THE BUSINESS OF THE TRUST

The Trust's activities are restricted to, among other things:

- (a) acquiring, investing in, transferring, disposing of, and otherwise dealing with securities, including those issued by the General Partner and the Partnership;
- (b) paying the expenses and liabilities of the Trust, paying amounts owing by the Trust in connection with the redemption of any Trust Units or other securities of the Trust and making distributions to holders of Trust Units and temporarily holding cash in interest bearing accounts, short-term government debt or short-term investment grade corporate debt for such purposes;
- (c) issuing Trust Units and other securities of the Trust (including warrants, options or other rights to acquire Trust Units or other securities of the Trust pursuant to the Trust Declaration), including for the purposes of:
  - (i) obtaining funds to conduct the activities described in paragraph (a) above, including raising funds for acquisitions or investments;
  - (ii) repayment of any indebtedness or borrowings of the Trust;
  - (iii) making non-cash distributions to Trust unitholders as contemplated by the Trust Declaration; and
  - (iv) giving effect to the exercise of the rights of exchange pursuant to the Exchange Agreement;
- (d) issuing debt securities, including the Trust Notes (including debt securities convertible into, or exchangeable for, Trust Units or other securities of the Trust) or otherwise borrowing and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering any of its assets as security;
- (e) redeeming Trust Units or Trust Notes;
- (f) repurchasing securities issued by the Trust;
- (g) guaranteeing (as guarantor, surety or co-principal obligor) the payment of any indebtedness, liability or obligation of any affiliate of the Trust, or the performance of any obligation of any affiliate of the Trust, and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering all or any part of the assets of the Trust, including securities issued by the Partnership and the General Partner, as security for such guarantee;
- (h) guaranteeing the obligations of the Partnership, or any affiliate of the Trust or the Partnership, pursuant to any good faith debt for borrowed money incurred by the Partnership or the affiliate, as the case may be, and mortgaging, pledging, charging, granting a security interest in or otherwise encumbering all or any part of the assets of the Trust as security for such guarantee and entering into any subordination agreements in connection therewith;
- (i) satisfying the obligations, liabilities, or indebtedness of the Trust;
- (j) disposing of all or any part of the assets of the Trust;

- (k) undertaking all other usual and customary actions for the conduct of the activities of the Trust in the ordinary course as are approved by the Trust Trustees from time to time, or as are contemplated by the Trust Declaration; and
- (l) acquiring, investing in, transferring, disposing of and otherwise dealing with securities of any of the Partnership, the General Partner, and their respective subsidiaries and successors in connection with the Trust's obligations under the Exchange Agreement;

provided that the Trust shall not undertake any activity, take any action or make or retain any investment which would result (or fail to take any action where such failure would result) in the Trust not being considered a "unit trust" for purposes of the Tax Act.

The Trust does not currently intend to hold securities of any entities other than the General Partner and the Partnership.

## **THE BUSINESS OF THE PARTNERSHIP**

The business of the Partnership is to operate the Pulp Business.

## **THE BUSINESS OF THE GENERAL PARTNER**

The business of the General Partner is to act as general partner of the Partnership and to operate the Pulp Business on behalf of the Partnership in its capacity as general partner. The General Partner has exclusive authority to manage the business and affairs of the Partnership, to make all decisions regarding the business of the Partnership and to bind the Partnership. The General Partner is to exercise its powers and discharge its duties honestly, in good faith and in the best interests of the Partnership and to exercise the care, diligence, and skill of a reasonably prudent person in comparable circumstances. The authority and power vested in the General Partner to manage the business and affairs of the Partnership includes all authority necessary or incidental to carry out the objects, purposes, and business of the Partnership, including without limitation, the ability to engage agents to assist the General Partner to carry out its management obligations or substantially administrative functions. The General Partner cannot dissolve the Partnership or wind up the Partnership's affairs except in accordance with the provisions of the Partnership Agreement.

As of the date of this AIF, other than as described in this document:

- (a) no material new products have been publicly announced;
- (b) no material intangible properties, such as brand names, circulation lists, copyrights, franchises, licences, patents, software, subscription lists and trademarks affect any segment described in the section describing the Business of the Partnership; and
- (c) other than the environmental policies discussed in this AIF, no social or environmental policies that are fundamental to the Business of the Partnership have been implemented.

## **RISK FACTORS**

### **Risks Related to the Structure of the Fund**

#### *Control of the Partnership*

Pursuant to the Shareholders' Agreement, Canfor is entitled to appoint the majority of directors to the board of the General Partner for so long as it owns not less than 30% of the outstanding LP Units. See "Acquisition, Liquidity, Support and Security Holder Agreements – Shareholders' Agreement" for a description of Canfor's board representation rights.

For so long as Canfor holds not less than a 20% indirect economic interest in the Fund, Canfor's consent will be required in order to approve certain significant transactions of the Partnership. In addition, under the Exchange Agreement, the Fund and the Trust will agree not to take certain actions without the prior approval of Canfor. As a result of these rights, Canfor will exercise significant influence or control over transactions submitted to the board of the General Partner and to the Fund Trustees and Trust Trustees. Canfor may have sufficient voting power to prevent a change of control of the Partnership. The Fund has an indirect minority interest in the Partnership and minority representation on the board of the General Partner and, therefore, has influence but not control over transactions of the Partnership.

The interests of Canfor may conflict with those of Unitholders.

### ***Dependence on the Partnership***

The Fund is an unincorporated open-ended, limited purpose trust that is entirely dependent on the operations and assets of the Partnership. Cash distributions to Unitholders will be dependent on, among other things, the ability of the Trust to pay interest on the Trust Notes and to make cash distributions in respect of the Trust Units, which, in turn, is dependent on the Partnership making cash distributions. The ability of the Fund and its subsidiaries to make cash distributions or other payments or advances is subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities, including restrictive covenants in the Credit Facilities.

### ***Cash Distributions Are Not Guaranteed and Will Fluctuate with the Business Performance***

Although the Fund intends to distribute the interest received in respect of the Trust Notes and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Fund Units, there can be no assurance regarding the amount of income to be generated by the Partnership's business or ultimately distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of the Partnership, and will be subject to various factors including its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margin and its capital expenditure requirements. The market value of the Fund Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be significant.

### ***Nature of Fund Units***

The Fund Units share certain attributes common to both equity securities and debt instruments. The Fund Units do not represent a direct investment in the business of the Partnership and should not be viewed by investors as direct securities of the Partnership. As holders of Fund Units, Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions or rights of dissent.

The Fund Units represent a fractional interest in the Fund. The Fund's primary assets will be Trust Units and Trust Notes. The price per Fund Unit is mainly a function of anticipated distributable income.

The Fund Units are not "deposits" within the meaning of the *Canada Deposit Insurance Corporations Act* (Canada) and are not insured under the provisions of that Act or any other legislation. Furthermore, the Fund is not a trust company and, accordingly, is not registered under, any trust and loan company legislation as it does not carry on or intend to carry on the business of a trust company.



### ***Market Price of Fund Units***

Publicly traded investment trusts such as the Fund do not necessarily trade at prices determined solely by reference to the underlying value of their investments. Increases in market rates of interest may lead purchasers to demand a higher yield on the Fund Units, which may adversely affect their price. In addition, the market price for the Fund Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities, taxation of the Fund or its cash distributions and other factors beyond the Fund's control.

The market value of the Fund Units may deteriorate if the Fund is unable to meet its distribution levels in the future, and that deterioration may be material. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

### ***Distribution of Securities on Redemption or Termination of the Fund***

Upon termination of the Fund, the Trustees may distribute the Trust Notes and Trust Units directly to the Unitholders, subject to obtaining all required regulatory approvals. Upon redemption of Fund Units, the Trustees may distribute the Trust Notes directly to Unitholders, subject to obtaining all required regulatory approvals. There is currently no market for the Trust Notes and the Trust Units. In addition, Trust Notes and the Trust Units are not freely tradable or listed on any stock exchange. See "The Business of the Fund" and "Description of Legal Structure –the Fund –Redemption Right". Securities so distributed may not be qualified investments for trusts governed by Plans, depending on the circumstances at the time.

### ***Dilution of Existing Unitholders***

The Fund Declaration authorizes the Fund to issue an unlimited number of Fund Units for such consideration and on such terms and conditions as shall be established by the Trustees without the approval of any Unitholders. The Unitholders have no pre-emptive rights in connection with such further issues. Additional Fund Units will be issued by the Fund in connection with the conversion of the Class B Exchangeable LP Units by Canfor into Fund Units pursuant to the conversion rights attached thereto See "Acquisition, Liquidity, Support and Security Holder Agreements – Exchange Agreement".

### ***Leverage and Restrictive Covenants in Agreements Relating to Indebtedness***

The ability of the Fund and its subsidiaries to make distributions, pay dividends or make other payments or advances are subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of those entities (including the Credit Facilities). The degree to which the Partnership is leveraged can have important consequences to the Unitholders including: the Partnership's ability to obtain additional financing for working capital could be affected, capital expenditures or acquisitions in the future may be limited; a significant portion of the Partnership's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interest, which exposes the Partnership to the risk of increased interest rates; and the Partnership may be more vulnerable to economic downturns and be limited in its ability to withstand competitor pressures. These factors may increase the sensitivity of Adjusted Distributable Cash to interest rate variations.

The Credit Facilities contain restrictive covenants that limit the discretion of the Partnership's management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of the Partnership to create liens or other encumbrances, to pay distributions or make certain other payments, investments, loans, and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. In addition, the Credit Facilities contain financial covenants that require the Partnership to meet certain financial ratios and financial condition tests. A failure by the Partnership to comply with the obligations in the Credit Facilities could result in a

default which, if not cured or waived, could result in a termination of distributions by the Partnership and require accelerated repayment of the relevant indebtedness. If the repayment of indebtedness under the Credit Facilities were to be accelerated, there can be no assurance that the assets of the Partnership would be sufficient to repay in full that indebtedness. In addition, the Bank Facility will mature in 2011, the Hydro LOC Facility in 2011, and the Term Facility will mature in 2013. The Partnership will then be required to refinance this indebtedness or seek alternative financing arrangements. There can be no assurance that the Credit Facilities will be able to be refinanced or refinanced on acceptable terms or that future borrowings or equity financings will be available to the Partnership, or available on acceptable terms, in an amount sufficient to fund the Partnership's needs. This could, in turn, have a material adverse effect on the business, financial condition, and results of operations of the Partnership and the ability of the Fund to make distributions on Fund Units.

Neither the Fund nor any of its subsidiaries have received any type of stability rating, including any provisional rating, from any approved rating organizations for their outstanding securities.

### ***Structural Subordination of the Fund Units***

In the event of a bankruptcy, liquidation, or reorganization of the Partnership, holders of its indebtedness and its trade creditors will generally be entitled to payment of their claims from the assets of the Partnership before any assets are made available for distribution to the Fund. The Fund Units are junior in priority to the debt outstanding under the Credit Facilities and other liabilities (including trade payables) of the Partnership. The Partnership will generate all of the Fund's cash available for distribution and will hold all of the Fund's consolidated assets.

### ***Future Sales of Fund Units by Canfor***

Canfor holds Class B Exchangeable LP Units representing approximately 50.2% of the outstanding Fund Units on a fully-diluted basis. Canfor has also been granted certain registration rights by the Fund. See "Acquisition, Liquidity, Support and Security Holder Agreements – Exchange Agreement". If Canfor sells substantial amounts of Fund Units in the public market, the market price of the Fund Units could fall. The perception among the public that these net sales will occur could also contribute to a decline in the market price of the Fund Units.

### ***Income Tax Matters***

In June 2007, legislation was substantively enacted to tax distributions of publicly traded income trusts, commencing in 2011. As a result, the Fund is required to recognize the future income tax assets and liabilities expected to arise when the tax on distributions becomes applicable. For existing income trusts there is a four-year transition period until their 2011 taxation year before the tax is applicable. In addition, the legislation includes a limitation on the growth of entities such as the Fund during the transition period, which may limit the amount of new units that can be issued by the Fund, which in turn can limit investment opportunities for the Fund.

Currently, a trust will not be considered to be a mutual fund trust if it is established or maintained primarily for the benefit of non-residents unless all or substantially all of its property is property other than taxable Canadian property as defined in the Tax Act. On September 16, 2004, the Minister of Finance (Canada) released draft amendments to the Tax Act. Under those draft amendments, a trust would lose its status as a mutual fund trust if the aggregate fair market value of all units issued by the trust that are held by non-residents, or partnerships that are not Canadian partnerships, is more than 50% of the aggregate fair market value of all the units issued by the trust, and more than 10% (based on fair market value) of the trust's property is taxable Canadian property or certain other types of property. If those draft amendments are enacted as proposed, and if, at any time, more than 50% of the aggregate fair market value of units of the Fund were held by non-residents or partnerships other than Canadian partnerships, the Fund would thereafter cease to be a mutual fund trust. Those draft amendments did

not provide any means of rectifying a loss of mutual fund trust status. On December 6, 2004, the Department of Finance tabled a Notice of Ways and Means Motion which did not include these proposed changes. The Department of Finance indicated that the implementation of the proposed changes would be suspended pending further consultation with interested parties.

If the Fund ceases to qualify as a "mutual fund trust" under the Tax Act, the income tax considerations described herein would be materially and adversely different in certain respects, including that Fund Units may cease to be qualified investments for Plans. The Tax Act imposes penalties for the acquisition or holding by Plans of non-qualified investments.

Although the Fund is of the view that all expenses to be claimed by the Fund, the Trust and the Partnership in the determination of their respective incomes under the Tax Act will be reasonable and deductible in accordance with the applicable provisions of the Tax Act and that the allocations of income and losses to be made for purposes of the Tax Act will be reasonable, there can be no assurance that the Tax Act or the interpretation of the Tax Act will not change, or that the CRA will agree with the expenses claimed. If the CRA successfully challenges the deductibility of expenses or the allocation of income and losses, the Partnership's allocation of taxable income and losses to the Trust, and indirectly the Fund and the Unitholders, may increase or change.

Interest on the Trust Notes accrues to the Fund for Canadian federal income tax purposes, whether or not actually paid. In addition, any amounts of income of the Trust that become payable in the year to the Fund will be included in the income of the Fund, whether or not the amount is actually paid to the Fund in the year. The Fund Declaration of Trust provides that a sufficient amount of the Fund's earnings and net realized capital gains will be distributed each year to Unitholders in order to eliminate the Fund's liability for tax under Part 1 of the Tax Act. Where such amount of net income (including interest on the Trust Notes and amounts payable by the Trust to the Fund) and net realized capital gains of the Fund in a taxation year exceeds the cash available for distribution in the year, such excess net income and net realized capital gains will be distributed to Unitholders in the form of additional Fund Units. Unitholders will generally be required to include an amount equal to the fair market value of those Fund Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

In addition, the Acquisition Agreement under which Canfor transferred the Mills and ancillary assets to the Partnership provides that Canfor and the Partnership will make elections under the Tax Act and corresponding provincial legislation, if applicable, to transfer such assets on a partially tax-deferred basis for income tax purposes. The cost to the Partnership of such assets for income tax purposes may, therefore, be less than their fair market value, such that the Partnership may realize greater taxable income on a future disposition of these assets than it would have, had it acquired the assets without such elections having been made. In addition, the Partnership's deductions for capital cost allowance and other tax deductions will be less than they would have been in the absence of a tax-deferred transfer.

Alternatively the CRA may seek to challenge the rollover, in whole or in part, in which case, if the CRA was successful, Canfor would be required to pay tax in respect of the transfer of the assets to the Partnership, the amount of which may be material.

### ***Implications of Exercise of Redemption Right***

It is anticipated that the redemption right will not be the primary mechanism for Unitholders to liquidate their investments. Upon redemption of Fund Units or termination of the Fund, the Trustees may distribute the Trust Units and Trust Notes directly to the Unitholders, subject to obtaining any required regulatory approvals and complying with the requisite terms and conditions of such approvals. Trust Units and Trust Notes so distributed may not be qualified investments for Plans depending upon the circumstances at the time. Additionally, such Trust Units and Trust Notes will not be listed on any stock exchange and no established market is expected to develop in such Trust Units and Trust Notes and they may be subject to resale restrictions under applicable securities laws.

### ***Limitation on Potential Growth***

The payout by the Partnership of substantially all of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of the Partnership and its cash flow.

### ***Restrictions on Certain Unitholders and Liquidity of Fund Units***

The Fund Declaration imposes various restrictions on Unitholders. Non-Resident Unitholders are prohibited from beneficially owning more than 49% of Fund Units (on a non-diluted and a fully-diluted basis). These restrictions may limit (or inhibit the exercise of) the rights of certain persons, including Non-Residents, to acquire Fund Units, to exercise their rights as Unitholders and to initiate and complete take-over bids in respect of the Fund Units. As a result, these restrictions may limit the demand for Fund Units from certain Unitholders and thereby adversely affect the liquidity and market value of the Fund Units held by the public.

### ***Statutory Remedies***

The Fund is not a legally recognized entity within the relevant definitions of the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* and, in some cases, the *Winding Up and Restructuring Act*. As a result, in the event a restructuring of the Fund were necessary, the Fund and its stakeholders may not be able to access the remedies and procedures available there under.

### ***Unitholder Limited Liability***

The Fund Declaration provides that no Unitholder will be subject to any liability in connection with the Fund or its obligations and affairs and, in the event that a court determines Unitholders are subject to any such liabilities, the liabilities will be enforceable only against, and will be satisfied only out of the Fund's assets. Pursuant to the Fund Declaration, the Fund will indemnify and hold harmless each Unitholder from any costs, damages, liabilities, expenses, charges and losses suffered by a Unitholder resulting from or arising out of such Unitholder not having such limited liability.

The Fund Declaration provides that all written instruments signed by or on behalf of the Fund must contain a provision to the effect that obligations under those instruments will not be binding upon Unitholders personally. Personal liability may, however, arise in respect of claims against the Fund that do not arise under contracts, including claims in tort, claims for taxes and possibly certain other statutory liabilities. The possibility of any personal liability of this nature arising is considered unlikely.

The *Trust Beneficiaries' Liability Act* (Ontario) came into force on December 16, 2004. The legislation provides that a Unitholder will not be, as a beneficiary, liable for any act, default, obligation or liability of the Trustee(s) that arises after the legislation came into force. However, this legislation has not yet been ruled on by the courts.

### ***Nature of Distributions***

Unlike interest payments on an interest-bearing security, distributions by income trusts on trust units (including those of the Fund) are, for Canadian tax purposes, composed of different types of payments (portions of which may be fully or partially taxable or may constitute non-taxable "returns of capital"). The composition for tax purposes of those cash distributions may change over time, thus affecting the after-tax return to Unitholders. Therefore, a Unitholder's rate of return over a defined period may not be comparable to the rate of return on a fixed-income security that provides a return on capital over the same period, because a Unitholder may receive distributions that constitute a return of capital (rather than a return on capital) to some extent during the relevant period. Returns on capital are generally taxed as ordinary income, dividends, or taxable capital gains in the hands of a Unitholder while returns of capital are generally non-taxable to a Unitholder (but reduce a Unitholder's adjusted cost base

in the Fund Unit for tax purposes). Unitholders are advised to consult their own tax advisors with respect to the implications of the distinction discussed above in their own circumstances.

### *Issuance of Additional Fund Units*

The Fund Declaration provides that an amount equal to the taxable income of the Fund will be payable each year to Unitholders in order to reduce the Fund's taxable income to zero. Where in a particular year, the Fund does not have sufficient Adjusted Distributable Cash to distribute such an amount to Unitholders, the Fund Declaration provides that additional Fund Units must be distributed to Unitholders in lieu of cash payments. Unitholders will generally be required to include an amount equal to the fair market value of those Fund Units in their taxable income, notwithstanding that they do not directly receive a cash payment.

## **Risks Related to the Pulp Business and Industry**

### *Cyclicality of Product Prices*

The Partnership's financial performance is dependent upon the selling prices of its pulp and paper products, which have fluctuated significantly in the past. The markets for these products are highly cyclical and characterized by (i) periods of excess product supply due to industry capacity additions, increased production and other factors; and (ii) periods of insufficient demand due to weak general economic conditions. The economic climate of each region where the Partnership's products are sold has a significant impact upon the demand, and, therefore, the prices, for pulp and paper. In particular, the list price of pulp has historically been unpredictable. For example, during the last 10 years, the average annual Northern Europe list price for NBSK Pulp has ranged from a low of US\$460 per ADMT in 2002 to a high of US\$900<sup>1</sup> per ADMT in 2008.

### *Currency Exchange Risk*

The Partnership's operating results are sensitive to fluctuations in the exchange rate of the Canadian dollar to the US dollar, as prices for the Partnership's products are denominated in US dollars or linked to prices quoted in US dollars. Therefore, an increase in the value of the Canadian dollar relative to the US dollar reduces the amount of revenue in Canadian dollar terms realized by the Partnership from sales made in US dollars which, in turn, reduces the Partnership's operating margin and the cash flow available to fund distributions.

### *Dependence on Canfor*

In 2009, approximately 63% of the total fibre used by the Partnership was derived from the Fibre Supply Agreement with Canfor. The Partnership's financial results could be materially adversely affected if Canfor is unable to provide the current volume of wood chips as a result of mill closures (whether temporary or permanent) or as a result of financial difficulties experienced by Canfor.

In addition, Canfor provides certain services to the Partnership under the Partnership Services Agreement. In the event that the Partnership is unable to derive those services from Canfor (for whatever reason), certain of those services would be difficult and/or more costly to obtain from third parties. Any reductions or loss of such services could have a materially adverse effect on the Partnership's business, assets, financial condition, results of operations, cash flows, liquidity, and/or Adjusted Distributable Cash.

<sup>1</sup> Source: RISI

### ***Raw Material Costs***

The principal raw material utilized by the Partnership in its manufacturing operations is wood chips. The Partnership's Fibre Supply Agreement with Canfor contains a pricing formula that currently results in the Partnership paying market prices for wood chips and contains provisions to adjust the pricing formula to reflect market conditions. Typically, wood chips are purchased in highly competitive, price-sensitive markets and these markets have historically exhibited price and demand cyclicality. Prices for wood chips are not within the Partnership's control and are driven by market demand, product availability, environmental restrictions, logging regulations, the imposition of fees or other restrictions on exports of lumber into the US and other matters. In addition, because the price paid for wood chips includes the cost of transporting the chips from the mills to the Partnership's production facilities, the cost of the wood chips is affected by the price of fuel, vehicle availability, and road and weather conditions. The Partnership is not always able to increase the selling prices of its products in response to increases in raw material costs. An inability to pass increased costs through to customers could have a material adverse effect on the Partnership's financial condition, results of operation and cash flow.

### ***Competitive Markets***

The Partnership's products are sold primarily in North America, Europe, and Asia. The markets for the Partnership's products are highly competitive on a global basis, with a number of major companies competing in each market with no company holding a dominant position. In the pulp industry, a large number of companies produce products that are reasonably standardized; therefore, a significant traditional basis for competition has been price. Other competitive factors are quality of product, reliability of supply and customer service. The Partnership's competitive position is influenced by the availability, quality, and cost of raw materials, energy and labour costs, free access to markets, currency exchange rates, plant deficiencies, and productivity in relation to its competitors.

### ***Dependence on Key Customers***

In 2009, the Partnership's top three customers accounted for approximately 20% of its pulp sales. The Partnership is therefore dependant on these customers. In the event that the Partnership cannot maintain these customers or the demand from these customers is diminished for any reason in the future, there is a risk that the Partnership would be forced to find alternative markets in which to sell its pulp, which in turn, could result in lower prices or increased distribution costs thereby adversely affecting its sales margins and Adjusted Distributable cash.

### ***Increased Production Capacity***

The Partnership currently faces substantial competition in the pulp industry and may face increased competition in the years to come if new manufacturing facilities are built. In addition, pulp capacity is constantly increasing as a result of improvements to existing mills. If increases in pulp production capacity exceed increases in pulp demand, selling prices for pulp could decline and adversely affect the Partnership's business, financial condition, results of operation and cash flows. In periods of excess capacity or reduced demand, which are characterized by lower pulp prices, the Partnership may not be able to compete with competitors who have greater financial resources and who are better able to weather a prolonged decline in prices.

### ***Obligations to BC Hydro***

Under the amended Cogeneration Agreement and the Energy Purchase Agreement (EPA) with BC Hydro, if the Cogeneration Project generates less than 338 GWh in any year, BC Hydro is entitled to be reimbursed for the shortfall by an amount equal to the average annual price paid for all energy exported through the EPA.

Under the agreement, the Partnership is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated.

As of December 31, 2009, the Partnership had no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of \$16.0 million has been issued to BC Hydro as security for future power generation commitments. This standby letter of credit is covered by a separate credit facility ("**Hydro LOC Facility**").

### ***Maintenance Obligations and Facility Disruptions***

The Partnership's manufacturing processes are vulnerable to operational problems that can impair the Partnership's ability to manufacture its products. The Partnership's facilities contain complex and sophisticated machines that are used in its manufacturing processes. The Partnership could experience a breakdown in any of its machines, or other important equipment, and from time to time the Partnership schedules planned and unplanned outages to conduct maintenance that cannot be performed safely or efficiently during operations. Such disruptions could cause significant loss of production, which could have a material adverse effect on the Partnership's business, financial condition, and operating results.

In addition, one or more of the Partnership's facilities could fully or partially cease operation unexpectedly due to a number of other events including, but not limited to: prolonged power failures; a chemical spill or release; explosion of a boiler; disruptions in transportation infrastructure (including roads, bridges, railroad tracks and tunnels); fires, floods, earthquakes or other catastrophes; terrorism or threats of terrorism.

### ***Governmental Regulation***

The Partnership is subject to a wide range of general and industry-specific environmental, health and safety and other laws and regulations imposed by federal, provincial and local authorities, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain hazardous materials and wastes, the remediation of contaminated soil and ground water and the health and safety of employees. If the Partnership is unable to extend or renew a material approval, licence or permit required by such laws, or if there is a delay in renewing any material approval, licence, or permit, the Partnership's business, financial condition, results of operations and cash flows could be materially adversely affected. The process of obtaining certain required approvals, including the completion of any necessary environmental impact assessments, can be lengthy, subject to public input, controversial and expensive. The Partnership's failure to comply with applicable environmental, health and safety regulations, including permits relating thereto, could result in civil or criminal fines or penalties or enforcement actions, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of equipment or remedial actions, any of which could result in significant expenditures or reduce results of operations. The Partnership believes that it is in substantial compliance with all applicable environmental, health and safety laws and regulations and the Partnership regularly incurs capital and operating expenditures to maintain such compliance. However, future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to additional expenditures or liabilities.

### ***Capital Requirements***

The pulp and paper industry is capital intensive, and the Partnership regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency, and comply with environmental laws. The Partnership anticipates available cash resources and cash generated from operations will be sufficient to fund its operating needs and capital expenditures. However, if it requires additional funds, it may not be able to obtain them on favourable terms, or at all. In addition, the Partnership's debt service obligations reduce its available cash. If the Partnership cannot

maintain or upgrade its equipment as is required or ensure environmental compliance, the Partnership could be required to cease or curtail some of its manufacturing operations, or the Partnership may become unable to manufacture products that can compete effectively in one or more of the Partnership's markets.

### *Work Stoppages*

Any labour disruptions and any costs associated with labour disruptions at the Partnership's mills could have a material adverse effect on the Partnership's production levels and results of operations. The Partnership's collective agreements with the CEP and PPWC have terms expiring on April 30, 2012. Any future inability to negotiate acceptable contracts could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

### *Native Land Claims*

Canadian courts have recognized that aboriginal people may have unextinguished claims of aboriginal rights and title to lands used or occupied by their ancestors in those areas of British Columbia, constituting about 80% of the Province, where treaties have not yet been concluded. In those areas where treaties have been concluded, resource development may be affected by the exercise of treaty rights. Aboriginal rights may vary from limited rights of use for traditional purposes to a right of aboriginal title, depending upon, among other things, the nature and extent of the prior aboriginal use and condition. Much of the fibre used by the Partnership is sourced from areas that are located within areas where there are claims of aboriginal rights and title. The courts have held that the Crown has an obligation to consult aboriginal people, and accommodate their concerns, where there is a reasonable possibility that a Crown-authorized activity, such as public forest tenure, may infringe asserted aboriginal rights or title, even if those claims have not yet been proven. If the Crown has not consulted and accommodated aboriginal people as required, the courts may quash a tenure or attach conditions to the exercise of harvesting rights under the tenure that may affect the quantity of fibre that can be harvested from such tenure.

### *Transportation Services*

The Partnership relies primarily on third parties for transportation of its products, as well as delivery of raw materials. In particular, a significant portion of the goods and raw materials the Partnership uses are transported by railroad, trucks, and ships. If any of the Partnership's third party transportation providers were to fail to deliver the goods or distribute them in a timely manner, the Partnership may be unable to sell those products at full value, or at all. Similarly, if any of those providers were to fail to deliver raw materials in a timely manner, the Partnership may be unable to manufacture its products. Any failure of a third-party transportation provider to deliver raw materials or finished products in a timely manner could harm the Partnership's reputation, negatively impact the Partnership's customer relationships, and have a material adverse effect on its financial condition and operating results.

### *Risks Associated with Future Acquisitions*

The ability of the Partnership to pursue selective and accretive acquisitions will be dependent on management's ability to identify, acquire, and develop suitable acquisition targets in both new and existing markets but, in certain circumstances, acceptable acquisition targets might not be available. Acquisitions involve a number of risks, including the possibility that the Partnership, as successor owner, may be legally and financially responsible for liabilities of prior owners if indemnities are inapplicable or the former owner has limited assets; the possibility that the Partnership pays more than the acquired company or assets are worth; the additional expense associated with completing an acquisition and amortizing any acquired intangible assets; and the inability to successfully integrate acquired businesses into the Partnership. These risks and difficulties, if they materialize, could disrupt the Partnership's ongoing business, distract management, and otherwise have a material adverse effect on the



Partnership's business, assets, financial condition, results of operations, cash flows, and/or Adjusted Distributable Cash.

### ***Senior Management***

The Partnership's success depends, in part, on the efforts of its senior management. The senior management team has significant industry experience and would be difficult to replace. Members of the senior management team possess sales, marketing, engineering, manufacturing, financial, and administrative skills that are critical to the operation of the Partnership's business. Moreover, the market for qualified individuals is highly competitive, and the Partnership may not be able to attract and retain qualified personnel to replace or succeed members of senior management should the need arise. The Partnership does not maintain any key-man or similar insurance policies covering any of its senior management.

## **DISTRIBUTIONS**

### **Distributions of the Fund**

The Fund makes distributions of its Adjusted Distributable Cash to Unitholders of record on the last Business Day of each month, to be paid on the 15th day following each month end, or, if not a Business Day, the next Business Day thereafter. The amount to be distributed on a pro-rata basis per month per Fund Unit is equal to the Fund's net monthly cash receipts, less estimated cash amounts required for the payment of expenses and other obligations of the Fund and cash redemptions of Fund Units and any tax liability. The Fund may make additional distributions in excess of the monthly distributions during the year, as the Fund Trustees may determine from time to time, and may increase or decrease or halt cash distributions from time to time as they see fit.

Unitholders who are Non-Residents may be subject to withholding taxes payable in respect of distributions by the Fund, whether those distributions are in the form of cash or additional Fund Units. Non-Residents should consult their own tax advisors regarding the tax consequences of investing in the Fund Units.

### **Distributions of the Trust**

The Trust makes monthly cash distributions to the holders of Trust Units of its net monthly cash receipts, after satisfaction of its interest obligations, if any, and less any estimated cash amounts required for expenses and other obligations of the Trust, any cash redemptions or repurchases of Trust Units or Trust Notes and any tax liability. Such distributions will be paid within 15 days following each calendar month end and are intended to be received by the Fund prior to its related cash distribution to Unitholders. The Trust Trustees may increase or decrease or halt cash distributions from time to time as they see fit.

If the Trust Trustees determine that the Trust does not have cash in an amount sufficient to make payment of the full amount of any distribution, then the payment may include the issuance of additional Trust Units having a value equal to the difference between the amount of such distribution and the amount of cash which has been determined by the Trust's Trustees to be available for the payment of such distribution.

Any Trust Units transferred to Unitholders pursuant to a distribution in specie may be subject to resale and transfer restrictions and cannot be resold or transferred, except as permitted by applicable securities law.

## Distributions of the Partnership

The Partnership makes monthly cash distributions to holders of record of LP Units on the last Business Day of each month on their pro-rata portions of its Adjusted Distributable Cash so that distributions to Canfor will be equal on a pro-rata basis to the distributions to be made to Unitholders by the Fund. Distributions will be paid within 15 days of the end of each month and are intended to be received by the Trust prior to its related cash distribution to holders of its Trust Units.

The board of directors of the General Partner has adopted a policy to initially distribute 90% of the annual Adjusted Distributable Cash of the Partnership, subject to applicable law and the covenants in the Credit Facilities, to the holders of the LP Units by way of monthly distributions, after:

- satisfying its debt service obligations, including principal and interest, such as interest accrued or payable in respect of drawings under the Credit Facilities, and paying its expenses and other obligations and liabilities (including taxes, if any);
- making provisions for capital expenditures in respect of the Partnership's assets; and
- retaining such reasonable working capital and other reserves as may be considered appropriate by the board of directors.

The Partnership may, in addition, make distributions at any other time.

## Summary of Distributions of the Fund

As the Fund is an income trust, it does not pay dividends. The table below sets out the cash distributions declared by the Fund for the last three completed years from January 01, 2007 until December 31, 2009, on a per Fund Unit basis.

<u>Record Date</u>	<u>Monthly Distribution</u>	<u>Supplemental Distribution</u>	<u>Total Distribution</u>	<u>Date Payable</u>
	\$	\$	\$	
December 29, 2006	0.14	0.22	0.36	January 15, 2007
January 31, 2007	0.14	-	0.14	February 15, 2007
February 28, 2007	0.14	-	0.14	March 15, 2007
March 30, 2007	0.14	-	0.14	April 13, 2007
April 30, 2007	0.14	-	0.14	May 15, 2007
May 31, 2007	0.18	-	0.18	June 15, 2007
June 29, 2007	0.18	-	0.18	July 13, 2007
July 31, 2007	0.18	-	0.18	August 15, 2007
August 31, 2007	0.18	-	0.18	September 14, 2007
September 28, 2007	0.18	-	0.18	October 15, 2007
October 31, 2007	0.14	-	0.14	November 15, 2007
November 30, 2007	0.12	-	0.12	December 14, 2007
December 31, 2007	0.12	-	0.12	January 15, 2008
January 31, 2008	0.12	-	0.12	February 15, 2008
February 29, 2008	0.12	-	0.12	March 14, 2008
March 31, 2008	0.12	-	0.12	April 15, 2008

April 30, 2008	0.12	-	0.12	May 15, 2008
May 30, 2008	0.12	-	0.12	June 13, 2008
June 30, 2008	0.12	-	0.12	July 15, 2008
July 31, 2008	0.12	-	0.12	August 15, 2008
August 29, 2008	0.12	-	0.12	September 15, 2008
September 30, 2008	0.12	-	0.12	October 15, 2008
October 31, 2008	0.12	-	0.12	November 14, 2008
November 28, 2008	0.12	-	0.12	December 15, 2008
December 31, 2008	0.04	-	0.04	January 15, 2009
January 30, 2009	0.04		0.04	February 13, 2009
February 27, 2009	0.01		0.01	March 13, 2009
March 31, 2009	0.01		0.01	April 15, 2009
April 30, 2009	0.01		0.01	May 15, 2009
May 31, 2009	0.01		0.01	June 15, 2009
June 30, 2009	0.01		0.01	July 15, 2009
July 31, 2009	0.01		0.01	August 14, 2009
August 31, 2009	0.01		0.01	September 15, 2009
September 30, 2009	0.01		0.01	October 15, 2009
October 31, 2009	0.01		0.01	November 13, 2009
November 30, 2009	0.05		0.05	December 15, 2009
December 31, 2009	0.08		0.08	January 15, 2010

## MARKET FOR SECURITIES

The Fund's Units are listed for trading on the Toronto Stock Exchange (TSX) under the symbol "CFX.UN".

## Trading Price and Volume

The following table shows the price ranges per Fund Unit, and the volume of Fund Units traded on the TSX for the most recently completed financial year: January 01, 2009 to December 31, 2009.

<u>Month</u>	<u>High</u>	<u>Low</u>	<u>Volume</u> (Fund Units)
	\$	\$	
January, 2009	3.64	2.80	2,262,349
February	2.85	1.61	1,673,112
March	1.68	1.30	2,511,522
April	2.65	1.35	3,348,712
May	3.21	1.85	1,526,350
June	2.50	1.89	1,438,746
July	3.24	2.18	1,215,107
August	4.20	3.10	1,464,641
September	4.35	3.81	1,158,600
October	6.00	4.10	1,660,277
November	7.25	4.80	1,930,235
December, 2009	8.98	7.03	1,478,526

## DIRECTORS AND OFFICERS

### Trustees of the Fund

The following three individuals serve as trustees of the Fund:

<u>Name and Municipality of Residence</u>	<u>Position with the Fund</u>	<u>Principal Occupation</u>	<u>Trustee Since</u>	<u>Number of Fund Units Beneficially Owned or over which Control or Direction is Exercised</u>
Stan E. Bracken-Horrocks, FCA <sup>(1)(3)</sup> Kelowna, British Columbia, Canada	Trustee	Retired Partner of PricewaterhouseCoopers LLP	April 28, 2006	15,000
Donald W. Campbell <sup>(1)(2)</sup> Montreal, Québec, Canada	Trustee	Senior Strategy Advisor, Davis LLP	April 28, 2006	61,000
Charles J. Jago, Ph.D., C.M., <sup>(1)(2)(3)</sup> Prince George, British Columbia, Canada	Trustee	Chairman of the Board of Canfor Pulp Holding Inc.	April 28, 2006	2,000

(1) Member of Audit Committee.

(2) Member of Governance Committee.

(3) Member of Compensation Committee.

The Fund Trustees will be elected at each annual meeting of Unitholders to hold office for a term expiring at the close of the next annual meeting of Unitholders or until their successors are elected or appointed. See "Description of Legal Structure – The Fund – Trustees".

## Directors and Executive Officers of the General Partner

The Directors are as follows:

<u>Name and Municipality of Residence</u>	<u>Position with the General Partner</u>	<u>Principal Occupation</u>	<u>Director Since</u>	<u>Number of Fund Units Beneficially Owned or over which Control or Direction is Exercised</u>
Charles J. Jago Ph.D., C.M. <sup>(1)(2)(3)(4)</sup> Prince George, British Columbia, Canada	Director and Chairman	Chairman of the Board of Canfor Pulp Holding Inc.	April 28, 2006	2,000
Peter J. G. Bentley, LL.D., O.C. <sup>(3)(4)</sup> Vancouver, British Columbia, Canada	Director	Chairman of the Board of Canfor Corporation	April 28, 2006	857,946
Stan E. Bracken-Horrocks, FCA, <sup>(1)(3)</sup> Kelowna, British Columbia, Canada	Director	Retired Partner of PricewaterhouseCoopers LLP	April 28, 2006	15,000
Donald W. Campbell <sup>(1)(2)(4)</sup> Montreal, Québec, Canada	Director	Senior Strategy Advisor, Davis LLP	April 28, 2006	61,000
Peter A. Lusztyg, Ph.D., CGA, <sup>(1)(2)</sup> Vancouver, British Columbia, Canada	Director	Dean Emeritus, Sauder School of Business, the University of British Columbia	April 28, 2006	2,096
Paul A. Richards West Vancouver, British Columbia, Canada	Director, President and Chief Executive Officer	President and Chief Executive Officer of Canfor Pulp Holding Inc.	April 28, 2006	67,163
James F. Shepard, P.Eng. Vancouver, British Columbia, Canada	Director	President and Chief Executive Officer of Canfor Corporation	May 4, 2007	81,000
William W. Stinson <sup>(1)(3)(4)</sup> Vancouver, British Columbia, Canada	Director	Chairman and Chief Executive Officer of Westshore Terminals Income Fund	February 17, 2009	95,000

- (1) Member of Audit Committee.
- (2) Member of Governance Committee.
- (3) Member of Compensation Committee.
- (4) Member of Planning Committee.

The term of office for each of the directors will expire at the time of the next annual meeting of the shareholders of the General Partner, unless earlier terminated.

The following are the executive officers of the Partnership, including each person's name and municipality of residence, positions with the General Partner, principal occupation, date of start of office and number of Fund Units beneficially owned:

<u>Name and Municipality of Residence</u>	<u>Position with the General Partner</u>	<u>Principal Occupation</u>	<u>Position Held Since</u>	<u>Number of Fund Units Beneficially Owned or over which Control or Direction is Exercised</u>
Paul A. Richards West Vancouver, British Columbia, Canada	Director, President and Chief Executive Officer	President and Chief Executive Officer of Canfor Pulp Holding Inc.	July 1, 2006	67,163
Terry D. Hodgins, CA West Vancouver, British Columbia, Canada	Chief Financial Officer and Secretary	Chief Financial Officer and Secretary of Canfor Pulp Holding Inc.	October 24, 2007	27,227
Joe Nemeth Langley, British Columbia, Canada	Vice President, Sales and Marketing	Vice President Sales and Marketing of Canfor Pulp Holding Inc.	July 1, 2006	59,985
Brett R. Robinson Prince George, British Columbia, Canada	Vice President, Operations	Vice President, Operations of Canfor Pulp Holding Inc.	October 27, 2008	62,462

As at January 28, 2010, the directors and executive officers of the General Partner as a group owned, directly or indirectly, or had control or direction over 1,330,879 Fund Units, representing approximately 3.75% of the outstanding Fund Units.

## Biographies

Set forth below are brief profiles of each of the Fund Trustees, Trust Trustees, directors, and executive officers of the General Partner. Each of the Fund Trustees, Trust Trustees, directors, and executive officers has been engaged for more than five years in his present principal occupation or in other capacities with the organization in which the person currently holds his principal occupation, except as set forth below.

### *Directors and Trustees*

*Charles J. Jago, Ph.D., C.M.*, of Prince George, British Columbia, Canada, was appointed to the Board of the General Partner on April 28, 2006 and appointed Chairman of the Board of the General Partner on July 25, 2006. Dr. Jago was President of the University of Northern British Columbia 1995-2006 and on an interim basis from 2008-09. Dr. Jago's professional service has included membership on the Boards of the Association of Universities and Colleges of Canada, the Association of Commonwealth Universities, the Office of Partnerships for Advanced Skills (OPAS) and Partnerships B.C. Dr. Jago has also served as Chair of the Council of Western University Presidents, The University President's Council of British Columbia, and the Northern BC United Way. He currently chairs the Boards of the Northern Health Authority of British Columbia and the Fraser Basin Council and serves as a member of the Board of Initiatives Prince George. Dr. Jago received his BA in Honours English and History from the University of Western Ontario in London, Ontario, graduating as the Honours gold medalist from Huron University College (an affiliated college of The University of Western Ontario), and received a PhD in History from Cambridge University. Dr. Jago was awarded the Queen's Jubilee Medal for community service in 2003 and the Order of Canada in 2006.

Dr. Jago is a member of the General Partner's Audit, Governance, Compensation, and Planning Committees.

*Peter J.G. Bentley, LL.D., O.C.*, of Vancouver, British Columbia, Canada, was appointed to the Board of the General Partner on April 28, 2006. Mr. Bentley has served on the Board of Canfor Corporation since 1966. Mr. Bentley is Chairman Emeritus of the Board of Directors of Canfor Corporation, and Co-chairman and a director of HSPP General Partner Ltd., the general partner of Howe Sound Pulp and Paper Limited Partnership. After working in various positions with Canfor Corporation, Mr. Bentley became Executive Vice-President in 1970, President in 1975, and Chairman and CEO in 1985, a position he held until April 24, 1995. Mr. Bentley was reappointed to the position of President and CEO of Canfor Corporation on July 25, 1997 and relinquished the position of President and CEO of Canfor Corporation on January 1, 1998. Mr. Bentley is President and a director of Sierra Mountain Minerals Inc. and a member of the Board of the Canadian Institute for Advanced Research, a member of the Advisory Board of BuildDirect.com and a Trustee and Chair Emeritus of the Vancouver General Hospital and University of British Columbia Hospital Foundation. He also served for many years as a director of Bank of Montreal and Shell Canada Ltd. Mr. Bentley retired as Chancellor of the University of Northern British Columbia in May 2007. Mr. Bentley holds an Honorary Doctorate of Laws degree from the University of British Columbia, and the University of Northern British Columbia.

Mr. Bentley chairs the General Partner's Compensation Committee and is a member of the General Partner's Planning Committee.

*Stan E. Bracken-Horrocks, FCA*, of Kelowna, British Columbia, Canada was appointed to the Board of the General Partner on April 28, 2006. Mr. Bracken-Horrocks is a retired partner of PricewaterhouseCoopers LLP and held various leadership positions during his career with PricewaterhouseCoopers LLP, including Global Leader of its Forest and Paper Industry practice. As a member of the Canadian Institute of Chartered Accountants, Mr. Bracken-Horrocks served as a member of the Board of Governors and a member of the Accounting Standards Committee and, as a member of the Institute of Chartered Accountants of British Columbia, he served as a member of council, Vice-President and President. Mr. Bracken-Horrocks is a director and Chairman of the Audit Committee of the Business Development Bank of Canada, and director and treasurer of the Vancouver Police Foundation.

Mr. Bracken-Horrocks chairs the General Partner's Audit Committee, and is a member of the General Partner's Compensation Committee.

*Donald W. Campbell*, of Montreal, Quebec, Canada was appointed to the Board of the General Partner on April 28, 2006. Mr. Campbell is Senior Strategy Advisor of Davis LLP, a position he has held since May, 2007. Previously he was Executive Vice President of CAE Inc. 2006 - 2007 and Group President, Military Simulation and Training Division, CAE 2000 - 2006. Prior to this position, Mr. Campbell served as Deputy Foreign Minister and as the Prime Minister's Personal Representative for G-8 Summits (1997-2000), Canada's Ambassador to Japan (1993-1997), Deputy Minister for International Trade (1989-1993) and Canada's Ambassador to Korea (1984-1985). Mr. Campbell is currently a director of Toyota Canada Inc., the Perimeter Institute, ExcelTech Aerospace Inc., and Davie Yards Inc. Mr. Campbell is a Distinguished Fellow of the Asia Pacific Foundation and the Canadian Chair of the Pacific Economic Cooperation Council. In April 1999, Mr. Campbell received the Outstanding Achievement Award of the Public Service of Canada from the Governor General and the Prime Minister. In 2003, Mr. Campbell was appointed by the Prime Minister as the Canadian co-chairman of the Canada-Japan Forum, an external advisory group established by the governments of Japan and Canada to provide advice and to promote the bilateral relationship between the two countries. Mr. Campbell is a graduate of Laurier University (Hon. B.A. Economics and Political Science) and holds Honorary Doctorate degrees from the University of Ottawa, Carleton University, and Laurier University. He is a graduate of the Institute of Corporate Directors programme of the University of Toronto and holds an ICD.D.

Mr. Campbell chairs the General Partner's Planning Committee, and is a member of the General Partner's Audit and Governance Committees.

*Peter A. Lusztig, Ph.D., CGA*, of Vancouver, British Columbia, Canada, was appointed to the Board of the General Partner on April 28, 2006. Mr. Lusztig is Dean Emeritus of Sauder School of Business at the University of British Columbia. Mr. Lusztig served as the federal commissioner for the B.C. Treaty Commission (Federal) (1995-2003) and is a past director of Canfor Corporation, ROINS Financial Holdings, Royal SunAlliance, Tree Island Industries, ICBC, and the Vancouver General Hospital and its Foundation. He was also the Chair and a Trustee of the Health Benefit Trust (BC). Mr. Lusztig received his Commerce Degree from the University of British Columbia, his Masters of Business Administration from the University of Western Ontario and his Doctorate Degree from Stanford University.

Dr. Lusztig chairs the General Partner's Governance Committee and is a member of the Audit Committee.

*Paul A. Richards*, of West Vancouver, British Columbia, Canada, was appointed to the Board of the General Partner on April 28, 2006. Mr. Richards is the President and Chief Executive Officer of the General Partner, and prior to July 1, 2006 he held the position of Vice-President, Pulp and Paper of Canfor Corporation. Prior to May 2, 2005, Mr. Richards was Vice-President, Pulp Manufacturing for Weldwood of Canada Limited, overseeing operations at Hinton and Quesnel, a position he held from 1997-2004. Prior to that, Mr. Richards served in a variety of positions with Repap from 1984 to 1997, most recently Vice President and General Manager of Repap New Brunswick. Mr. Richards is a director of Forest Products Association of Canada.

Mr. Richards received a Bachelor of Chemical Engineering degree from the Technical University of Nova Scotia.

*James F. Shepard, P.Eng.*, of Vancouver, British Columbia, Canada was appointed to the Board of the General Partner on May 4, 2007. Mr. Shepard is President and Chief Executive Officer of Canfor Corporation. Mr. Shepard retired from Finning International Inc. in April 2000 after a 32-year career, including nine years as Chief Executive Officer (1991 to 2000). Mr. Shepard also served as Chairman of the Board of Finning International Inc., Chairman of the Board of MacDonald Dettwiler and Associates, Vice-Chairman of the Conference Board of Canada, Vice-Chairman of the Business Council on National Issues, Honorary Chairman of Leadership Vancouver and is the past Chairman of the Executive Committee for the Business Council of B.C. He was founding Co-Chairman of the Business Summit of B.C. and is a member of The Conference Board, Inc., New York. Mr. Shepard is an initial Chairman of the Cabinet of the Business Laureates of the B.C. Hall of Fame.

Mr. Shepard received a B.Sc. Degree in Civil Engineering from the University of British Columbia and is a member of the Association of Professional Engineers of B.C.

*William W. Stinson*, of Vancouver, British Columbia was appointed to the Board of the General Partner on February 17, 2009. Mr. Stinson spent the majority of his business career with Canadian Pacific Ltd. retiring as Chairman and CEO in 1996 after 11 years in that position. He has served on a wide variety of boards and has held the positions of Chairman of Sun Life Financial, Chairman of the Executive Committee of United Dominion Industries and Lead Director of CHC Helicopters Ltd. He is currently the Chairman and CEO of Westshore Terminals Income Fund and a Director of Grant Forest Products Ltd.

Mr. Stinson is a member of the General Partner's Audit, Compensation, and Planning Committees.

#### *Executive Officers*

*Joe Nemeth* is the Vice President, Sales and Marketing of the General Partner. He previously held the position of Vice President, Pulp & Paper Marketing of Canfor from January 2003 until he joined the General Partner. Mr. Nemeth's forest industry experience includes woodlands, solid wood products, and



pulp & paper in both production and marketing disciplines. Prior to joining Canfor, Mr. Nemeth spent 14 years with Fletcher Challenge Canada (now Catalyst Paper Corporation) with his last two positions being Paper Mill Manager at Elk Falls and Vice-President, North American Newsprint Sales. Mr. Nemeth has a Master of Business Administration degree from the University of Western Ontario and a Bachelor of Forestry (Honours) degree from the University of British Columbia.

*Terry D. Hodgins, CA*, is the Chief Financial Officer and Secretary of the General Partner. From October 24, 2007 until February 18, 2008, he was the Interim Chief Financial Officer and Secretary of the General Partner. Mr. Hodgins was actively involved in the creation of the Partnership and the Fund in 2006. From April, 2004 to December, 2005, he was Vice President & Treasurer of Canfor Corporation, and from December, 2004 to August, 2005 he also served as Acting Chief Financial Officer of Canfor. Prior to joining Canfor, Mr. Hodgins was Vice President and Financial Officer of Slocan Forest Products. Mr. Hodgins has a Bachelor of Mechanical Engineering degree from the University of Saskatchewan and is a member of the Institute of Chartered Accountants of British Columbia.

*Brett R. Robinson* was appointed Vice President, Operations of the General Partner on October 27, 2008. Mr. Robinson previously held the position of General Manager, Intercontinental and Prince George Pulp and Paper Mills of the General Partner. Over the past 19 years, he has held a variety of pulp and solid wood positions within the Northwood and Canfor organizations. Mr. Robinson has a Bachelor of Mechanical Engineering degree from the University of Manitoba and is a Registered Professional Engineer.

## **Committees of the Board of Directors of the General Partner**

The Board of Directors of the General Partner has an Audit Committee, a Governance Committee (formerly the Nominating Committee), and a Compensation Committee.

### ***Audit Committee***

The purpose of the Audit Committee is to assist the board of directors in fulfilling its responsibilities of oversight and supervision of the accounting and financial reporting practices and procedures; the adequacy of internal accounting and financial reporting controls and procedures; and the quality and integrity of financial statements of the Partnership. In addition, the Audit Committee will be responsible for directing the auditors' examination into specific areas of the Partnership.

#### **Audit Committee Terms of Reference**

The Board of Directors of the General Partner has approved the terms of reference for the Audit Committee on November 16, 2006 as is set out in Appendix A to this Annual Information Form.

#### **Composition of the Audit Committee**

The Audit Committee is composed of five members. Stan Bracken-Horrocks, Donald Campbell, Peter Lusztig, Charles Jago, and William Stinson are members of the Audit Committee. Each member of the Audit Committee is independent of each of the Fund and the Partnership and financially literate as required under Multilateral Instrument 52-110 – *Audit Committees*.

#### **Relevant Education and Experience of the Audit Committee Members**

In addition to each member's general business experience, the education and experience of each Audit Committee member that is relevant to the performance of his or her responsibilities as an Audit Committee member is as follows:

- (i) *Stan E. Bracken-Horrocks* chairs the Audit Committee. He is an FCA who has had many years of experience in public practice, as an accountant, an auditor, and as a partner of PricewaterhouseCoopers LLP. He held the position of global leader of the firm's Forest

and Paper Industry practice prior to his retirement in 2005. Mr. Bracken-Horrocks has extensive experience in financial reporting, in assessing the quality and integrity of financial statements and the accounting principles used therein, in assessing financial reporting policies, procedures and internal controls, and in assessing the effectiveness – external and internal – of audits. He has served both as a member, as well as on the Board of Governors of the Accounting Standards Committee of the Canadian Institute of Chartered Accountants. He is a director and Chairman of the Audit Committee of the Business Development Bank of Canada.

- (ii) *Donald W. Campbell* is a graduate of Laurier University (Hon. B.A. Economics and Political Science) and of the Institute of Corporate Directors programme of the University of Toronto. He is a director of Toyota Canada Inc., the Perimeter Institute, ExcelTech Aerospace Inc., and Davie Yards Inc.
- (iii) *Peter A. Lusztig* is a Certified General Accountant (Hon.) and Dean Emeritus, Sauder School of Business, the University of British Columbia. He has received his Bachelor of Commerce degree from the University of British Columbia, MBA from the University of Western Ontario and Ph.D. with focus on finance from Stanford University. He has previously served on the audit committees of Insurance Corporation of BC, Royal Insurance, ROINS Financial Holdings, Royal SunAlliance, Canfor Corporation, Healthcare Benefit Trust and he chaired the finance and audit committee of the BC Treaty Commission. Dr. Lusztig has co-authored Financial Management in a Canadian Setting (6 editions).
- (iv) *Charles J. Jago* has received his Bachelor of Arts in Honours English and History from the University of Western Ontario and Ph.D. in history from Cambridge University. He was President of the University of Northern British Columbia 1995-2006, and on an interim basis from 2008-09. His professional service has included membership on the Boards of the Association of Universities and Colleges of Canada, the Association of Commonwealth Universities, and the Office of Partnerships for Advanced Skills. He has served as Chair of the Council of Western University Presidents and The University Presidents' Council of British Columbia and he is Chair of the Board of Fraser Basin Council.
- (v) *William W. Stinson* spent the majority of his business career with Canadian Pacific Ltd. retiring as Chairman and CEO in 1996 after 11 years in that position. He has served on a wide variety of boards and has held the positions of Chairman of Sun Life Financial, Chairman of the Executive Committee of United Dominion Industries and Lead Director of CHC Helicopters Ltd. He is currently the Chairman and CEO of Westshore Terminals Income Fund and a Director of Grant Forest Products Ltd.

#### **Pre-approval Policies and Procedures**

The Audit Committee has adopted a policy for the engagement of the external auditor for non-audit services, whereby the prior approval by the Chairman of the Audit Committee is required for all such services not exceeding \$30,000 in value, and services exceeding such value required Audit Committee approval. All non-audit engagements of the auditor are reported to the Audit Committee.

The Audit Committee will also require and review a report from the external auditor, if deemed appropriate by the Audit Committee, of all relationships between the external auditor and its related entities and the Fund and the Partnership and their related entities, including all work performed and fees paid for such work of a non-audit nature, that in the external auditor's professional judgment may reasonably be perceived to bear on its objectivity and independence and confirming that in the external auditor's professional judgment it is independent of the Fund and the Partnership and discuss this report with the external auditor in order to evaluate the objectivity and independence of the external auditor.

The Audit Committee will also review steps taken by the external auditor to address any findings in any of the foregoing reviews.

### Audit Fees

PricewaterhouseCoopers LLP has served as the Fund's and Partnership's auditing firm since July 25, 2006. Fees payable by the Fund and the Partnership for the year ended December 31, 2009 to PricewaterhouseCoopers LLP and its affiliates are \$602,136.

	<b>Period ended December 31, 2009</b>	<b>Period ended December 31, 2008</b>	<b>Period ended December 31, 2007</b>
Audit fees	\$ 429,000	\$ 429,000	\$ 401,000
Audit-related fees	126,000	146,000	151,361
Tax fees	25,720	13,168	27,265
All other fees	<u>21,416</u>	<u>12,416</u>	<u>6,806</u>
	<u>\$ 602,136</u>	<u>\$ 600,584</u>	<u>\$ 586,432</u>

The nature of each category of fees is described below:

Audit Fees – for the audit of the Fund's and the Partnership's financial statements and services normally provided by the principal auditor in connection with the Fund's statutory filings.

Audit Related Fees – for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements that are not reported in Audit Fees, including accounting consultations, interim review work, and various agreed upon procedures, but excluding travel costs and other disbursements.

Tax Fees – for tax compliance services.

### *Governance Committee*

Donald Campbell, Charles Jago, and Peter Lusztig are members of the Governance Committee. The Governance Committee is responsible for making recommendations to the board of directors in respect of corporate governance principles and the roles of the board of directors and its committees, and for ensuring that the Partnership's governance practices comply with regulatory requirements and that disclosures are made as required. In addition, the committee is responsible for proposing candidates for election to the board of directors of the General Partner and as trustees of the Fund and the Trust.

### *Compensation Committee*

Peter Bentley, Stan Bracken-Horrocks, Charles Jago, and William Stinson are members of the Compensation Committee. The purpose of the Compensation Committee is to make recommendations to the board of directors on, among other things, executive compensation, including the compensation of the Partnership's President and Chief Executive Officer, and to review other aspects of executive compensation. The committee also assists the board of directors in complying with securities laws relating to the disclosure of executive compensation.

### *Planning Committee*

Peter Bentley, Donald Campbell, Charles Jago, and William Stinson are members of the Planning Committee. The focus of the Planning Committee is to consider various mid to long-term strategic issues confronting the Partnership including succession, growth, energy, and de-trusting.

### *Independent Committee Process*

Any material commercial transaction that the Partnership or any subsidiary proposes to enter into after the Effective Date with Canfor or any of its affiliates and any material amendment of the terms of any material contract between the Partnership or any subsidiary, on the one hand, and Canfor or any of its affiliates, on the other hand, entered into prior to the Effective Date will be considered and approved by an Independent Committee comprised of the independent directors of the General Partner who are not directors, officers or employees of Canfor or any of its affiliates other than the General Partner.

### **Corporate Cease Trade Orders or Bankruptcies**

No director, executive officer or shareholder holding a sufficient number of securities of the Issuer to affect materially the control of the Fund is, or within the 10 years before the date of this AIF has been, a director or officer of any other issuer that, while such person was acting in that capacity:

- (i) was the subject of a cease trade or similar order or an order that denied such other issuer access to any exemptions under Canadian securities legislation for a period of more than 30 consecutive days; or
- (ii) was subject to an event that resulted, after the director or executive officer ceased to be a director or executive officer, in the issuer being the subject of a cease trade order or similar order or an order that denied the relevant issuer access to any exemption order under Canadian securities legislation, for a period of more than 30 consecutive days; or
- (iii) within a year of that person ceasing to act in that capacity, became bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency or was subject to or instituted any proceedings, arrangement or compromise with creditors or had a receiver, receiver manager or trustee appointed to hold its assets;

other than:

- Mr. Don Campbell was a director of Rutter Inc. ("Rutter"), which voluntarily requested a management cease trade order ("MCTO") as a result of Rutter's delay in filing its audited annual financial statements, CEO and CFO certifications, MD&A and annual information form for the year ended August 31, 2008 (the "Required Filings"). Rutter attributed this delay to the lack of final agreement on a potential restructuring of the debt with Rutter's principal lender. The Ontario Securities Commission ("OSC") issued a temporary MCTO on December 2, 2008 which prohibited the then current Chief Executive Officer of Rutter (the "Rutter CEO") and Chief Financial Officer of Rutter (the "Rutter CFO") from trading in or acquiring securities of Rutter for a period of 15 days. The OSC issued a permanent MCTO on December 16, 2008, prohibiting the Rutter CEO and Rutter CFO from trading in or acquiring securities of Rutter until the earlier of two (2) full business days after the Required Filings were received by the OSC, or a further order of the OSC (in the case of the permanent MCTO). The Required Filings were made on or about January 12, 2009 and the permanent MCTO was subsequently lifted. Neither the temporary nor the permanent MCTO were imposed on Mr. Campbell. Mr. Campbell ceased to be a director of Rutter on January 15, 2010.
- Mr. Campbell was a director of Mecachrome International Inc. ("Mecachrome") from July, 2007 to December, 2009. Between December 2008 to 2009, Mecachrome obtained creditor protection from the Quebec Superior Court under the Companies Creditors Arrangement Act (Canada). In December, 2009, Mecachrome completed its financial restructuring and reorganization process. Mr. Campbell ceased to be a director in December 2009.

- Mr. Campbell is a director of ExelTech Aerospace Inc. (“ExelTech”). On February 4, 2010, ExelTech filed a notice of intention (NOI) to file a proposal under the Bankruptcy and Insolvency Act (Canada), seeking protection from its creditors. On February 9, 2010, the Superior Court of Quebec appointed RSM Richter Inc. as interim receiver of the assets of ExelTech Canada Inc., a wholly-owned subsidiary of ExelTech.
- Mr. Stinson is a director of Grant Forest Products Inc. (“Grant”). On June 25, 2009, Grant obtained creditor protection from the Ontario Superior Court under the Company Creditors Agreement Act (Canada).
- Messrs. Bentley and Shepard, each of whom was a director and/or executive officer of HSPP General Partner Ltd., general partner of Howe Sound Pulp and Paper Limited partnership (“HSLP”), during the period of January 29 to February 1, 2008 when HSLP completed a restructuring under the Companies Creditors Arrangement Act (Canada).

### **Personal Bankruptcies**

No director, officer or shareholder holding a sufficient number of the Issuer’s securities to affect materially the control of the Fund has, within 10 years before the date of the AIF, become bankrupt, made a proposal under any legislation relating to bankruptcy or insolvency, or become subject to or instituted any proceedings, arrangement or compromise with creditors, or had a receiver, receiver manager or trustee appointed to hold his or her assets.

### **Penalties or Sanctions**

No director, officer or shareholder holding a sufficient number of the Fund’s securities to affect materially the control of the Fund has been subject to any penalties or sanctions imposed by a court relating to Canadian securities legislation or has entered into a settlement agreement with a Canadian securities regulatory authority, or has been subject to any other penalties or sanctions imposed by a court or regulatory body that would likely be considered important to a reasonable investor in making an investment decision.

### **Conflicts of Interest**

None of the directors, trustees or executive officers, as applicable, of (a) the Fund, the Trust, the Partnership or Canfor, or (b) any associate or affiliate of the persons referred to in (c), has or has had any material interest, direct or indirect, in any transaction within the past three years or in any proposed transaction that has materially affected or will materially affect the Fund, the Trust, the Partnership or any of their subsidiaries.

## **ACQUISITION, LIQUIDITY, SUPPORT AND SECURITY HOLDER AGREEMENTS**

### **Acquisition Agreement**

The Acquisition Agreement governed the transfer of the Pulp Business to the Partnership. The following is a summary of certain provisions of the Acquisition Agreement, which summary is not intended to be complete. Reference is made to the Acquisition Agreement for the full text of its provisions.

Under the Acquisition Agreement, Canfor transferred the Pulp Business to the Partnership, and entered into the Fibre Supply Agreement and the Partnership Services Agreement with the Partnership. The Partnership assumed all of the liabilities of Canfor relating to the Pulp Business from and after the Effective Date, including liabilities arising under the Cogeneration Agreement and the Chemical Supply Agreement. The liabilities assumed by the Partnership include, without limitation:

- all liabilities under assigned contracts, but excluding liabilities arising under such contracts before the Effective Date and liabilities for retroactive rate or payment adjustments relating to matters that occurred before the Effective Date;
- all liabilities under licences and permits other than environmental permits, but excluding those liabilities, other than environmental liabilities, arising from the breach of such licences and permits prior to the Effective Date;
- all liabilities included in working capital on the financial statements of the Pulp Business;
- all liabilities with respect to permitted encumbrances, other than taxes payable by Canfor;
- all environmental liabilities and liabilities under environmental permits, other than liabilities for breach of environmental permits prior to the Effective Date;
- all liabilities with respect to aboriginal claims affecting the Pulp Business; and
- all liabilities with respect to certain disclosed legal proceedings.

The Partnership is responsible for its own insurance coverage, including all property and liability coverage, commencing from the Effective Date.

The Partnership continued the employment of all unionized and non-unionized employees who were employed in connection with the Pulp Business on the Effective Date.

The Acquisition Agreement contained customary representations and warranties and related indemnities from Canfor in favour of the Partnership. No amounts were payable under these indemnities until all claims exceed 1% of the purchase price (the "**Purchase Price**") under the Acquisition Agreement. The total maximum liability under the indemnities is limited to 50% of the Purchase Price.

Canfor's obligation to indemnify the Partnership in respect of the representations and warranties of Canfor survive the Effective Date for a period of 12 months, except for (a) title representations, which survive without limitation of time, (b) obligations relating to taxation matters, which survive until 90 days after the end of the applicable reassessment and appeal periods, and (c) obligations related to environmental matters, which survive for a period of 24 months. These indemnification obligations are the sole remedy of the Partnership against Canfor under the Acquisition Agreement.

## Exchange Agreement

On completion of the Spinout, the Fund, the Trust, the Partnership, and Canfor entered into the Exchange Agreement. The following is a summary of certain provisions of the Exchange Agreement, which summary is not intended to be complete. Reference is made to the Exchange Agreement for the full text of its provisions.

Under the Exchange Agreement, Canfor (or any transferee of its GP Shares and Class B Exchangeable LP Units) is entitled to indirectly exchange its holdings of Class B Exchangeable LP Units and GP Shares for Fund Units on the basis of one Fund Unit in exchange for one Class B Exchangeable LP Unit and one GP Share, subject to adjustment. Alternatively, at Canfor's election, Class B Exchangeable LP Units and GP Shares may be exchanged for a cash payment equal to the net proceeds of an underwritten offering of the applicable number of Fund Units, subject to the Fund's ability to complete an underwritten offering of the applicable number of Fund Units on terms acceptable to the independent Fund Trustees and Canfor (or its transferee). These rights of exchange are subject to the restrictions respecting non-resident ownership contained in the Fund Declaration as described under the heading "Description of Legal Structure – The Fund – Limitations on Non-Resident Ownership". The Exchange Agreement contains customary anti-dilution provisions to preserve the economic equivalence of one Class B Exchangeable LP Unit and one GP Share with one Fund Unit.

Under the Exchange Agreement, the Fund and the Trust agreed not to take, directly or indirectly, any of the following actions without the prior written approval of the board of directors of the General Partner: (a) make any investment (whether or not for consideration) in any person other than the Partnership; (b) issue any Fund Units or other securities or repurchase outstanding Fund Units or other securities other than pursuant to the exercise of the liquidity and exchange rights granted to Canfor (and any transferee) under the Exchange Agreement, or the redemption rights in the Fund Declaration or the Trust Declaration; or (c) issue any debt securities (other than, in the case of the Trust, pursuant to the Note Indenture) or guarantee the indebtedness of any third party, other than the obligations of the Partnership under the Credit Facilities.

The Exchange Agreement provides that the Fund will, at the request of Canfor (or its transferee) on up to 10 occasions qualify for distribution under Canadian provincial and territorial securities laws all or any portion of the Fund Units owned, directly or indirectly, by Canfor (or its transferee), subject to certain restrictions, including only one prospectus offering per 6 month period and a \$25 million minimum offering size. The agreement also provides Canfor with "piggy-back" registration rights, subject to certain restrictions, requiring the Fund to qualify for distribution under applicable securities laws all or any portion of the Fund Units owned, directly or indirectly, by Canfor in the event that the Fund proposes to qualify Fund Units for distribution. The costs of any public offerings of Fund Units owned, directly or indirectly, by Canfor, will be borne by Canfor (or its transferee). The Fund will indemnify, or contribute to any amount paid or payable by, Canfor for certain losses, claims, damages or liabilities incurred in connection with any qualification for distribution of Fund Units.

The Exchange Agreement may be assigned, in whole or in part, by Canfor (upon notice to the Trust and the Fund) to any transferee of Class B Exchangeable LP Units and GP Shares, other than the Fund and the Trust. The Exchange Agreement will terminate on the date that the Fund has acquired, directly or indirectly, all of the outstanding Class B Exchangeable LP Units or upon the agreement of all of the holders of Class B Exchangeable LP Units.

## **Shareholders' Agreement**

On completion of the Spinout, the Trust and Canfor, as the sole holders of the GP Shares, and the General Partner, the Partnership and the Fund entered into the Shareholders' Agreement with respect to the interests of the Trust and Canfor in their GP Shares. The following is a summary of certain provisions of the Shareholders' Agreement, which summary is not intended to be complete. Reference is made to the Shareholders' Agreement for the full text of its provisions.

*Board.* The Shareholders' Agreement provides that the board of directors of the General Partner is comprised of eight directors. So long as Canfor holds, directly or indirectly, not less than a 30% Partnership Interest, Canfor is entitled to appoint the majority of directors of the General Partner, three of whom must be "resident Canadians" (as defined in the CBCA) and two of whom must be "independent" (as such term is defined under applicable Canadian securities laws). If Canfor's Partnership Interest falls below 30%, but is not less than 20%, Canfor is entitled to appoint three directors (one of whom must be "independent" and two of whom must be "resident Canadians"); if Canfor's Partnership Interest falls below 20%, but is not less than 10%, Canfor is entitled to appoint two directors (neither of whom must be "independent" but one of whom must be a "resident Canadian"); if Canfor's Partnership Interest falls below 10%, but is not less than 5%, Canfor is entitled to appoint one director (who does not need to be "independent" or a "resident Canadian"); and if Canfor's Partnership Interest falls below 5%, Canfor will cease to have any right to appoint directors of the General Partner. The Shareholders' Agreement will permit the Trust to appoint the balance of the directors of the General Partner, provided that each of the Trust's appointees must be a Fund Trustee.

*Committees of the Board.* The Shareholders' Agreement provides that the board of directors of the General Partner will have an Audit Committee, a Governance Committee, a Compensation Committee, and such other committees as may be determined from time to time by the board of directors. Each of the

committees will consist of three members. Canfor is entitled to appoint one of the members of each of the committees for so long as it holds at least a 10% Partnership Interest and Canfor's nominee on the Audit Committee shall be the chair of the Audit Committee for so long as Canfor holds at least a 20% Partnership Interest. Canfor's right to nominate members of each of the committees is subject to the requirement that Canfor's nominees be "independent". The balance of the members of each committee will be appointed by the board of directors of the General Partner.

*Nomination of Fund Trustees and Trust Trustees.* The number of Fund Trustees is equal to the number of directors the Trust is entitled to appoint as directors of the General Partner. The number of Fund Trustees is three, consisting of Stan Bracken-Horrocks, Donald Campbell and Charles Jago. A majority of the Fund Trustees must be Canadian citizens resident in Canada. The Fund Trustees shall be nominated from time to time by the board of directors of the General Partner after considering the recommendation of the Governance Committee. All nominees for Fund Trustee proposed by the board shall be independent of Canfor. Unitholders are not required to vote in favour of these nominees, and may elect the Fund Trustees as they see fit. The chair of the board of the Fund Trustees shall be appointed by the Fund Trustees.

The Shareholders' Agreement provides that there shall be three Trust Trustees, currently Stan Bracken-Horrocks, Donald Campbell, and Charles Jago. A majority of the Trust Trustees must be Canadian citizens resident in Canada. The Trust Trustees shall be appointed by the Fund from time to time, provided that each of the Fund's appointees must be a Fund Trustee.

*Transfers.* The Shareholders' Agreement provides that no transfer of GP Shares to any person (whether such person already holds, directly or indirectly, GP Shares or otherwise) will be permitted (other than pursuant to the exercise of the liquidity rights or exchange rights under the Exchange Agreement) unless the transferor transfers (or causes to be transferred, where such interest is held indirectly) an identical number of LP Units concurrently to the same person and such person agrees to be bound by the provisions of the Shareholders' Agreement. Any purported transfer by a shareholder of any GP Shares without a transfer of an identical number of LP Units held by that shareholder will be void to the maximum extent permitted by law. The Shareholders' Agreement permits the pledge of GP Shares and LP Units to a bank or other financial institution for the purpose of securing borrowings, subject to certain restrictions.

*Assignment.* The Shareholders' Agreement may not be assigned by any party without the written consent of all of the other parties to the agreement, except by Canfor to an affiliate of Canfor which agrees to be bound by the Shareholders' Agreement. However, such affiliate is only entitled to exercise Canfor's rights to appoint members of the board of directors of the General Partner and members of committees of the board of the General Partner and to approve certain matters (as described under "Shareholders' Approval for Certain Matters" below) for so long as it remains an affiliate of Canfor.

*Share Issuance and Pre-emptive Rights.* The Shareholders' Agreement provides that, subject to certain limited exceptions, if the Partnership authorizes the issuance of additional LP Units, or securities convertible into LP Units, it shall offer to sell to Canfor and to the Trust such LP Units or securities convertible into LP Units in proportion to their respective then current direct or indirect Partnership Interests. The Shareholders' Agreement also provides that, subject to certain limited exceptions, if the Fund authorizes the issuance of additional Fund Units or securities convertible into Fund Units, then it shall offer to sell to Canfor such Fund Units or other securities, as the case may be, in proportion to Canfor's then current direct or indirect Partnership Interest. Canfor may exercise its pre-emptive right, in whole or in part, by either purchasing additional Fund Units or purchasing additional LP Units.

These pre-emptive rights also apply in respect of the issuance of certain non-bank indebtedness by the Fund or the Partnership.

*Take-Over Bids.* The Shareholders' Agreement provides that Canfor shall not transfer any GP



Shares or LP Units, other than to one or more of its affiliates in accordance with the terms of the Shareholders' Agreement or to the Trust, unless (a) the transferee would not be required under applicable securities legislation as a result of such transfer to make an offer to all holders of Fund Units to acquire such units on the same terms and conditions if, immediately prior to such transfer, all outstanding LP Units had been exchanged for Fund Units in accordance with the terms of the Exchange Agreement, or (b) the transferee makes a contemporaneous offer to Unitholders for Fund Units on the same terms and conditions (in terms of price, timing and proportion of securities sought to be acquired) and does not acquire such GP Shares or LP Units unless the offeror also acquires a proportionate number of Fund Units tendered to such offer, if any.

*Shareholders' Approval for Certain Matters.* The Shareholders' Agreement provides that, so long as Canfor's Partnership Interest is not less than 20%, the General Partner shall not, either on its own behalf or on behalf of the Partnership, without the affirmative vote of the directors of the General Partner and the written consent of Canfor as a shareholder of the General Partner:

- (a) enter into any merger, amalgamation, consolidation, business combination, joint venture or other material corporate transaction, including the acquisition of property or assets with a fair market value in excess of \$25 million;
- (b) adopt any plan or proposal for a complete or partial liquidation or dissolution or any reorganization or commence any case, proceeding, or action seeking relief under any laws relating to bankruptcy or insolvency;
- (c) take, or permit to be taken, any action that would prevent the Pulp Business, as it exists on the Effective Date, from continuing on an ongoing basis;
- (d) change the size of the board of directors of the General Partner;
- (e) enter into any agreement or make any offer or grant any right capable of becoming an agreement to allot or issue a number of GP Shares and LP Units or any combination of the foregoing, in each case where the aggregate number of GP Shares and LP Units to be issued or allotted exceeds 5% of the total number of such securities then outstanding;
- (f) enter into any agreement or make any offer or grant any right capable of becoming an agreement to allot or issue any shares or units of a subsidiary of the General Partner to any person other than the General Partner or one of its wholly-owned subsidiaries;
- (g) take any action which could reasonably be expected to lead to or result in a material change in the nature of the business of the Partnership;
- (h) sell, lease, exchange, or dispose of property or assets with a fair market value in excess of \$25 million, other than the sale or disposition of inventory in the ordinary course of business;
- (i) take, hold, subscribe for or agree to purchase or acquire shares in the capital of any body corporate with a fair market value in excess of \$25 million;
- (j) enter into a partnership or any arrangement for a sharing of profits, union of interests, joint venture or reciprocal concession with any person if the aggregate fair market value of the assets contributed and liabilities assumed by the Partnership in connection therewith either exceeds on formation, or at any time in the future could reasonably be expected to exceed, \$25 million;
- (k) directly or indirectly participate in any business other than the pulp and paper business; or

- (l) make any commitment or agreement to do any of the foregoing.

Canfor is entitled to provide or withhold its written consent to any such action in its sole discretion, and shall have no obligation to consider the interests of the Trust or the Fund in doing so.

*Term.* The Shareholders' Agreement will continue in force until the earlier of (a) the date on which it is terminated by the written agreement of all the shareholders of the General Partner; or (b) the date on which the Fund holds, directly or indirectly, greater than 95% of the outstanding GP Shares. The restrictions on transfer of the GP Shares and the LP Units will survive the termination of the Shareholders' Agreement, so long as there is more than one shareholder of the General Partner.

## **Partnership Services Agreement**

Concurrently with the execution of the Acquisition Agreement, Canfor and the Partnership entered into the Partnership Services Agreement, pursuant to which Canfor provides the Partnership with certain specified services in order to facilitate the transfer of operations and support the sale of the Pulp Business to the Partnership. The services provided by Canfor include corporate secretarial, financial, internal audit, maintenance, inventory, and purchasing systems, hourly payroll and time entry systems, production tracking systems and software and technology support. Canfor does not receive a fee for the provision of these services but receives a reimbursement for its direct and indirect costs and expenses. The Partnership Services Agreement is terminable, in whole or in part, at the election of the General Partner or Canfor, upon 12 months' written notice.

## **Fund Support Agreement**

Except as expressly prohibited by law, the Fund Declaration and the Trust Declaration permit the Fund Trustees and the Trust Trustees, respectively, to grant or delegate certain of their authority to effect the actual administration of their duties under the Fund Declaration and the Trust Declaration. The Fund Trustees and the Trust Trustees may grant broad discretion to a third party to administer and manage the Fund's and the Trust's day-to-day operations.

On completion of the Spinout, the Fund, the Trust, the Partnership and the General Partner entered into the Fund Support Agreement whereby the Partnership agreed, subject to the supervision of the Fund Trustees and the Trust Trustees, where applicable, to provide or arrange for the provision of services required in the Fund's and the Trust's administration, including those necessary to (a) effect the Fund's compliance with continuous disclosure obligations under applicable securities legislation, including the preparation of financial statements; (b) provide investor relations services; (c) provide or cause to be provided to Unitholders all information to which Unitholders are entitled under the Fund Declaration or the Trust Declaration, including relevant information with respect to income taxes; (d) assist in the calling and holding of meetings of Unitholders and distribute required materials, including notices of meetings and information circulars, in respect of all such meetings; (e) provide for the preparation of calculations to assist the Fund Trustees and the Trust Trustees in determining the distributions to Unitholders; (f) attend to all administrative matters arising in connection with any redemptions of Fund Units; (g) effect compliance with limitations on non-resident ownership; and (h) provide general accounting, bookkeeping and administrative services. The Fund Support Agreement may be terminated by the Fund and the Trust upon payment to the Partnership of all costs and expenses incurred by the Partnership in terminating contracts entered into by it with third parties (provided such contracts were approved by the Fund or the Trust, as the case may be) for the performance by the Partnership of its duties under the Fund Support Agreement.

The Partnership will pay all expenses incurred by it and attributable to the exercise of its duties in the administration of the Fund and the Trust. The Fund will reimburse all the expenses incurred by the Partnership on the Fund's behalf and could be required to pay the Partnership an annual fee not to exceed \$100,000.

## DESCRIPTION OF LEGAL STRUCTURE

### The Fund

#### *Fund Declaration*

The Fund is an unincorporated, open-ended trust established under the laws of the Province of Ontario by the Fund Declaration. It is intended that the Fund will qualify as a "mutual fund trust" for the purposes of the Tax Act. The following is a summary of the material attributes and characteristics of the Fund Units and certain provisions of the Fund Declaration, which summary is not intended to be complete. Reference is made to the Fund Declaration for a complete description of the Fund Units and the full text of its provisions.

#### *Trustees*

The Fund Declaration provides that the Fund will have a minimum of three trustees and a maximum of seven trustees, as fixed from time to time by the Fund Trustees provided that, until otherwise determined, the number of Fund Trustees is three. Until the close of the annual meeting of Unitholders, the initial Fund Trustees are Stan Bracken-Horrocks, Don Campbell, and Charles Jago. The Fund Trustees will be elected at each annual meeting of Unitholders to hold office for a term expiring at the close of the next annual meeting of Unitholders or until their successors are elected or appointed. The Fund Declaration requires that at least a majority of the Fund Trustees be Canadian citizens resident in Canada.

The Fund Declaration provides that, subject to its terms and conditions, the Fund Trustees may, in respect of the trust assets and the investments and affairs of the Fund, exercise any and all rights, powers, and privileges that could be exercised by a legal and beneficial owner thereof. The role of the Fund Trustees includes, among other things:

- supervising the activities and managing the investments and affairs of the Fund;
- maintaining records and providing reports to Unitholders;
- seeking to ensure that the ownership restrictions in the Fund Declaration are met;
- declaring and effecting payments of distributions to Unitholders;
- acting for, voting on behalf of and representing the Fund as a holder of Trust Units and Trust Notes; and
- voting in favour of the Fund's nominees to serve as Trust Trustees and directors of the Partnership.

The Fund Trustees have the right, subject to applicable stock exchange requirements, to approve the adoption of a Unitholder rights plan if the Fund Trustees determine in good faith that such action is appropriate.

A Fund Trustee may resign upon 30 days' written notice to the Fund unless such resignation would cause the number of remaining Fund Trustees to be less than three, and a Fund Trustee (other than the trustee appointed by Canfor) may be removed by a resolution passed by a majority of the votes cast by Unitholders at a meeting called for that purpose or by a written resolution signed by the holders of not less than 100% of the Fund Units entitled to vote on such resolution. The vacancy created by the removal may be filled at the same meeting, failing which it may be filled by a quorum of the remaining Fund Trustees. The term of office of a Fund Trustee will also terminate and a vacancy will occur in the event that the Fund Trustee dies, is declared bankrupt, or otherwise no longer satisfies the qualification requirements provided in the Fund Declaration. Notwithstanding the foregoing, resignation of a

Fund Trustee will not be accepted and termination due to bankruptcy or lack of qualification will not occur if such resignation or termination would result in the majority of Fund Trustees at any time not consisting of persons who are Canadian citizens resident in Canada.

Fund Trustees shall be paid such remuneration for their services as the Compensation Committee of the Partnership may determine from time to time. Currently such compensation for each Fund Trustee (in the event that the Fund Trustee is not a director and is neither employed by the Partnership nor by Canfor) is an annual retainer of \$24,000, an attendance fee of \$1,200 for each day of a scheduled meeting, and an attendance fee of \$1,600 for each day of a non-scheduled meeting of the Board or any Committee of the Board. Those Trustees who are not officers of the General Partner or the Fund and serve on a Committee are also currently paid a pro-rated retainer of \$4,000 for the financial year. In addition, the Chairman of each Committee is currently paid an annual fee of \$4,000. The Chairman of the Board of the General Partner was paid a quarterly fee of \$10,000 for serving as Chairman. The Fund Trustees shall also be entitled to be reimbursed for reasonable travelling and other expenses properly incurred by them in attending meetings of the Fund Trustees or any committee thereof or in connection with their services as Fund Trustees.

A quorum of the Fund Trustees, being a majority of the Fund Trustees then holding office (provided that a majority of such quorum consists of persons who are Canadian citizens resident in Canada), may fill a vacancy among the Fund Trustees, other than a vacancy which Canfor is entitled to fill as a result of the resignation or removal of a trustee appointed by Canfor or a vacancy resulting from a failure of the Unitholders to elect the required number of trustees. A vacancy among the Fund Trustees resulting from the resignation or removal of the Fund Trustee appointed by Canfor may be filled by an appointment by Canfor. In the absence of a quorum of Fund Trustees, or if the vacancy has arisen from a failure of the Unitholders to elect the required number of Fund Trustees, the Fund Trustees will be required to promptly call a special meeting of the Unitholders to fill the vacancy. If the Fund Trustees fail to call that meeting or if there are no Fund Trustees then in office, any Unitholder may call the meeting. The Fund Trustees may, between annual meetings of Unitholders, appoint one or more additional Fund Trustees to serve until the next annual meeting of Unitholders, but the number of additional Fund Trustees will not at any time exceed one third of the number of Fund Trustees who held office at the expiration of the immediately preceding annual meeting of Unitholders.

The Fund Declaration provides that the Fund Trustees will act honestly and in good faith with a view to the best interests of the Fund and in connection with that duty will exercise the degree of care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. The duties and standard of care of the Fund Trustees are intended to be similar to, and not any greater than, those imposed on a director of a corporation governed by the CBCA. The Fund Declaration provides that each Fund Trustee will be entitled to indemnification and reimbursement from the Fund out of the assets of the Fund in respect of the exercise of the Fund Trustee's powers, and the discharge of the Fund Trustee's duties, provided that the Fund Trustee acted honestly and in good faith with a view to the best interests of the Fund, and in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, where the Fund Trustee had reasonable grounds for believing that his or her conduct was lawful.

Except as prohibited by law, the Fund Trustees may appoint from their number one or more committees of Trustees and delegate such authority of the Fund Trustees as the Fund Trustees may deem necessary or desirable to effect the administration of the duties of the Fund Trustees under the Fund Declaration.

### ***Fund Units***

An unlimited number of Fund Units may be issued under the Fund Declaration. Each Fund Unit will be transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains (other than net realized capital gains allocated and distributed to redeeming Unitholders) or other amounts, and in any net assets of the Fund in the

event of termination or winding-up of the Fund. All Fund Units are of the same class with equal rights and privileges. The Fund Units issued in connection with the Spinout will not be subject to future calls or assessments on account of their subscription price and will entitle the holder thereof to one vote for each Fund Unit held at all meetings of Unitholders (except as may be required by law, including securities laws or stock exchange rules). No Unitholder has or is deemed to have any right of ownership in any of the assets of the Fund, nor shall a Unitholder be entitled to interfere with or give any direction to the Fund Trustees. Except as set out under "Redemption Right" below, the Fund Units have no conversion, retraction, redemption, or pre-emptive rights. As of the Effective Date, no person shall be entitled, as a matter of right, to subscribe for or purchase any Fund Units from the Fund, other than as provided for in the Exchange Agreement and the Shareholders' Agreement.

The Fund Units are not "deposits" within the meaning of the *Canada Deposit Insurance Corporation Act* (Canada) and are not insured under the provisions of that act or any other legislation. Furthermore, the Fund is not a trust company and is not registered under any trust and loan company legislation, as it does not carry on or intend to carry on the business of a trust company.

### ***Issuance of Fund Units***

The Fund Declaration provides that the Fund Units or rights, warrants or options to acquire Fund Units may be issued at those times, to those persons, for that consideration and on the terms and conditions that the Fund Trustees determine. Fund Units may be issued pursuant to any Unitholder rights plan or any incentive or other compensation plan established by the Fund, or in satisfaction of any non-cash distribution of the Fund, to Unitholders on a pro-rata basis to the extent that the Fund does not have Adjusted Distributable Cash to fund such distributions. The Fund Declaration also provides that, immediately after any pro-rata distribution of Fund Units to all Unitholders in satisfaction of any non-cash distribution, the number of outstanding Fund Units will be consolidated so that each Unitholder will hold after the consolidation the same number of Fund Units as the Unitholder held before the non-cash distribution (except where tax is required to be withheld in respect of the Unitholder's share of the distribution). Each certificate, if any, representing a number of Fund Units prior to the non-cash distribution is deemed to represent the same number of Fund Units after the non-cash distribution and the consolidation (except where tax is required to be withheld in respect of the Unitholder's share of the distribution). Fractions of Fund Units will not be issued. The Fund Declaration contains certain restrictions on the issuance and transfer of Fund Units to Non-Residents. See "Limitation on Non-Resident Ownership" below.

### ***Redemption Right***

Fund Units are redeemable at any time on demand by the holders thereof upon delivery to the Fund of a duly completed and properly executed irrevocable notice requesting redemption in a form approved by the Fund Trustees. As the Fund Units will be issued on a non-certificated basis, a Unitholder who wishes to exercise its redemption right will be required to obtain a redemption notice form from its investment dealer, who will be required to deliver the completed redemption notice form to the Fund at its head office and to CDS. Upon receipt of the redemption notice by the Fund, all rights with respect to the Fund Units tendered for redemption, including the right to receive any distributions which are declared payable to Unitholders of record on a date subsequent to the date of receipt by the Fund of such notice, will be surrendered and the holder will be entitled to receive a price per Fund Unit (the "Redemption Price") equal to the lesser of:

- 90% of the "market price" of the Fund Units as of the date on which the Fund Units are surrendered for redemption (the "Redemption Date"); and
- 100% of the "closing market price" on the Redemption Date.

For purposes of this calculation, the "market price" of a Fund Unit as at a specified date will be:

- (i) an amount equal to the weighted average trading price of a Fund Unit on the principal stock exchange or securities market on which the Fund Units are listed or quoted for trading during the period of ten consecutive trading days ending on and including such date;
- (ii) an amount equal to the weighted average of the closing prices of a Fund Unit on the principal stock exchange or securities market on which the Fund Units are listed or quoted for trading during the period of ten consecutive trading days ending on and including such date, if the applicable stock exchange or securities market does not provide information necessary to compute a weighted average trading price; or
- (iii) if there was trading on the applicable stock exchange or securities market for fewer than five of the ten trading days, then an amount equal to the weighted average of the following prices established for each of the ten consecutive trading days ending on and including such date: the simple average of the last bid and last asking prices of the Fund Units for each day on which there was no trading; the closing price of the Fund Units for each day that there was trading if the stock exchange or securities market provides a closing price; and the simple average of the highest and lowest prices of the Fund Units for each day that there was trading, if the market provides only the highest and lowest prices of Fund Units traded on a particular day.

The "closing market price" of a Fund Unit for the purpose of the 100% test above, at any date, will be:

- (i) an amount equal to the weighted average trading price of a Fund Unit on the principal stock exchange or securities market on which the Fund Units are listed or quoted for trading on the specified date if the principal stock exchange or securities market provides information necessary to compute a weighted average trading price of the Fund Units on the specified date;
- (ii) an amount equal to the closing price of a Fund Unit on the principal stock exchange or securities market, if there was a trade on the specified date and the principal exchange or market provides only a closing price of the Fund Units on the specified date;
- (iii) an amount equal to the simple average of the highest and lowest prices of the Fund Units on the principal stock exchange or securities market, if there was trading on the specified date and the principal stock exchange or securities market provides only the highest and lowest trading prices of the Fund Units on the specified date; or
- (iv) the simple average of the last bid and last asking prices of the Fund Units on the principal stock exchange or securities market, if there was no trading on the specified date.

The total Redemption Price payable by the Fund in respect of all Fund Units surrendered for redemption during any calendar month will be satisfied by way of a cash payment no later than the last day of the month following the month in which the Fund Units were tendered for redemption, provided that the entitlement of Unitholders to receive cash upon the redemption of their Fund Units will be suspended if:

- the total amount payable by the Fund in respect of those Fund Units and all other Fund Units tendered for redemption in the same calendar month exceeds \$50,000, provided that the Fund Trustees may, in their sole discretion, waive this limitation in respect of all Fund Units tendered for redemption in any calendar month;

- at the time the Fund Units are tendered for redemption, the outstanding Fund Units are not listed for trading or quoted on any stock exchange or securities market which the Fund Trustees consider, in their sole discretion, provides representative fair market value prices for the Fund Units; or
- the normal trading of Fund Units is suspended or halted on any stock exchange on which the Fund Units are listed (or, if not listed on a stock exchange, on any securities market on which the Fund Units are quoted for trading) on the Redemption Date or for more than five trading days during the ten day trading period ending on the Redemption Date.

If a Unitholder is not entitled to receive cash upon the redemption of Fund Units as a result of one or more of the foregoing limitations, then the Redemption Price per Fund Unit tendered for redemption will, subject to the receipt of any applicable regulatory approvals, be paid and satisfied by way of a distribution in specie. In such circumstances, Trust Units of a value equal to 49.8% of the Redemption Price will be redeemed by the Trust in consideration for the issuance of Series 2 Trust Notes and Series 1 Trust Notes of a value equal to 50.2% of the Redemption Price will be redeemed by the Trust in consideration of the issuance to the Fund of Series 3 Trust Notes. The Series 2 Trust Notes and Series 3 Trust Notes will then be distributed in satisfaction of the Redemption Price. No Series 2 Trust Notes or Series 3 Trust Notes will be distributed in integral multiples of less than \$10.00 and, where the number of securities of the Trust to be received by a Unitholder includes a fraction or a multiple less than \$10.00, that number shall be rounded to the next lowest whole number or integral multiple of \$10.00 and the balance settled in cash. The Fund will be entitled to all interest paid or accrued and unpaid on the Trust Notes and the distributions paid on the Trust Units on or before the date of the distribution in specie. Where the Fund makes a distribution in specie on the redemption of Fund Units of a Unitholder, the Fund currently designates and treats as payable to that Unitholder any income or capital gain realized by the Fund as a result of the redemption of securities of the Trust and the distribution of securities to the Unitholder.

It is anticipated that the redemption right described above will not be the primary mechanism for Unitholders to dispose of their Fund Units. Series 2 Trust Notes and Series 3 Trust Notes distributed in specie to Unitholders in connection with a redemption will not be listed on any stock exchange and no securities market is expected to develop in Series 2 Trust Notes and Series 3 Trust Notes, and they will be subject to an indefinite "hold period" or other resale restrictions under applicable securities laws. Series 2 Trust Notes and Series 3 Trust Notes so distributed will not be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans, and registered education savings plans.

### *Meetings of Unitholders*

The Fund Declaration provides that meetings of Unitholders must be called and held annually for the election of Fund Trustees and the appointment of auditors of the Fund. Unitholders will be entitled to pass resolutions that will bind the Fund Trustees only with respect to:

- the election or removal of Fund Trustees;
- the appointment or removal of the auditors of the Fund;
- the appointment of an inspector to investigate the performance by the Fund Trustees of their respective responsibilities and duties in respect of the Fund;
- the approval of amendments to the Fund Declaration (except as described under "Amendments to the Fund Declaration" below);
- the termination of the Fund;
- the sale of all or substantially all of the assets of the Fund;

- the exercise of certain voting rights attached to the securities of the Trust held by the Fund and, subject to the terms of the Partnership Agreement, the securities of the Partnership held by the Trust (see "Exercise of Certain Voting Rights Attached to Securities of the Trust" below);
- the ratification of any Unitholder rights plan, distribution reinvestment plan, distribution reinvestment and Fund Unit purchase plan, Fund Unit option plan or other compensation plan contemplated by the Fund Declaration requiring Unitholder approval;
- the dissolution or winding-up of the Fund; and
- any other matters requiring by securities law, stock exchange rules or other laws or regulations to be submitted to Unitholders for their approval;

provided that any resolution of the Unitholders that would cause the Fund or the Trust to breach the terms of any material contract shall not be binding on the Fund Trustees.

No other action taken by Unitholders or any other resolution of the Unitholders at any meeting will in any way bind the Fund Trustees.

A resolution approving the election or removing a Fund Trustee (except filling casual vacancies), appointing or removing the auditors of the Fund or with respect to the exercise of certain voting rights attached to securities of the Trust held by the Fund must be passed by a simple majority of the votes cast by Unitholders or by unanimous written approval. Except as otherwise required by law or stock exchange requirements, the balance of the foregoing matters must be passed by a resolution passed by the affirmative vote of the holders of not less than 66 2/3% of the Fund Units who voted in respect of that resolution at a meeting at which a quorum was present, or a resolution or instrument signed in one or more counterparts by the holders of not less than 100% of the Fund Units entitled to vote on such resolution (a "Special Resolution").

A meeting of Unitholders may be convened at any time and for any purpose by the Fund Trustees and must be convened, except in certain circumstances, if requisitioned in writing by the holders of not less than 5% of the Fund Units then outstanding. A requisition must state in reasonable detail the business proposed to be transacted at the meeting. One or more persons present in person or represented by proxy and representing in total at least 10% of the votes attached to all outstanding Fund Units will constitute a quorum for the transaction of business at all meetings. Instructions for voting at the first meeting of Unitholders are detailed in the information circular distributed to Unitholders.

The Fund Declaration contains provisions as to the notice required and other procedures with respect to the calling and holding of meetings of Unitholders.

#### ***Limitations on Non-Resident Ownership***

In order for the Fund to maintain its status as a mutual fund trust under the Tax Act, the Fund must not be established or maintained primarily for the benefit of non-residents of Canada within the meaning of the Tax Act and, pursuant to certain proposed amendments to the Tax Act, not more than 50% of the fair market value of the Fund Units may be held by non-residents of Canada and/or partnerships (other than Canadian partnerships as defined in the Tax Act) (collectively referred to below as "Non-Residents"). Accordingly, the Fund Declaration provides that at no time may Non-Residents be the beneficial owners of more than 49% of the Fund Units (calculated on either a non-diluted or fully-diluted basis). The Fund Declaration also provides that the Fund Trustees shall require annual declarations as to the jurisdictions in or of which beneficial owners of Fund Units are resident or as to their status as Canadian partnerships. If the Fund Trustees become aware that the beneficial owners of 49% of the Fund Units (calculated on either a non-diluted or fully-diluted basis) are, or may be, Non-



Residents or that such a situation is imminent, then the Fund's transfer agent and registrar will make a public announcement and will not accept a subscription for Fund Units from or issue or register a transfer of Fund Units to a person unless the person provides a declaration that the person is not a Non-Resident and will not hold such Fund Units for the benefit of a Non-Resident. If, notwithstanding the foregoing, the Fund Trustees determine that more than 49% of the Fund Units are held by or for the benefit of Non-Residents (calculated on either a non-diluted or fully-diluted basis), they may direct the transfer agent of the Fund Units to send a notice to such holders of Fund Units, chosen in inverse order to the order of acquisition or registration or in such manner as the Fund Trustees may consider equitable and practicable, requiring them to sell their Fund Units or a portion thereof within a specified period determined by the Fund Trustees and, in the interim, shall suspend the voting and distribution rights attached to such Fund Units (other than the right to receive proceeds from the sale). If the Unitholders receiving such notice have not sold the specified number of Fund Units or provided the Fund Trustees with satisfactory evidence that they are not Non-Residents within such period, the Fund Trustees may direct the transfer agent to sell such Fund Units on behalf of such Unitholders and, in the interim, the voting and distribution rights attached to such Fund Units will be suspended. Upon such sale, the affected holders will cease to be holders of the Fund Units and their rights will be limited to receiving the net proceeds of such sale.

### *ERISA Plans*

The Fund Declaration will also contain restrictions preventing, until such time as the Fund makes a public announcement that the Fund Trustees have determined that such restrictions are no longer applicable or are not in the best interests of the Fund, any of the Fund Units from being held by or for the benefit of "ERISA Funds", which are: (i) any "employee benefit plan" as defined in Section 3 of ERISA that is subject to Title I of ERISA; (ii) any "plan" as defined in, and subject to, Section 4975 of the United States Internal Revenue Code of 1986, as amended, or any successor statute (the "Code"); and (iii) any other entity which may be deemed (pursuant to ERISA, regulations of the United States Department of Labor or otherwise) to hold at any time assets of any such "employee benefit plan" or "plan". If the Fund Trustees become aware that these restrictions have been contravened, then the Fund Trustees may direct the transfer agent to send a notice to any ERISA Fund holding Fund Units requiring them to sell their Fund Units within a specified period determined by the Fund Trustees and, in the interim, the voting and distribution rights attached to such Fund Units (other than the right to receive proceeds from the sale) shall be suspended. If the Unitholders receiving such notice have not sold all of their Fund Units or provided the Fund Trustees with satisfactory evidence within such period that they are not ERISA Funds and do not hold such Fund Units for the benefit of ERISA Funds, then the Fund Trustees may direct the transfer agent to sell such Fund Units on behalf of such Unitholders. Upon such sale, the affected holders shall cease to be holders of Fund Units and their rights shall be limited to receiving the net proceeds of sale of such Fund Units.

### *Amendments to the Fund Declaration*

The Fund Declaration may be amended or altered from time to time by a Special Resolution of the Unitholders. The Fund Trustees may, without the approval of the Unitholders, make certain amendments to the Fund Declaration, including amendments:

- for the purpose of ensuring continuing compliance with applicable laws, regulations, requirements or policies of any governmental authority having jurisdiction over the Fund Trustees or over the Fund, including ensuring that the Fund continues to qualify as a "mutual fund trust" under the Tax Act;
- which, in the opinion of the Fund Trustees, are necessary or desirable as a result of changes in Canadian taxation laws;
- which, in the opinion of the Fund Trustees on the advice of counsel, provide additional protection for or benefit to the Unitholders; and

- to remove any conflicts or inconsistencies or cure ambiguity in the Fund Declaration or to make minor or typographical corrections or correct a clerical omission, mistake or manifest error which, in the opinion of the Fund Trustees, are necessary or desirable and not prejudicial to the Unitholders.

Notwithstanding the foregoing, the Fund Trustees may not amend the Fund Declaration in a manner that would result in the Fund failing to qualify as a "mutual fund trust" under the Tax Act and no such amendment shall modify the right to one vote per Fund Unit or reduce the fractional undivided interest in the assets of the Fund represented by any Fund Unit without the consent of the holder of such Fund Unit and no amendment shall reduce the percentage of votes required to be cast at a meeting of the Unitholders for the purpose of the amendment provisions, without the consent of the holders of all of the Fund Units then outstanding.

### *Term of the Fund*

Unless the Fund is sooner terminated as otherwise provided herein, the Fund shall continue in full force and effect so long as any property of the Fund is held by the Fund Trustees, and the Fund Trustees shall have all the powers and discretions, expressed and implied, conferred upon them by law or by the Fund Declaration.

The Unitholders may vote by Special Resolution to terminate the Fund at any meeting of Unitholders duly called for the purpose of considering the termination of the Fund. Following the approval of such termination, the Trustees shall commence to wind up the affairs of the Fund. Such Special Resolution may contain such directions to the Trustees as the Unitholders determine.

The Fund Declaration provides that, upon being required to commence to wind up of the affairs of the Fund, the Fund Trustees will give notice to the Unitholders, which notice will designate the time or times at which Unitholders shall surrender their Fund Units for cancellation and the date at which the register of Fund Units will be closed. After the date that the register is closed, the Fund Trustees will proceed to wind up the affairs of the Fund as soon as may be reasonably practicable and for that purpose will, subject to any direction to the contrary in respect of a termination authorized by a resolution of the Unitholders, sell and convert into money the Trust Units and the Trust Notes and all other assets comprising the Fund in one transaction or in a series of transactions at public or private sales and do all other acts appropriate to liquidate the Fund. If the Fund Trustees are unable to sell all or any of the Trust Units and Trust Notes or other assets which comprise part of the Fund by the date set for termination, the Fund Trustees may, subject to obtaining all necessary regulatory approvals, distribute the remaining Trust Units and Trust Notes and other assets in specie directly to the Unitholders in accordance with their pro-rata interests. After paying, retiring, discharging or making provision for the payment, retirement or discharge of all known liabilities and obligations of the Fund and providing for indemnity against any other outstanding liabilities and obligations, the Fund Trustees will, subject to obtaining all necessary regulatory approvals, be required to distribute the remaining part of the proceeds of the sale of the Trust Units and Trust Notes and other assets of the Fund among the Unitholders in accordance with their pro-rata interests.

### *Take-over Bids*

The Fund Declaration contains provisions to the effect that, if a take-over bid is made for the Fund Units and is accepted by Unitholders representing not less than 90% of the Fund Units (including Fund Units that may be acquired on the exchange of any Class B Exchangeable LP Units pursuant to the Exchange Agreement but other than Fund Units and Class B Exchangeable LP Units beneficially owned or over which control or direction is exercised at the date of the takeover bid by the offeror or associates or affiliates of the offeror or any person acting jointly or in concert with the offeror), and such Fund Units are taken up and paid for by the offeror, the offeror will be entitled to acquire the Fund Units held by Unitholders who did not accept the take-over bid on the terms on which the offeror acquired Fund Units from Unitholders who accepted the take-over bid. At the same time, the holder of Class B Exchangeable

LP Units will be required to indirectly exchange its Class B Exchangeable LP Units pursuant to the terms of the Exchange Agreement in order for the offeror to be able to acquire the Fund Units delivered on the mandatory exchange of such Class B Exchangeable LP Units.

#### *Exercise of Certain Voting Rights Attached to Securities of the Trust*

The Fund Declaration provides that, without the approval of the Unitholders by Special Resolution, the Fund will not vote any securities of the Trust held by the Fund except as may be authorized under the Shareholders' Agreement, and will not permit the Trust to vote its securities of the General Partner or the Partnership, to authorize:

- any sale, lease or other disposition of all or substantially all of the assets of the Trust, the General Partner or the Partnership, except in conjunction with an internal reorganization of the Trust or the Partnership;
- any amalgamation, arrangement or other merger of the Trust, the General Partner or the Partnership with any other entity, except in conjunction with an internal reorganization of the Trust, the General Partner or the Partnership;
- any material amendment to the Note Indenture that would be prejudicial to the holders of Series 2 Trust Notes or Series 3 Trust Notes;
- the winding-up or dissolution of the Trust, the General Partner or the Partnership;
- any material amendment to the constating documents of the Trust, the General Partner or the Partnership to change the authorized Trust Units or Partnership interests in a manner which may be prejudicial to the Fund; or
- any change to the allocation or priority of distribution provisions of the Partnership Agreement or the allocation or priority of the distribution of proceeds of liquidation, dissolution or winding up of the Partnership.

The Trust may not be entitled, or may choose not to exercise its entitlement, to vote in respect of the foregoing matters, in either of which case the approval of the Unitholders by Special Resolution will not be sought.

#### *Information and Reports*

The Fund files and/or furnishes to Unitholders, in accordance with applicable securities laws, the audited annual and unaudited quarterly consolidated financial statements of the Fund and the Partnership and other materials as are from time to time required by applicable securities laws. The Fund will also furnish Unitholders with such other reports as are from time to time required by applicable law, including prescribed forms needed for the completion of Unitholders' tax returns under the Tax Act and equivalent provincial legislation.

Prior to each meeting of Unitholders, the Fund Trustees will provide the Unitholders (along with notice of the meeting) with all information as is required by applicable law and the Fund Declaration to be provided to Unitholders.

Pursuant to the Shareholders' Agreement, the General Partner has agreed to make, on behalf of the Partnership, such filings under applicable securities laws, including the filing of financial statements, and to take such other reasonable steps as may be required to be taken by the General Partner, on behalf of the Partnership, in order that the Fund may comply with its obligations under applicable securities laws and commitments and undertakings given to any Commissions prior to the Effective Date. Accordingly, it is expected that the Partnership will provide the Fund with information regarding any material change that occurs in its affairs and with quarterly and annual financial statements accompanied

by MD&A for the period covered by such financial statements in form and content that it would file with the applicable regulatory authorities as if it were a reporting issuer. Information, financial statements, and MD&A will be provided to the Fund in a timely manner so as to permit the Fund to comply with the continuous disclosure requirements relating to reports of material changes in its affairs and the filing and delivery to security holders of financial statements as required under applicable securities laws.

The Fund has provided all required undertakings to the Commissions that, for so long as the Fund is a reporting issuer under applicable securities laws:

- in complying with its reporting issuer obligations, the Fund will treat the Partnership as a subsidiary of the Fund; however, if Canadian GAAP prohibits the consolidation of financial information of the Partnership and the Fund, for as long as the Partnership (including any of its significant business interests) represents a significant asset of the Fund, the Fund will provide its Unitholders with separate consolidated financial statements for the Partnership (including information about any of the Partnership's significant business interests); and
- the Fund will annually certify that it has complied with this undertaking, and file the certificate on SEDAR concurrently with the filing of its annual financial statements.

The Partnership has provided an undertaking to the Fund that, for so long as the Fund is a reporting issuer under applicable securities laws:

- in order to facilitate compliance by the Fund with the Fund's reporting issuer obligations, the Partnership will permit itself to be treated as a subsidiary of the Fund; however, if Canadian GAAP prohibits the consolidation of financial information of the Partnership and the Fund, for as long as the Partnership (including any of its significant business interests) represents a significant asset of the Fund, the Partnership will provide the Fund with separate consolidated financial statements for the Partnership (including information about any of the Partnership's significant business interests). For greater certainty, the Partnership will prepare and provide to the Fund annual audited financial statements and related MD&A, and an annual certificate thereon under MI 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings, for the Pulp Business so that the Fund is able to file such financial statements and MD&A on or before the 90th day after the most recent year end of the Pulp Business; and
- the Partnership will annually certify that it has complied with this undertaking, and provide the certificate to the Fund so that the Fund may file the certificate on SEDAR concurrently with the filing of the Fund's annual financial statements.

The Fund has also provided all required undertakings to the Commissions that, for so long as the Fund is a reporting issuer under applicable securities laws:

- the Fund will take appropriate measures to require each person who would be an insider of the Partnership if the Partnership were a reporting issuer to: (i) file insider reports in respect of trades in units of the Fund (including securities which are exchangeable into units of the Fund), and (ii) comply with statutory prohibitions against insider trading; and
- the Fund will annually certify that it has complied with this undertaking, and file the certificate on SEDAR concurrently with the filing of its annual financial statements.

The Partnership has provided an undertaking to the Fund that, for so long as the Fund is a reporting issuer under applicable securities laws:

- the Partnership will take appropriate measures to require each person who would be an insider of the Partnership if the Partnership were a reporting issuer to: (i) file insider reports

in respect of trades in units of the Fund (including securities which are exchangeable into units of the Fund), and (ii) comply with statutory prohibitions against insider trading; and

- the Partnership will annually certify that it has complied with this undertaking, and provide the certificate to the Fund so that the Fund may file the certificate on SEDAR concurrently with the filing of the Fund's annual financial statements.

Persons who would be insiders of the Partnership if the Partnership were a reporting issuer provided undertakings to the Fund and the Partnership in order to facilitate compliance by the Fund and the Partnership with their undertakings in respect of insider reporting and compliance with the insider trading prohibitions referred to above.

### *Rights of Unitholders*

The rights of Unitholders are governed by the Fund Declaration. Although the Fund Declaration confers upon a Unitholder many of the same protections, rights and remedies as an investor would have as a shareholder of a corporation governed by the CBCA, there exist significant differences.

Many of the provisions of the CBCA respecting the governance and management of a corporation have been incorporated in the Fund Declaration. For example, Unitholders are entitled to exercise voting rights in respect of their holdings of Fund Units in a manner comparable to shareholders of a CBCA corporation and to elect Fund Trustees and appoint auditors. The Fund Declaration also includes provisions modeled after comparable provisions of the CBCA dealing with the calling and holding of meetings of Unitholders and Fund Trustees, the quorum for and procedures at such meetings and the right of Unitholders to participate in the decision-making process where certain fundamental actions are proposed to be undertaken. The matters in respect of which Unitholder approval is required under the Fund Declaration are generally less extensive than the rights conferred on the shareholders of a CBCA corporation, but effectively extend to certain fundamental actions that may be undertaken by the Fund's subsidiary entities, as described under "Exercise of Certain Voting Rights Attached to Securities of the Trust" above. These Unitholder approval rights are supplemented by provisions of applicable securities laws that are generally applicable to issuers (whether corporations, trusts or other entities) that are "reporting issuers" or the equivalent or listed on the TSX.

Unitholders do not have recourse to a dissent right under which shareholders of a CBCA corporation are entitled to receive the fair value of their shares where certain fundamental changes affecting the corporation are undertaken (such as an amalgamation, a continuance under the laws of another jurisdiction, the sale of all or substantially all of its property, a going private transaction or the addition, change or removal of provisions restricting (a) the business or businesses that the corporation can carry on, or (b) the issue, transfer or ownership of shares). As an alternative, Unitholders seeking to terminate their investment in the Fund are entitled to redeem their Fund Units, as described under "Description of Legal Structure – The Fund – Redemption Right". Unitholders similarly do not have recourse to the statutory oppression remedy that is available to shareholders of a CBCA corporation where the corporation undertakes actions that are oppressive, unfairly prejudicial or disregard the interests of security holders and certain other parties.

Shareholders of a CBCA corporation may also apply to a court to order the liquidation and dissolution of the corporation in those circumstances, whereas Unitholders could rely only on the general provisions of the Fund Declaration that permit the winding up of the Fund with the approval of a Special Resolution of the Unitholders. Shareholders of a CBCA corporation may also apply to a court for the appointment of an inspector to investigate the manner in which the business of the corporation and its affiliates is being carried on where there is reason to believe that fraudulent, dishonest, or oppressive conduct has occurred. The Fund Declaration allows Unitholders to call meetings to consider the appointment of an inspector to investigate the Fund Trustees' performance of their responsibilities and duties, but this process would not be subject to court oversight or assure the other investigative procedures, rights, and remedies available under the CBCA. The CBCA also permits shareholders to

bring or intervene in derivative actions in the name of the corporation or any of its subsidiaries, with the leave of a court. The Fund Declaration does not include a comparable right of the Unitholders to commence or participate in legal proceedings with respect to the Fund.

### ***Registration of Fund Units***

Registration of interests in and transfers of the Fund Units will be made only through participants in CDS. Fund Units must be purchased, transferred, and surrendered for redemption through a participant in the CDS depository service. All rights of Unitholders must be exercised through, and all payments or other property to which the Unitholder is entitled will be made or delivered by, CDS or the CDS participant through which the Unitholder holds the Fund Units. Upon a purchase of any Fund Units, the Unitholder will receive only a customer confirmation from the registered dealer that is a CDS participant and from or through which the Fund Units are purchased. References in this AIF to a Unitholder mean, unless the context otherwise requires, the owner of the beneficial interest in those Fund Units.

The Fund and the Fund Trustees will not be liable for any records maintained by CDS relating to the beneficial interests in the Fund Units or any actions taken, or advice given, by CDS with respect to the rules and regulations of CDS.

The ability of a beneficial owner of Fund Units to pledge those Fund Units or otherwise take action with respect to the Unitholder's interest in those Fund Units (other than through a CDS participant) may be limited due to the lack of a physical certificate.

The Fund has the option to terminate the non-certificated form of Fund Units, in which case certificates for the Fund Units in fully registered form would be issued to beneficial owners of those Fund Units or their nominees.

### ***Conflict of Interest Restrictions and Provisions***

The Fund Declaration contains "conflict of interest" provisions that serve to protect Unitholders without creating undue limitations on the Fund. The Fund Declaration contains provisions, similar to those contained in the CBCA, that require each Fund Trustee to disclose to the Fund, as applicable, any interest in a material contract or transaction or proposed material contract or transaction with the Fund, or the fact that such person is a director or officer of, or otherwise has a material interest in, any person who is a party to a material contract or transaction or proposed material contract or transaction with the Fund. In any case, a Fund Trustee who has made disclosure to the foregoing effect is not entitled to vote on any resolution to approve the contract or transaction unless the contract or transaction is one relating primarily to (a) his or her remuneration as a Fund Trustee or officer of the Fund, as applicable, (b) insurance or indemnity, or (c) a contract or transaction with the Trust.

## **The Trust**

### ***General***

The Trust Declaration contains provisions substantially similar to those of the Fund Declaration relating to the Fund. The description below is a summary only and is qualified in its entirety by reference to the text of the Trust Declaration and the Fund Declaration.

### ***Restrictions on the Trust Trustees' Powers***

The Trust Declaration provides that the Trust's Trustees may not, without approval by ordinary resolution of the holders of Trust Units, vote LP Units with respect to any matter which, under the Partnership Agreement, requires or permits the approval of the holders of LP Units by "Ordinary Resolution", as such term is defined in, and in accordance with, the Partnership Agreement.

Furthermore, the Trust Declaration states that the Trust Trustees may not, without approval by special resolution of the holders of Trust Units:

- (a) vote the LP Units with respect to any matter which, under the Partnership Agreement, requires or permits the approval of the holders of LP Units by "Special Resolution", as such term is defined in, and in accordance with, the Partnership Agreement, which includes any matter which under applicable law would require approval by "Special Resolution", as such term is defined in the Partnership Agreement;
- (b) amend the Partnership Agreement;
- (c) authorize the sale, lease or exchange or all or substantially all of the property of the Trust other than in the ordinary course of business or in connection with an internal reorganization;
- (d) authorize the termination, liquidation or winding-up of the Trust, other than at the end of the term of the Trust; or
- (e) authorize the amalgamation, arrangement or other merger or similar transaction of the Trust with any other person other than in connection with an internal reorganization.

### *Redemption Rights*

The Trust Units are redeemable at any time on demand by the holders thereof upon delivery to the Trust of a duly completed and properly executed irrevocable notice requiring the Trust to redeem the Trust Units, in a form reasonably acceptable to the Trust Trustees, together with the certificates for the Trust Units representing the Trust Units to be redeemed and written instructions as to the number of Trust Units to be redeemed. Upon tender by a holder of Trust Units for redemption, the holder of the Trust Units tendered for redemption will no longer have any rights with respect to such Trust Units, other than the right to receive the redemption price for such Trust Units. The redemption price for each Trust Unit tendered for redemption will be equal to the greater of \$0.01 and the result of the following formula:

$$\frac{(A \times B) - C + D}{E}$$

where:

- A = the cash redemption price per Fund Unit, as determined under the Fund Declaration, calculated as of the close of business on the date the Trust Units were so tendered for redemption by a holder of Trust Units;
- B = the aggregate number of Fund Units outstanding as of the close of business on the date the Trust Units were so tendered for redemption by a holder of Trust Units;
- C = the aggregate unpaid principal amount of the Series 1 Trust Notes and accrued interest thereon and any other indebtedness of the Trust held by or owed to the Fund and the fair market value of any other assets or investments held by the Fund (other than Trust Units) as of the close of business on the date the Trust Units were so tendered for redemption by a holder of Trust Units;
- D = the aggregate unpaid liabilities of the Fund (prior to redemption of Fund Units for such date) as of the close of business on the date the Trust Units were so tendered for redemption by a holder of Trust Units; and

E = the aggregate number of Trust Units outstanding held by the Fund as of the close of business on the date the Trust Units were so tendered for redemption by a holder of Trust Units.

The aggregate redemption price payable by the Trust in respect of any Trust Units tendered for redemption by the holders thereof during any month will be satisfied, at the option of the Trust Trustees, (a) in immediately available funds by cheque; (b) by the issuance to or to the order of the holders of Trust Units whose Trust Units are to be redeemed of such aggregate amount of the Series 2 Trust Notes as is equal to the aggregate redemption price payable to such holder of Trust Units rounded down to the nearest \$10.00, with the balance of any such aggregate redemption price not paid in Series 2 Trust Notes to be paid in immediately available funds by cheque; or (c) by any combination of funds and Series 2 Trust Notes as the Trust Trustees shall determine in their sole discretion, in each such case payable or issuable on the day before the last day of the calendar month following the calendar month in which the Trust Units were so tendered for redemption. A holder of Trust Units whose Trust Units are tendered for redemption may elect, at any time prior to the payment of the redemption price, to receive Series 2 Trust Notes pursuant to (b) above in the place of all or part of the funds otherwise payable, the amount of such Series 2 Trust Notes payable to be equal to the funds otherwise payable, rounded down to the nearest \$10.00, with the difference to be paid in immediately available funds by cheque.

### *Trust Notes*

The aggregate principal amount of Trust Notes is unlimited and may be issued as Series 1, Series 2, or Series 3. Trust Notes will be issuable in Canadian currency. Trust Notes are issuable in denominations of \$10 and integral multiples of \$10. No fractional Trust Notes will be distributed and where the number of Trust Notes to be received by a Unitholder includes a fraction, such number shall be rounded to the next lowest whole number (with the balance paid in cash). Following the Effective Date, the Trust will redeem a portion of the Trust Units held by the Fund and issue to the Fund Series 1 Trust Notes having a principal amount equal to the value of the redeemed Trust Units.

Series 2 Trust Notes will be reserved by the Trust to be issued exclusively to holders of Trust Units as full or partial payment of the redemption price of Trust Units, as the Trust Trustees may decide or, in certain circumstances, may be obliged to issue.

Series 3 Trust Notes will be reserved by the Trust to be issued exclusively as full or partial payment of the redemption price of Series 1 Trust Notes.

### *Interest and Maturity*

The Series 1 Trust Notes that were issued on the Effective Date will be payable on demand, will mature on the 10th anniversary of the date of issuance and will bear interest at a rate of 3% per annum, payable on the last day of each calendar month that such Series 1 Trust Notes are outstanding.

The Series 2 Trust Notes will mature on a date which is no later than the first anniversary of the date of issuance thereof and will bear interest at a market rate to be determined by the Trust Trustees at the time of issuance thereof, payable on the last day of each calendar month that such Series 2 Trust Notes are outstanding.

The Series 3 Trust Notes will mature on the 10th anniversary of the date of issuance of the Series 1 Trust Notes and will bear interest at a market rate to be determined by the Trust Trustees at the time of issuance thereof, payable on the 15th day of each calendar month that such Series 3 Trust Notes are outstanding.



### Payment upon Maturity

On maturity, the Trust will be required to repay the Trust Notes by paying to the trustee under the Note Indenture in cash an amount equal to the principal amount of the outstanding Trust Notes that have then matured, together with accrued and unpaid interest thereon.

### Redemption

The Trust Notes are redeemable (at a redemption price equal to the principal amount thereof plus accrued and unpaid interest, payable in cash) at the option of the Trust prior to maturity.

### Subordination

Payment of the principal amount and interest on the Trust Notes will be subordinated in right of payment to the prior payment in full of the principal of and accrued and unpaid interest on, and all other amounts owing in respect of, all senior indebtedness (which will be defined as all indebtedness, liabilities and obligations of the Trust which, by the terms of the instrument creating or evidencing the same, are expressed to rank in right of payment in priority to the indebtedness evidenced by the Note Indenture). The Note Indenture will provide that, upon any distribution of the assets of the Trust in the event of any dissolution, liquidation, reorganization or other similar proceedings relative to the Trust, the holders of all such senior indebtedness will be entitled to receive payment in full before the holders of the Trust Notes are entitled to receive any payment.

### Default

The Note Indenture provides that any of the following shall constitute an event of default:

- (a) default in payment of any principal of the Trust Notes when the same becomes due and the continuation of such default for a period of 90 days;
- (b) subject to the terms of any senior indebtedness, default in payment of any interest due on any Trust Notes and continuation of such default for a period of 90 days;
- (c) default in the observance or performance of any other covenant or condition of the Note Indenture and continuance of such default for a period of 90 days after notice in writing has been given by the trustee under the Note Indenture to the Trust Trustees specifying such default and requiring the Trust to rectify the same; and
- (d) certain events of dissolution, winding up, liquidation, reorganization or other similar proceedings relative to the Trust.

The provisions governing an event of default under the Note Indenture and remedies available there under do not provide protection to the holders of Trust Notes which would be comparable to the provisions generally found in debt securities issued to the public as, among other things, covenants there under may be waived by the Partnership and amended by agreement by the Fund and the Trust without further approvals.

### Unit Certificates

As Trust Units are not intended to be issued or held by any person other than the Fund and shall not be issued or held by any person other than the Fund without Unitholder approval, registration of interests in, and transfers of, the Trust Units will be made on a registered, certificated basis, with holders of Trust Units being entitled to receive certificates therefore.

### *Meetings of Unitholders*

Meetings of holders of Trust Units may be held at such time and place as shall be prescribed for the purpose of transacting such business as the Trust Trustees may determine or as may properly be brought before the meeting.

### *Term of the Trust*

Unless the Trust is sooner terminated as otherwise provided herein, the Trust shall continue in full force and effect so long as any property of the Trust is held by the Trust Trustees, and the Trust Trustees shall have all the powers and discretions, expressed and implied, conferred upon them by law or by the Trust Declaration.

The Trust unitholders may vote by special resolution to terminate the Trust at any meeting of Trust unitholders duly called for the purpose of considering the termination of the Trust. Following the approval of such termination, the Trust Trustees shall commence to wind up the affairs of the Trust. Such special resolution may contain such directions to the Trust Trustees as the Trust unitholders determine.

## **The Partnership**

The following is a summary of the material attributes and characteristics of the LP Units and certain provisions of the Partnership Agreement. This summary is qualified in its entirety by reference to the provisions of the Partnership Agreement, which contains a complete statement of those attributes and characteristics and provisions.

### *Capitalization*

The Partnership is entitled to issue various classes of interests, for consideration and on such terms and conditions as are established by the General Partner. Immediately following the Effective Date, there were 14,254,005 Class A LP Units (all of which are held by the Trust) and 57,016,020 Class B Exchangeable LP Units (all of which were initially held by Canfor's subsidiary) issued and outstanding. After the November 2006 Dividend, Canfor continued to hold 35,776,483 Class B Exchangeable LP Units, with the Trust holding the remaining 21,239,537 Class B Exchangeable LP Units. The General Partner holds the GP Interest, representing a 0.001% undivided interest in the Partnership. All classes of LP Units, except as otherwise noted, have materially equivalent economic and voting rights.

The Class B Exchangeable LP Units are indirectly exchangeable at the option of the holder on a one-for-one basis for Fund Units in accordance with the provisions of the Exchange Agreement.

### *Allocation of Net Income and Losses*

The income or loss for income tax purposes of the Partnership for a particular taxation year will be allocated to each partner in an amount calculated by multiplying the total income or loss for income tax purposes allocated to the partners by a fraction, the numerator of which shall be the sum of the cash distributions received by that partner with respect to that taxation year and the denominator of which shall be the total amount of the cash distributions made by the Partnership to all partners with respect to that taxation year. The amount of income for income tax purposes allocated to a partner may exceed or be less than the amount of cash distributed by the Partnership to that partner. If no cash distribution is made by the Partnership to its partners in a taxation year, the income or loss of the Partnership for that taxation year will be allocated to the partners based on the number of LP Units held by the partners at the end of that taxation year.

### *Limited Liability*

The Partnership is required to operate in a manner so as to ensure to the greatest extent possible the limited liability of the limited partners. If limited liability is lost by reason of the gross negligence of

the General Partner in performing its duties and obligations under the Partnership Agreement, then the General Partner has agreed to indemnify the limited partners in respect of any loss, damage cost, or expense arising from the absence of the limited liability intended by the Partnership Agreement.

### *Transfer of LP Units*

The LP Units are not transferable except in accordance with the Shareholders' Agreement, the Exchange Agreement and the Partnership Agreement and subject to compliance with applicable securities restrictions, provided that LP Units may not be transferred to any person that is a Non-Resident for purposes of the Tax Act, to a partnership other than a Canadian partnership or if such transfer would jeopardize the Fund's regulatory status for tax purposes. An LP Unit is not transferable in part. No transfer of an LP Unit will be accepted by the Partnership unless a transfer form, duly completed and signed by the registered holder of the LP Unit and the transferee, has been remitted to the registrar and transfer agent of the Partnership. A transferee of an LP Unit will become a partner, and will be subject to the obligations and entitled to the rights of a partner under the Partnership Agreement, on the date on which the transfer is recorded.

### *Take-Over Bids*

The Partnership Agreement provides that no holder of GP Shares or LP Units shall transfer any GP Shares or LP Units, other than to one or more of its affiliates or to the Trust in accordance with the terms of the Exchange Agreement, unless (a) the transferee would not be required under applicable securities legislation as a result of such transfer to make an offer to all holders of Fund Units to acquire such units on the same terms and conditions if, immediately prior to such transfer, all outstanding LP Units and the same number of GP Shares had been exchanged for Fund Units in accordance with the terms of the Exchange Agreement, or (b) the offeror acquiring such LP Units and GP Shares makes a contemporaneous offer for Fund Units on the same terms (in terms of price, timing and proportion of securities sought to be acquired) and conditions and does not acquire such LP Units or GP Shares unless the offeror also acquires a proportionate number of Fund Units tendered to such offer, if any.

### *Amendment*

The Partnership Agreement may be amended with approval by special resolution of the holders of LP Units, except for amendments that require unanimous approval of holders of LP Units. Unanimous approval of holders of LP Units is required for: (a) altering the ability of the limited partners to involuntarily remove the General Partner as general partner; (b) changing the liability of any limited partner; (c) changing the right of a limited partner to vote at any meeting; (d) changing the allocation or priority of distributions, or the allocation or priority of the distribution of proceeds of liquidation, dissolution or winding up of the Partnership; or (e) changing the Partnership from a limited partnership to a general partnership. Notwithstanding the foregoing, no amendment that would adversely affect the rights and obligations of the General Partner, as general partner, may be made without its prior written consent. The General Partner may make amendments to the Partnership Agreement to reflect: (a) a change in the name of the Partnership or the location of the principal place of business of the Partnership or the registered office of the Partnership; (b) a change in the governing law of the Partnership to any other province of Canada; (c) admission, substitution, withdrawal or removal of limited partners in accordance with the Partnership Agreement; (d) a change that, as determined by the General Partner, is reasonable and necessary or appropriate to qualify or continue the qualification of the Partnership as a limited partnership in which the limited partners have limited liability under the applicable laws; (e) a change that, as determined by the General Partner, is reasonable, necessary or appropriate to enable the Partnership to take advantage of, or not be detrimentally affected by, changes in the Tax Act or other taxation laws; (f) a change to amend or add any provision, or to cure any ambiguity or to correct or supplement any provisions contained in the Partnership Agreement which may be defective or inconsistent with any other provision contained in the Partnership Agreement or which should be made to make the Partnership Agreement consistent with the disclosure set out in this AIF; or (g) a change that, as determined by the General Partner, does not materially adversely affect the limited partners.

### *Meetings*

The General Partner may call meetings of partners and will be required to convene a meeting on receipt of a request in writing of the holder(s) of not less than 10% in number of the outstanding LP Units. Each partner is entitled to one vote for each LP Unit held. A quorum at a meeting of partners consists of two or more partners present in person or by proxy.

## **The General Partner**

### *Functions and Powers of the General Partner*

Under the terms of the Partnership Agreement, Canfor Pulp Holding Inc., as General Partner, has exclusive authority to manage the business and affairs of the Partnership, to make all decisions regarding the Pulp Business and to bind the Partnership. The General Partner will exercise its powers and discharge its duties honestly, in good faith and in the best interests of the Partnership and exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances. The authority and power vested in the General Partner to manage the business and affairs of the Partnership includes all authority necessary or incidental to carry out the objects, purposes and business of the Partnership including, without limitation, the ability to engage agents to assist the General Partner to carry out its management obligations or administrative functions. The General Partner cannot dissolve the Partnership or wind-up the Partnership's affairs, except in accordance with the provisions of the Partnership Agreement.

### *Withdrawal or Removal of the General Partner*

The General Partner may resign on not less than 180 days' written notice to the limited partners of the Partnership, provided that the General Partner will not resign if the effect would be to dissolve the Partnership. The General Partner may not be removed as general partner of the Partnership unless:

- the General Partner has committed a material breach of the Partnership Agreement, which breach has continued unremedied for 30 days after notice, and that removal is also approved by a Special Resolution of the partners of the Partnership;
- the shareholders or directors of the General Partner pass a resolution in connection with the bankruptcy, dissolution, liquidation or winding-up of the General Partner; or
- the General Partner commits certain other acts of bankruptcy or ceases to be a subsisting corporation, provided that certain other conditions are satisfied, including a requirement that a successor general partner with the same ownership and governance structure at the relevant time agrees to act as general partner under the Partnership Agreement.

## **PROMOTERS**

Canfor may be considered a promoter of the Fund by reason of its initiative in organizing the business and affairs of the Fund.

## **LEGAL PROCEEDINGS**

There are no material legal or regulatory proceedings that in the opinion of management could have a material adverse impact on the financial condition of the Fund or the Partnership.

## INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Other than as set out under "Material Contracts" or described elsewhere in this AIF, none of the directors, trustees or executive officers, as applicable, of (a) the Fund, the Trust, the Partnership or Canfor, or (b) any associate or affiliate of the persons referred to in (a), has or has had any material interest, direct or indirect, in any transaction within the past three years or in any proposed transaction that has materially affected or will materially affect the Fund, the Trust, the Partnership or any of their subsidiaries.

## TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Fund is CIBC Mellon Trust Company at its principal transfer offices located in Vancouver and Toronto.

## MATERIAL CONTRACTS

The only material contracts entered into by any of the Fund, the Trust, or the Partnership, other than in the ordinary course of business, are as follows:

1. the Fund Declaration referred to under "Business of the Fund" and "Description of Legal Structure – The Fund";
2. the Trust Declaration referred to under "Business of the Trust" and "Description of Legal Structure – The Trust";
3. the Note Indenture referred to under "Description of Legal Structure – The Trust – Trust Notes";
4. the Partnership Agreement referred to under "Description of Legal Structure – The Partnership" and "Description of Legal Structure – The General Partner";
5. the Shareholders' Agreement referred to under "Acquisition, Liquidity, Support and Security Holder Agreements – Shareholders' Agreement";
6. the Exchange Agreement referred to under "Acquisition, Liquidity, Support and Security Holder Agreements – Exchange Agreement";
7. the Acquisition Agreement referred to under "Acquisition, Liquidity, Support and Security Holder Agreements – Acquisition Agreement";
8. the Fibre Supply Agreement referred to under "The Pulp and Paper Business of the Partnership – Fibre Supply – Fibre Supply Agreement";
9. the Cogeneration Agreement, and amended Cogeneration Agreement referred to under "The Pulp and Paper Business of the Partnership – Energy – Cogeneration Agreement", and under "Risk Factors – Risks Related to the Pulp Business and Industry – Obligations to BC Hydro";
10. the Chemical Supply Agreement referred to under "The Pulp and Paper Business of the Partnership – Chemicals";
11. the Fund Support Agreement referred to under "Acquisition, Liquidity, Support and Security Holder Agreements – Fund Support Agreement";
12. the Partnership Services Agreement referred to under "Acquisition, Liquidity, Support and Security Holder Agreements – Partnership Services Agreement";

13. a note purchase agreement dated November 30, 2006 (the "Term Facility") between the Partnership and certain institutional investors in the United States under which the Partnership sold US\$110 million of unsecured notes (the "Notes"). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013.

The Term Facility requires compliance with covenants that could, in certain circumstances, restrict the Partnership's ability to incur additional indebtedness, make distributions to partners, dispose of assets, or require the pledging of assets to the lenders as security. The principal financial covenants require that, on a quarterly basis, the Partnership's Net Debt/EBITDA ratio remains at less than 3.25:1 and Interest/EBITDA ratio remains at greater than 2.5:1.

14. a \$40 million unsecured bank credit facility (the "Bank Facility"), referred to under "Risk Factors – Risks related to the Structure of the Fund – Leverage and Restrictive Covenants in Agreements Related to Indebtedness". The Bank Facility was entered into on September 30, 2009 and matures on November 30, 2011.

The Bank Facility bears interest and fees at rates that vary depending on prevailing market rates. The leverage ratio and the interest coverage ratio covenants under the Bank Facility remain consistent with the financial covenants under the Term Facility.

15. a Standby Letter of Credit secured by a credit facility to BC Hydro under the amended Cogeneration Agreement (**Hydro LOC Facility**), referred to under "Risk Factors – Risks related to the Structure of the Fund – Leverage and Restrictive Covenants in Agreements related to Indebtedness", and under "Risk Factors – Risks Related to the Pulp Business and Industry – Obligations to BC Hydro". This Standby Letter of Credit is currently issued for \$16.0 million and the facility expires on November 30, 2011.
16. the Labour Agreements referred to under "The Pulp and Paper Business of the Partnership – Human Resources". The Labour Agreements are for terms of four years expiring on April 30, 2012.

## INTERESTS OF EXPERTS

PricewaterhouseCoopers LLP are auditors of the Fund and have advised that they are independent with respect to the Fund within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia as of January 28, 2010.

## ADDITIONAL INFORMATION

Additional information relating to the Issuer may be found on the System for Electronic Documents Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com) and on the Partnership's web site at [www.canforpulp.com](http://www.canforpulp.com).

Additional information, including trustees', directors' and officers' remuneration and indebtedness, principal holders of the Fund's securities authorized for issuance under equity compensation plans are contained in the Fund's information circular for its annual meeting of Unitholders of the Fund. Additional financial information is provided in the Fund's financial statements and management's discussion and analysis for the periods ended December 31, 2009.

The Fund will, upon request to the Secretary of the Fund, 1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia V6P 6G2, provide to any person or company, the documents specified below:

- (a) when the Fund is in the course of a distribution of its securities under a short form prospectus, or has filed a preliminary short form prospectus in respect of a proposed distribution of its securities:
- (i) one copy of the Fund's latest annual information form, together with one copy of any document or the pertinent pages of any document, incorporated therein by reference;
  - (ii) one copy of the comparative consolidated financial statements of the Fund for the most recently completed financial year for which financial statements have been filed, together with the auditors' report thereon, and one copy of any interim financial statements of the Fund for any period after its most recently completed financial year;
  - (iii) one copy of the information circular of the Fund in respect of its most recent annual meeting of shareholders that involved the election of trustees or one copy of any annual filing prepared instead of that information circular, as appropriate; and
  - (iv) one copy of any other documents that are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under subparagraphs (i) to (iii); or
- (b) at any other time, the Fund shall provide to any person or company one copy of any of the documents referred to in subparagraphs (a)(i), (ii) and (iii) above, provided that the Fund may require the payment of a reasonable charge if the request is made by a person or company who is not a holder of the Fund's securities.

## GLOSSARY OF TERMS

In this Initial Annual Information Form, the following terms shall have the meanings set forth below, unless otherwise indicated:

"**Acquisition**" means the transfer of the Pulp Business from CFP to the Partnership;

"**Acquisition Agreement**" means the asset purchase agreement between Canfor and the Partnership dated as of the Effective Date, setting out the terms of the Acquisition;

"**AAC**" means allowable annual cut;

"**Adjusted Distributable Cash**" means, for any given period, Standardized Distributable Cash prior to the effects of changes in non-cash working capital and long-term deferred maintenance, and after provision for accrued capital expenditures and provision for current asset retirement obligation expenditures and accruals.

"**amended Cogeneration Agreement**" means, the Cogeneration Agreement plus the amendments made to this agreement as of September 15, 2009;

"**ADMT**" means an air-dried metric tonne;

"**AIF**" means this Annual Information Form;

"**Bank Facility**" means a \$40 million bank credit facility entered into by the Partnership on September 30, 2009, and maturing on November 30, 2011;

"**Business Day**" means a day, other than a Saturday, Sunday or statutory holiday, when banks are generally open in Vancouver, British Columbia for the transaction of banking business;

"**Canfor**" means Canfor Corporation, a company incorporated under the laws of British Columbia and, unless otherwise indicated or the context otherwise requires, includes its subsidiaries and interests in joint ventures and other entities or any two of them or more, collectively;

"**CBCA**" means the *Canada Business Corporations Act*, as amended, and the regulations there under;

"**CDS**" means The Canadian Depository for Securities Limited;

"**CFP**" means Canadian Forest Products Ltd., a wholly-owned subsidiary of Canfor, incorporated under the laws of British Columbia;

"**Chemical Supply Agreement**" means the long-term, sodium chlorate supply agreement between Chemtrade and Canfor, which was assigned by Canfor to the Partnership after the Effective Date;

"**Chemtrade**" means Chemtrade Pulp Chemicals Limited Partnership;

"**Class A LP Units**" means the class A units of the Partnership;

"**Class B Exchangeable LP Units**" means the class B exchangeable units of the Partnership;

"**Cogeneration Agreement**" means the agreement between BC Hydro and Canfor relating to the Cogeneration Project, which was assigned to the Partnership after the Effective Date;

"**Cogeneration Project**" means the cogeneration project described in more detail in "The Pulp and Paper Business of the Partnership – Energy – Cogeneration Agreement";



"**Commissions**" means the securities commission or other securities regulatory authority in each of the provinces and territories of Canada;

"**CRA**" means the Canada Revenue Agency;

"**Credit Facilities**" means the Term Facility, the Bank Facility, and the Hydro LOC Facility;

"**EBITDA**" means net earnings adjusted to exclude amortization of property, plant and equipment, other amortization, interest expense, transaction costs, income taxes, and other non-operating income and expenses;

"**Effective Date**" means July 1, 2006, the date upon which the plan of arrangement became effective pursuant to which the Spinout was effected;

"**EPA**" means the Electricity Purchase Agreement entered into with BC Hydro as of September 15, 2009 with a term of 10 years;

"**ERISA**" means the *United States Employee Retirement Security Act of 1974*, as amended;

"**Exchange Agreement**" means the exchange agreement among CFP, the Fund, the Trust, the General Partner and the Partnership dated as of the Effective Date containing, among other things, the procedure through which the Class B Exchangeable LP Units may be exchanged for Fund Units;

"**Fibre Supply Agreement**" means the fibre supply agreement between Canfor and the Partnership dated as of the Effective Date;

"**Fund**" means Canfor Pulp Income Fund, an unincorporated open-ended limited purpose trust established pursuant to the Fund Declaration under the laws of the Province of Ontario;

"**Fund Declaration**" means the declaration of trust made as of April 19, 2006, governed by the laws of the Province of Ontario, pursuant to which the Fund was established, as amended, supplemented, restated or replaced from time to time;

"**Fund Support Agreement**" means the fund support agreement between the Fund, the Trust, the Partnership, and the General Partner dated as of the Effective Date;

"**Fund Trustee**" means a trustee from time to time of the Fund;

"**Fund Units**" means the trust units of the Fund, each trust unit representing an equal undivided beneficial interest in the Fund;

"**GAAP**" means generally accepted accounting principles;

"**General Partner**" means Canfor Pulp Holding Inc., a corporation incorporated under the laws of Canada;

"**GTP**" means the Pulp and Paper Green Transformation Program announced by the Canadian government on June 17, 2009.

"**GP Interest**" means the undivided nominal interest of the General Partner in the Partnership;

"**GP Shares**" means common shares of the General Partner;

"**Hydro LOC Facility**" means the separate credit facility which secures the standby letter of credit issued to BC Hydro, under the amended Cogeneration Agreement;

"**Kraft Paper**" means bleached and unbleached kraft paper;

"**LP Units**" means the limited partnership units of the Partnership, consisting of Class A LP Units and Class B Exchangeable LP Units;

"**Mills**" means, collectively, the Intercontinental Pulp Mill, Northwood Pulp Mill and Prince George Pulp and Paper Mill, and ancillary assets;

"**NBSK Pulp**" or "**NBSK**" means northern bleached softwood kraft pulp;

"**Non-Residents**" means non-residents of Canada within the meaning of the Tax Act;

"**Note Indenture**" means the note indenture entered into on or prior to the Effective Date between the Trust and CIBC Mellon Trust Company, as trustee thereunder, pursuant to which the Trust will issue the Trust Notes, as amended, supplemented, restated or replaced from time to time;

"**ODT**" means oven-dried metric tonnes;

"**Partnership**" means Canfor Pulp Limited Partnership, a limited partnership formed under the laws of the Province of Manitoba;

"**Partnership Agreement**" means the limited partnership agreement made as of April 19, 2006 between CFP and the General Partner governed by the laws of the Province of Manitoba, as amended, supplemented, restated or replaced from time to time;

"**Partnership Interest**" of any person means the percentage of the outstanding LP Units held by that person;

"**Partnership Services Agreement**" means the partnership services agreement between the Partnership and Canfor dated as of the Effective Date, under which Canfor provides certain operational and transitional services to the Partnership;

"**person**" means any individual, partnership, firm, trust, body corporate, government, governmental body, agency or instrumentality, unincorporated body of persons or association;

"**PGP&P**" means the Prince George Pulp and Paper Mill;

"**Plans**" means registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans, collectively;

"**Promissory Note**" means the promissory note in the principal amount of \$125 million issued by the Partnership to Canfor as partial consideration for the Partnership's acquisition of the Pulp Business;

"**Pulp Business**" means Canfor's NBSK pulp and paper business, primarily consisting of owning and operating the Mills, which business was acquired by the Partnership under the Acquisition Agreement;

"**PPPC**" means the Pulp and Paper Products Council, an alliance of product associations serving an international membership in the pulp and paper industry, based in Montreal, Canada;

"**Qualified Purchaser**" has the meaning set forth in Section 2(a)(51)(A) of the 1940 Act;

"**Redemption Date**" means the date upon which Fund Units are surrendered for redemption;

"**Redemption Price**" means the price to which a Unitholder is entitled upon the surrender of its Fund Units on the exercise of its redemption rights;

"**Registered Canfor Shareholder**" means a registered holder of Canfor Shares;

"**RISI**" means RISI, a leading information provider for the forest products industry owned by United Business Media and Pegasus Capital Advisors L.P., originally founded as Resource Information Systems Inc. in 1985;

"**SEDAR**" means the System for Electronic Documents Analysis and Retrieval;

"**Shareholders' Agreement**" means the unanimous shareholders' agreement dated as of the Effective Date between Canfor, the Fund, the Trust, the General Partner, and the Partnership;

"**Special Resolution**" means a resolution passed by at least two thirds of the votes cast by holders of Fund Units;

"**Standardized Distributable Cash**" is defined under the Canadian Institute of Chartered Accountants interpretive release in July 2007, which for the purposes of the Partnership is defined as the periodic cash flows from operating activities, including the effects of changes in non cash working capital less cash capital expenditures, as reported in the GAAP financial statements for the Partnership.

"**Spinout**" means the transaction pursuant to which Canfor initially distributed Fund Units to shareholders of Canfor;

"**Tax Act**" means the *Income Tax Act* (Canada), as amended, and the regulations there under;

"**Term Facility**" means the private placement of US\$110 million senior notes, due in full in 2013, entered into by the Partnership on November 30, 2006, the proceeds of which were used to repay the Promissory Note;

"**Trust**" means Canfor Pulp Trust, an unincorporated trust established pursuant to the Trust Declaration under the laws of the Province of Ontario;

"**Trust Declaration**" means the declaration of trust made as of April 19, 2006, governed by the laws of the Province of Ontario, pursuant to which the Trust was established, as amended, supplemented, restated or replaced from time to time;

"**Trust Notes**" means the notes issued by the Trust from time to time in accordance with the Note Indenture;

"**Trust Trustee**" means a trustee from time to time of the Trust;

"**Trust Units**" means the trust units of the Trust, each trust unit representing an equal undivided beneficial interest therein;

"**TSX**" means the Toronto Stock Exchange;

"**United States**" or "**US**" means the United States of America and any territory or possession thereof;

"**Unitholder**" and "**Unitholders**" means the holders from time to time of Fund Units;

## Appendix "A"

### AUDIT COMMITTEE: TERMS OF REFERENCE

#### 1. Purpose

The Audit Committee is appointed by the Board to assist the Board in fulfilling its oversight responsibilities. The Audit Committee will:

- (a) Review the financial reports and other financial information provided by the General Partner to its unitholders;
- (b) Monitor the integrity of the financial reporting process and the system of internal controls that management and the Board have established;
- (c) Monitor the management of the principal risks that could impact the financial performance of the General Partner, including the distribution policy;
- (d) Review and receive the Audit Plan, process, results and performance of the General Partner's independent external auditors and the internal audit department while providing an open avenue of communication between the external auditors, the internal auditors, risk manager, management and the Board;
- (e) Monitor the management of risk by the General Partner generally; and
- (f) Review and assess capital expenditures exceeding \$2.5 million including AFE's, economic assumptions, economic benefits, and strategic value to the General Partner.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities and it has direct access to the external auditors as well as anyone in the organization. The Audit Committee has the authority to retain, at the General Partner's expense, special legal, accounting and other consultants or experts it deems necessary in the performance of its duties.

#### 2. Audit Committee Composition and Meetings

All members of the Audit Committee must be Independent Directors.

All Audit Committee members must be financially literate with the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the General Partner's financial statements. At least one Audit Committee member should have accounting or related financial expertise, including:

- (a) an understanding of financial statements and accounting principles used by the General Partner to prepare its financial statements;
- (b) the ability to assess the general application of such accounting principles in connection with accounting for estimates, accruals and reserves;
- (c) experience preparing, auditing, analyzing or evaluating financial statements, or experience supervising the preparation, audit, analysis or evaluation of financial statements, that present a breadth and level of complexity of accounting issues that are

generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the General Partner's financial statements;

- (d) an understanding of internal controls and procedures for financial reporting; and
- (e) an understanding of audit committee functions.

A Chair shall be appointed by the Board annually from among the members of the Audit Committee.

The Audit Committee shall schedule regular meetings and shall meet at least four times annually, or more frequently as deemed necessary by the Chair. The Chair shall prepare and/or approve an agenda in advance of each meeting.

The Chief Executive Officer, the Chief Financial Officer and the external auditors shall be given notice of, and have the right to appear before and to be heard at, every meeting of the Audit Committee, and shall appear before the Audit Committee when requested to do so by the Committee.

### **3. Primary Duties and Responsibilities**

To fulfill its primary duties and responsibilities, the Audit Committee shall adhere to the following terms:

#### **(a) Review and Reporting Procedures**

- (i) The Audit Committee is authorized to review and/or investigate any financial, internal control, or risk management related issue or activity of the General Partner. The Audit Committee shall report to the Board at its next regular meeting all such action it has taken since the previous report.
- (ii) The Audit Committee is authorized to request the presence, at any meeting, of a representative from the external auditors, senior management, internal audit, legal counsel, or anyone else who could contribute to the subject of a meeting.
- (iii) The Audit Committee will review and reassess these Terms of Reference at least annually to determine whether revisions are necessary. The Audit Committee shall periodically self-assess its performance and effectiveness in fulfilling its role.
- (iv) Supporting schedules and information reviewed by the Committee will be available for examination by any director of the Audit Committee upon request to the Secretary of the Audit Committee.

#### **(b) Internal Controls and Risk Management Processes**

To assure itself that the General Partner has appropriate controls in place to achieve the following objectives:

- (i) Effectiveness and efficiency of operations (including safeguarding of assets);
- (ii) Reliability of internal and external reporting;
- (iii) Compliance with applicable laws and regulations and internal policies.

To ensure the General Partner has appropriate processes in place to manage the principal risks of its businesses, the Audit Committee shall:

- (iv) Consider and review internal processes for managing the principal risks of the General Partner's businesses, including a review of insurance coverage and hedging activities.
- (v) Obtain assurance from management regarding the adequacy of risk management processes.
- (vi) Review with management and the external auditor:
  - The adequacy of the General Partner's internal controls including computerized information systems, controls and security.
  - Any related significant internal control findings and recommendations of the external auditor, together with management's responses thereto.
  - The General Partner's compliance or adherence to debt covenants, terms or conditions.
  - Significant related party transactions and potential conflicts of interest

(c) **Financial Reporting**

In order to satisfy itself that the General Partner's annual financial statements are fairly presented in accordance with generally accepted accounting principles ("GAAP") and in a form sufficient for the Audit Committee's recommendation for approval by the Board, and that the financial information contained in the General Partner's financial statements, Annual Report to Unitholders, Annual Information Form and other financial disclosure documents such as Management's Discussion and Analysis, is complete and accurate in all material respects, the Audit Committee shall:

General

- (i) Review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements.

Interim Financial Statements

- (ii) Review the General Partner's interim financial statements with management prior to their release or distribution. This review will include a detailed reporting of quarterly and year-to-date results, variance against budget and prior year and a discussion with the external auditor. Upon satisfactory completion of the review, the Audit Committee shall recommend to the Board approval of the financial statement release.
- (iii) Review any significant proposed changes to the General Partner's accounting principles or policies, or financial reporting practices.
- (iv) Review the financial statement impact of any significant, unusual event or transaction.

- (v) Review news releases containing financial information disclosure and Management's Discussion and Analysis.

#### Annual Financial Statements and Other Financial Information

- (vi) Obtain draft annual financial statements in advance of the Committee meeting and assess, on a preliminary basis, the reasonableness of the financial statements in light of the analyses provided by management.
- (vii) Review any material changes in accounting policies, GAAP, or financial reporting requirements that may affect the current year's financial statements.
- (viii) Obtain and review summaries of significant or unusual transactions, and other potentially complex matters whose treatment in the annual financial statements merits advance consideration.
- (ix) Review a summary provided by the General Partner's legal counsel of the status of any material pending or threatened litigation, claims and assessments.
- (x) Review and discuss the annual financial statements and the external auditor's report thereon in detail with management and the external auditors.
- (xi) Through discussion with management and the external auditors, obtain assurance that the risk of material misstatement of the financial statements is acceptably low.
- (xii) Review the financial information included in the Management's Discussion and Analysis, and consider whether the information is adequate and consistent with the Audit Committee member's knowledge of the General Partner.
- (xiii) Review the tax status of the General Partner and understand the status of any related tax reserves, potential reassessments or other matters which could affect the annual financial statements.
- (xiv) Review and assess the quality and appropriateness of the General Partner's accounting and reporting principles and policies.
- (xv) Provide to the Board a recommendation as to whether the annual financial statements should be approved.
- (xvi) Review the news release announcing the annual financial results of the General Partner.
- (xvii) Review the annual financial disclosure contained in the Annual Information Form.

#### Prospectus and Information Circulars

- (xviii) Review the financial information included in any prospectus or information circular prior to their release and, as appropriate, recommend to the Board whether such prospectus or information circular should be approved by the Board.

**(d) External Audit**

The external auditors are accountable to the Audit Committee and the Board as representatives of the unitholders.

In order to assure itself that the external audit function has been effectively carried out and that any matters that the external auditors consider appropriate to bring to the attention of the Board have been addressed, the Audit Committee shall:

- (iv) Recommend to the Board the selection (retention or replacement) of the external auditors, considering independence and effectiveness, and approve the fees and other compensation to be paid to the external auditors. On an annual basis, the Audit Committee should review and discuss with the external auditors all significant relationships its accountants have with the General Partner to confirm their independence. If there is a recommendation to change auditors, review all the issues to change and the steps planned for an orderly transition.
- (v) Review the external auditor's Audit Plan and engagement letter with management and the external auditors, including audit scope and approach.
- (vi) Meet with the external auditor and management in separate private sessions to discuss any matters that the Audit Committee or these groups believe should be discussed privately with the Audit Committee.
- (vii) Pre-approve any non-audit services to be provided by the external auditor. The Audit Committee may delegate this responsibility to the Chair and provided that any pre-approval granted pursuant to such delegation must be detailed as to the service to be provided and must be reported to the full Audit Committee at its next scheduled meeting
- (viii) Review and assess the performance of the external auditor, including consideration of demonstrated external audit judgment and application and adherence to accounting policy and standards.
- (ix) Review the external auditor's policy on partner rotation.

**(e) Finance**

The Audit Committee is authorized to review and approve for recommendation to the Board:

- (i) the General Partner's annual financing plan and any amendments thereto from time to time;
- (ii) any proposed financings;
- (iii) the method by which the General Partner measures financial results or performance; and
- (iv) post audit or follow up reviews of capital projects.



#### 4. Other Duties

##### (a) Legal and Regulatory Compliance

To provide assurance of General Partner compliance with all legal and regulatory requirements, the Audit Committee shall:

- (i) In areas in which it has oversight responsibility, monitor the General Partner's compliance and obtain management's assurance of compliance with applicable laws, regulations, and internal policies in all jurisdictions where the General Partner does business. The Audit Committee will consider the financial statement implications of applicable laws and regulations, including the laws and regulations overseen by other Committees of the Board.
- (ii) Receive and review copies of legal letters provided to the external auditors by in-house and outside counsel regarding claims and possible claims against the General Partner.
- (iii) Make inquiries of management and the external auditors to ensure that all material legal matters have been brought to the attention of the Audit Committee.
- (iv) On at least an annual basis, review with the General Partner's counsel any legal matters that could have a significant impact on the organization's financial statements or risk profile, the General Partner's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.
- (v) Ensure that all annual and interim financial statement filings are personally certified by the Chief Executive Officer and the Chief Financial Officer if and as required by applicable law.
- (vi) Review the General Partner's procedures and establish procedures for the Audit Committee for the:
  - receipt, retention and resolution of complaints regarding accounting, internal accounting controls, financial disclosure or auditing matters; and
  - confidential, anonymous submission by employees regarding questionable accounting, auditing, or financial reporting and disclosure matters.

##### (b) Pension Funds

Be responsible for oversight of the supervision of the pension plans in which the General Partner employees participate by:

- (i) receiving, at least annually, a report from the Committee of the Canfor Board which has oversight responsibility over the relevant pension plans (the "Canfor Committee"), detailing the performance of the plans' money managers and the investment policies and practices in respect of the funds contributed to the General Partner's pension plans;
- (ii) reviewing actuarial reports in respect of the General Partner's pension obligations so as to determine the level of unfunded liabilities, if any; and

(iii) receive a report from the Canfor Committee immediately upon the identification or disclosure of any issue or circumstance that may materially impact the General Partner's obligations, liabilities, or responsibilities with respect to such pension plans.

(c) **Officer Expenses**

Review policies and procedures with respect to the Chairman of the Board and President and Chief Executive Officer's expense accounts and perquisites, including the use of corporate assets.

Periodically review major expenses incurred by the office of the Chairman of the Board and President and Chief Executive Officer.

(d) **Other Duties**

The Audit Committee will perform such other functions as assigned by law or regulation or as required by the Board.