

Before the

ADDITIONAL FACILITY OF THE
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

Mercer International Inc.,

Claimant,

v.

Government of Canada,

Respondent.

ICSID Case No. ARB(AF)/12/3

WITNESS STATEMENT OF DAVID GANDOSSİ

I, David Gandossi, hereby declare as follows:

INTRODUCTION

1. I am Executive Vice-President, Chief Financial Officer, and Secretary for Mercer International Inc. (“Mercer”), the largest Northern Bleached Softwood Kraft (“NBSK” or “kraft”) market pulp producer in the world. My date of birth is [REDACTED] and my current address is [REDACTED]. I offer this testimony to recount my personal knowledge and experience of Mercer’s acquisition of and initial investment plans for the Zellstoff Celgar kraft pulp mill in Castlegar, Canada (“Celgar” or “Celgar Mill”).

2. My testimony is organized in the following manner: I first provide my education and professional background (Part I); I then describe Mercer International (Part II); next, I

explain the Market for NBSK Pulp (Part III); then I recount the history of the Celgar Mill before Mercer's 2004 acquisition (Part IV); I then detail Mercer's acquisition of the Celgar Mill and its plans for the property (Part V); and finally I explain both the BC Pulp and Paper Task Force (Part VI) and the BC Working Group on Pulp and Paper Self-Generation Sales (Part VII) .

I. EDUCATION AND PROFESSIONAL BACKGROUND

A. Higher Education

3. I obtained a Bachelor of Commerce Degree from the University of British Columbia in 1980. I am a chartered accountant (CPA/CA), certified in 1983.

B. Professional Experience and Experience in the Kraft Pulp Industry

4. From 1979 until 1994, I was engaged in public practice as a chartered accountant at Arthur Andersen and Pricewaterhouse Coopers. From 1994 to 1998, I was the Controller and Treasurer of Harmac Pacific, Inc., a Canadian pulp manufacturing company. And, from 1998 to 2001, I was the Chief Financial Officer, Vice-President of Finance and Secretary of Pacifica Papers, Inc., a 900,000 ton per year North American specialty pulp and paper manufacturing company.

5. I began my present career at Mercer as Executive Vice-President, CFO, and Secretary in 2003. My responsibilities include accounting and financial reporting functions, treasury functions, all banking arrangements, internal control functions, supervision of all employees in the financial and accounting departments, investor relations, corporate secretarial functions, preparation of budgets and business plans, and development of policies and programs. Through my years of experience at Mercer International, I have developed extensive knowledge of Mercer's investment plans with respect to Celgar, its operations, and the economics and financial data associated with those operations.

6. I was very involved in Mercer's decision to invest in and eventually acquire the Celgar Mill from 2003, when we first learned of the opportunity to buy the mill, through 2004, when we conducted due diligence and acquired the mill from the banks that owned it.

7. Through my membership in different advisory committees and task forces, I also have developed a thorough understanding of the pulp industry in British Columbia. From 2007 to the present, I have served as Chair of the British Columbia Pulp and Paper Joint Task Force, a government, industry, and labour effort formed to identify measures to renew British Columbia's pulp and paper industry.

8. I also have been a member of the Pulp and Paper Advisory Committee to the BC Competition Counsel and was on BC's Working Roundtable on Forestry and the UBC Faculty of Forestry Advisory Committee. I am currently a Director of FPInnovations and Chair of the FPInnovations National Research Advisory Committee, a research institute focused on the Canadian forest products industry. I also co-chair the BC Bio-economy Transformation Council, a collaborative effort between the British Columbia government and industry.

II. MERCER INTERNATIONAL, INC.

9. Mercer is a publicly-traded United States corporation, incorporated under the laws of the State of Washington and is traded on the NASDAQ Global Market (MERC) and the Toronto Stock Exchange (MRI.U). Its registered address is as follows:

14900 Interurban Avenue South
Suite 282
Seattle, WA 98168
United States of America

10. Mercer is the largest producer of NBSK market pulp in the world, with its mills having a combined rated capacity of over 1.5 million air dried metric tons (“ADMT”).¹ In addition to controlling the Celgar Mill, Mercer also controls two NBSK pulp mills in eastern Germany: (1) Rosenthal (located near the town of Blankenstein) and Stendal (located near the town of Stendal). Mercer acquired its first pulp operations in 1994, with the acquisition of its Rosenthal mill and other assets in the former East Germany. Mercer then converted the mill from the production of dissolving sulfite pulp to kraft pulp. The aggregate cost was roughly €361.0 million, of which roughly €102.0 million was financed through grants from the German government to promote the revitalization of industry in the east.² In September 2004, and also with German government assistance, Mercer completed construction of the Stendal mill, a greenfield (or previously undeveloped) kraft pulp mill in the former East Germany, at an aggregate cost of approximately €1.0 billion, in which it has a 83 percent interest.³

11. Mercer was first formed as a business trust under the name “Pacific West Fund” under Washington state law on July 1, 1968.⁴ On September 28, 1971, the trust changed its name to “Pacific West Realty Trust.”⁵ On December 23, 1985, Mercer again changed its name

¹ C-252, Brian McClay & Associates Inc., Top 15 Global NBSK Market Pulp Producers, www.pulpmarket.ca.

² See C-55, Mercer International Inc., 2012 Form 10-K (15 February 2013), at 6.

³ C-57, Mercer International Inc., 2013 Form 10-K (21 February 2014), at 5.

⁴ See C-196, Secretary of State of the State of Washington, Declaration of Trust “The Pacific West Fund” (7 August 2002).

⁵ C-200, Secretary of State of the State of Washington, Amended Declaration of Trust of The Pacific West Fund Changing name to Pacific West Realty Trust (28 September 1971).

to Asiamerica Equities Ltd., and, on January 1, 1992, to its current name, Mercer International Inc.⁶

12. Mercer was subsequently reorganized through a series of amalgamations that occurred on March 1, 2006 and April 4, 2006. On March 1, 2006, Mercer International Inc. (the business trust) merged with and into Mercer Delaware Inc., a Delaware corporation.⁷ Mercer Delaware Inc. then merged with and into Mercer International Regco Inc., a Washington corporation, with the surviving corporation once again being named “Mercer International Inc.”⁸ On April 4, 2006, Zellstoff Celgar Holdings Ltd. (“ZCHL”), a Delaware corporation, merged with and into Mercer International Inc., with the surviving corporation being Mercer International Inc. and continuing its existence under the laws of the State of Washington, United States of America.⁹

13. Mercer International, Inc. remained a Washington state trust from its formation in 1968 until March 1, 2006, and has been a Washington state corporation in good standing continuously from that date through the present.¹⁰

⁶ C-201, Secretary of State of the State of Washington, Amended Declaration of Trust of The Pacific West Realty Trust Changing name to Asiamerica Equities Ltd. (23 December 1985).

⁷ See C-153, Certificate of Merger of Mercer International, Inc. with and into Mercer Delaware Inc. (1 March 2006).

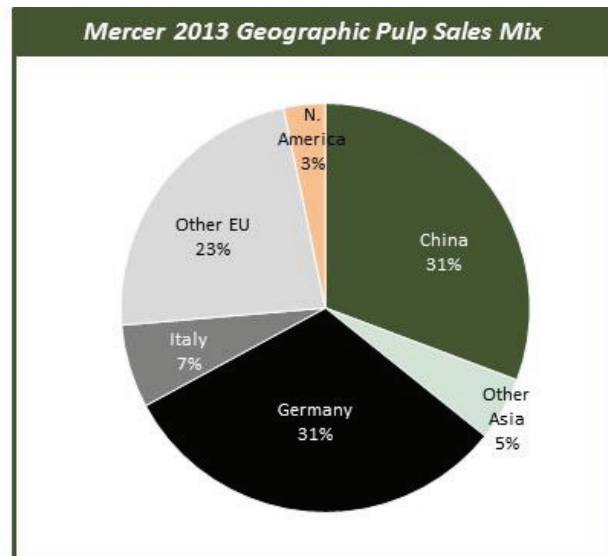
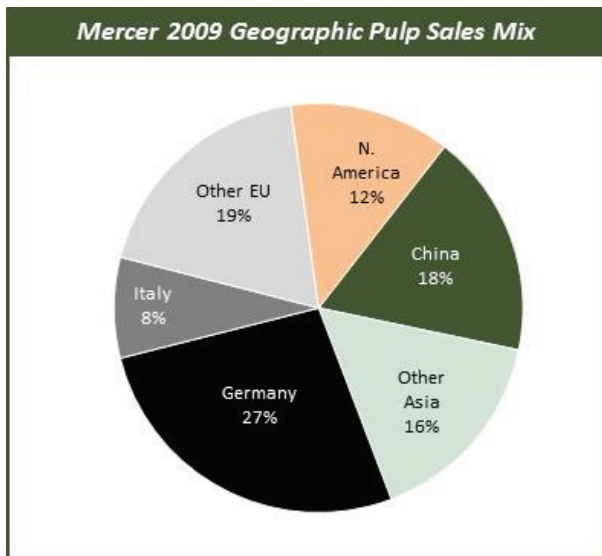
⁸ See C-199, Certificate of Merger of Mercer Delaware Inc. with and into Mercer International Regco, Inc. (1 March 2006).

⁹ See C-154, Articles of Merger of Zellstoff Celgar Holdings Ltd. and Mercer International Inc. (4 April 2006); C-155, Mercer International Inc. Certificate of Existence from Secretary of State of the State of Washington (7 January 2014).

¹⁰ See C-155, Mercer International Inc. Certificate of Existence from Secretary of State of the State of Washington (7 January 2014) (“Mercer International Inc. {,} a Washington corporation, was incorporated on July 12, 2005 and is duly authorized to transact business in the State of Washington; with a license expiration date of July, 31 2014. . .”).

III. THE MARKET FOR NBSK PULP

14. The graphs below provide insight into major NBSK pulp markets globally and show Mercer's total geographic sales mix (2009 and 2013), as well as Celgar's geographic sales mix (2009 and 2013):



15. As the charts illustrate, China [REDACTED] It is also one of the most important markets globally in the NBSK industry, as it is one of the fastest growing and

largest markets today. The Pulp and Paper Products Council estimates that 2013 NBSK pulp production will be 15.4 million tons, 41.5 percent of which will be produced in Canada. Hawkins Wright further estimates that 25 percent of global NBSK production will be produced in British Columbia.¹¹ Canada and British Columbia have held similar positions in past years and are expected to maintain their positions in future years.

A. Differences Between NBSK and other Pulp

16. Northern Bleached Softwood Kraft, called NBSK, is pulp of a premium grade known for its long, thin fibres, which provide strength and brightness to tissue and specialty paper products.¹² These fibres essentially act like “rebar” in paper products, reinforcing other lower quality fibres that make up a paper product. Hardwood trees, often grown in the southern hemisphere in areas of Asia and Latin America, have shorter fibres that do not provide products with as much strength and softness. Thus, Northern Softwood fibres are some of the best quality fibres in the pulp market. Most paper users of market kraft pulp use a mix of softwood and hardwood grades to optimize cost and performance factors.

17. Kraft, or sulphate, pulp production is a chemical form of pulp production, different from mechanical pulp production that uses a process which grinds down fibres. The chemical treatment allows the long fibres to be separated without breaking, as they would in a mechanical treatment. Cheaper hardwood fibres and mechanical pulps can be used in a variety of end-use products, although any products requiring strength characteristics will require a minimum content of NBSK. The stronger the product must be, the more NBSK content is required.

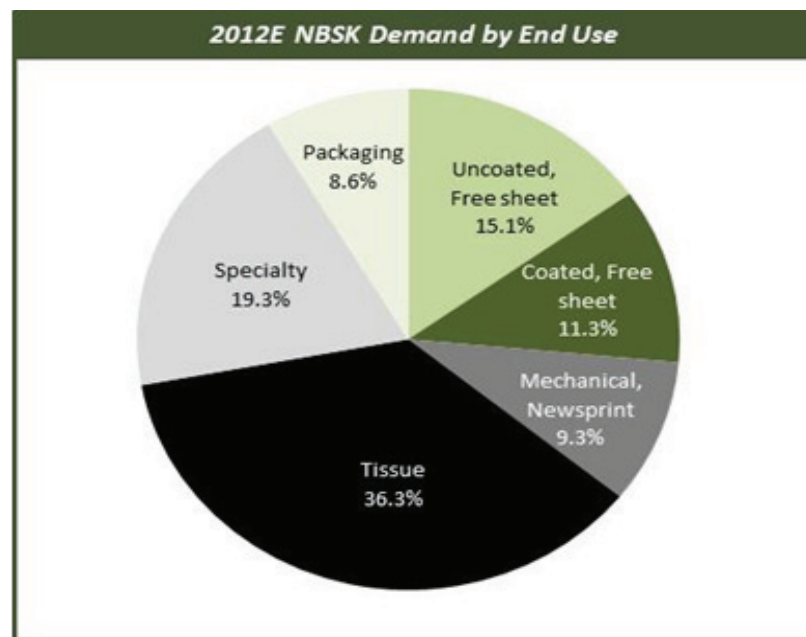
¹¹ C-260, Pulp and Paper Products Council, Supply and Demand Chemical Market Pulp (November 2013); C-261, Hawkins Wright, *Outlook for Market Pulp* (December 2013).

¹² Celgar produces NBSK pulp from trees predominant in northern regions, such as spruce, pine, fir and larch.

18. The NBSK market is growing due to the increased demand for tissue and specialty products in developing countries.

1. Nature of demand, supply, and pricing

19. Demand is growing slightly globally. Certain grades of paper in the developed world are declining due to digital substitution; however, the growth in developing countries seems to be more than offsetting this. Supply of NBSK is fairly constant as producers have announced very little new capacity. China is becoming a dominant market for NBSK. Because NBSK is the key input into tissue, NBSK has good, long-term demand fundamentals.



20. Due to the high capital costs and long lead-times required for the construction of NBSK plants, the supply of NBSK is relatively fixed in the short term. Kraft pulp mills operate on a continuous basis, which means they do not have the flexibility to “ramp up” or “slow down” production in response to changes in demand. As a result of this supply inelasticity, when the economy turns and demand falls, prices tend to plummet. The highest cost mills cannot stay

competitive and often curtail production. Pricing thus is very cyclical and margins are often tight. For example, significant producer shutdowns and curtailments, along with strong demand from China, resulted in an improved supply-demand balance and improved prices in the second half of 2009 through 2010.

IV. HISTORY OF THE ZELSTOFF CELGAR MILL: PRE-MERCER ACQUISITION

21. The Celgar Mill is located on a 400 acre site near the city of Castlegar, British Columbia, Canada. It utilizes an integrated, joint production process to produce market pulp and generate electric power.

22. The Celgar Mill first opened in a and began its first pulp operations under the ownership of the Celanese Corporation of America. As originally configured, the plant had installed little generation capacity, having only a 3.5 MW steam turbine. The mill went through a series of different owners, including the BC Government, during the 1970s and 1980s.¹³ While owned by the BC Government, the Celgar Mill became part of BC Timber Ltd, and in 1984 BC Timber Ltd. was renamed Westar Timber. In 1986, Westar sold the Celgar Mill to a joint venture of Consolidated Bathurst and Power Corporation, in alliance with Chinese International Trust and Investment Corp. (CITIC), named Power Consolidated (China) Pulp.

23. By 1989, the mill was wholly-owned by Stone Venepal (Celgar) Pulp, Inc., a joint venture of Stone Container Corp and the CITIC. At the time, British Columbia's pollution regulations had become more stringent, and the mill was one of the first in British Columbia to have a significant pollution issue, with respect to both air and effluent emissions. The company

¹³ The mill was majority or wholly-owned by the BC Government from 1973-1986. *See* C-262, Celgar Mill History Timeline. In 1973, the British Columbia Government purchased 81 percent of the mill's parent company and renamed it the Canadian Cellulose Company. *See* C-263, R. Sexty, Canadian Cellulose Company, Case Study, Institute of Public Administration of Canada, p. 3. British Columbia purchased the remaining 19 percent of the mill's parent company in 1980, and the mill became part of BC Timber Ltd. *See* C-262, Celgar Mill History Timeline.

had a decision to make: either shut down the mill as its emissions levels were no longer permitted, or reinvest and build a new mill. In that year, Stone Venepal announced that it would undertake a major revitalization of the mill.

24. By late 1993, Stone Venepal had completely rebuilt the Celgar Mill, at a cost of C\$ 850 million. The modernization, which was financed in part through a C\$ 750 million loan from the Royal Bank of Canada and National Westminster, included the installation of a new 52 MW steam turbine and generator, which became operational in 1994.¹⁴

25. By 1998, the Celgar Mill's revenues proved insufficient to cover the substantial debt taken on to rebuild the mill. On July 15, 1998, Stone Container Corp, which had acquired Consolidated Bathurst, advised the lenders that it would no longer cover the mill's cash shortfalls, and that the mill would be put into bankruptcy. The Royal Bank of Canada appointed KPMG to serve as receiver and to operate the mill until a buyer could be found. The mill operated on a caretaker basis in bankruptcy receivership from 1998 to 2005.

V. MERCER'S INVESTMENT IN THE CELGAR MILL

A. The Celgar Mill: An Investment Opportunity for Mercer, 2003-2004

1. Investment Opportunity

26. Mercer first learned of the opportunity to acquire the Celgar Mill in July 2003, [REDACTED]

[REDACTED]

[REDACTED]

27. In preparation for and after the initial visit we reviewed materials provided in KPMG's mill data room, which included organizational charts, environmental and operating permits, financial and performance data, information on capital expenditures, supply contracts,

¹⁴ In that year, the Celgar Mill's original 3.5 MW turbine also failed, and was decommissioned.

and industry surveys. We also toured the facilities and had extensive meetings with management, employees, and the receiver.

28. We conducted extensive due diligence, involving individuals from Mercer with backgrounds in finance, marketing, production, and maintenance conducted due diligence. We also engaged [REDACTED] a highly-regarded consulting and engineering company, based in Norway, to perform technical reviews on various areas. [REDACTED] is particularly strong in the pulp and paper industry, as it got its start in 1958 designing a pulp mill in Finland. [REDACTED] made several visits to the mill, first in August 2004 and again in September 2004, to evaluate capital expenditure plans, contracts, and realized transaction prices with the goal of confirming Mercer's valuation of the mill.¹⁵ Through our due diligence, we identified areas for improvement. These included energy and chemical costs savings, pulp sales improvements, and mill reliability and capacity.

29. At the conclusion of our review, we determined that the mill was a solid, well-built, but poorly run asset. Mercer appreciated that the Celgar Mill was, and had been, under receivership for over five years. This placed the Celgar Mill in a caretaker stasis, in which it refrained from the aggressive pursuit of operational improvements and investment opportunities that otherwise would be expected. We therefore felt that an acquisition at the right price would provide a means to create shareholder value through our continuous improvement of the mill in cutting costs and, in particular, by implementing best practices from our German operations.

¹⁵ See C-178, Letter from [REDACTED], and [REDACTED], to David M. Gandossi, Mercer International (1 September 2004) (outlining plan for due diligence); C-159, [REDACTED], "Project Next Step — Technical Due Diligence" for Mercer International Inc. (18 November 2004).

30. Our evaluation of the mill focused principally on the mill’s pulp production capabilities, as we wanted to determine whether an investment in the mill’s pulp production alone would make good sense. We did not separately evaluate the Mill’s potential to generate revenue from electricity sales — principally because we did not think that selling the mill’s self-generated electricity would be necessary to earn a reasonable rate of return on our investment. This being said, we knew from our experience with our German operations that increasing the mill’s electricity generation, and the reliability of such generation, could lead to increased revenues from electricity sales. Indeed, we had had good experience in selling self-generated electricity from our German mills to the local grid, resulting in significant revenues. This was a practice well-established by the world’s large, modern NBSK pulp producers at the time.

31. [REDACTED] prepared a fairness opinion to support our recommendations to our board regarding the acquisition of the Celgar Mill. The fairness opinion assessed whether the consideration we planned to pay for the mill was justified. To make this assessment, [REDACTED] reviewed past financial statements from the Celgar Mill, financial forecasts, and other data.¹⁶

32. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

33. On November 19, 2004, the board reviewed presentations prepared by Mercer management, the [REDACTED] report, and the [REDACTED] fairness opinion. The

¹⁶ C-179, [REDACTED] Fairness Opinion Presentation.

¹⁷ C-159, [REDACTED] “Project Next Step — Technical Due Diligence for Mercer International Inc. (18 November 2004).

board gave the approval to execute on the acquisition on November 21, 2004. Unfortunately, the initial negotiations did not go well, and we abandoned our [REDACTED]

[REDACTED] Nonetheless, we remained interested in the asset. In 2004, we reached out to the banks that owned the mill [REDACTED] and again expressed our interest in the mill. We eventually engaged in negotiations with the banks, and agreed to acquire the mill.

2. *Mercer's Vision for the Celgar Mill*

34. Building upon the success Mercer experienced with its investment in and transformation and improvement of the Rosenthal Mill in Germany, Mercer considered the Celgar Mill an excellent opportunity. We wanted to transform and improve another pulp mill and its cogeneration operation to enhance operations to the world class capacity and efficiency standards set by the Rosenthal (and Stendal) mills, while improving profitability and creating value for its stakeholders. Focused on NBSK pulp production, we aimed to operate large, modern facilities, enhance them through continuous improvements, and increase our customer base through geographic expansion and diversification.¹⁸

35. Our strategy was to make the acquisition at a good price and to start the work of making Celgar the best it could be. We identified [REDACTED]¹⁹ in profit improvement initiatives, including debottlenecking capital projects, energy and chemical savings, and improving the mills marketing strategy.²⁰ We created a plan to increase mill reliability through

¹⁸ C-182, PowerPoint Presentation titled Mercer International Inc.: Analyst Day (8 December 2004).

¹⁹ C-182, PowerPoint Presentation titled Mercer International Inc.: Analyst Day (8 December 2004).

²⁰ See C-183, Letter from [REDACTED] to Competition Bureau, Industry Canada (10 December 2004) at 2-3.

improved efforts to conduct predictive and preventative maintenance and incident reporting aimed at increasing the mill's reliability to 90 percent by 2007.²¹

36. Our evaluation was that the mill was a good investment based on the pulp operation alone. Of our three pulp mills, the Celgar mill would be the cheapest in terms of the net investment per ton, with acquisition costs well below the relative costs of acquiring or constructing our two German Mills.²² It also had a very competitive cost position when compared with other North American mills. However, our rule of thumb was that each additional ton of pulp the mill should produce fuel to generate an additional megawatt of electricity. Celgar's capacity fit well with the Mercer International strategy of maintaining world class assets that were net producers of electricity.²³

37. As we improved the capacity and reliability of the Mill, Celgar was able to generate more electricity on a more consistent and stable basis. As a result, relatively early on in our ownership, we increased sales of electricity. Towards the end of 2005, we were selling roughly 1,500 MWh to FortisBC each month, and our total sales for the year were roughly 24,000 MWh.²⁴ These all were non-firm sales of power in excess of the Mill's own needs, that flowed onto FortisBC's system without the need for scheduling. We received around [REDACTED], a price tied to the Rate Schedule 3808 price FortisBC paid to BC Hydro.

²¹ C-184, Zelstoff Celgar Ltd., Presentation titled Mercer International: Management Team Meeting (17 August 2005).

²² C -182, PowerPoint Presentation titled Mercer International Inc.: Analyst Day (8 December 2004) at 45.

²³ C -182, PowerPoint Presentation titled Mercer International Inc.: Analyst Day (8 December 2004).

²⁴ C-186, Zelstoff Celgar Ltd., Monthly Report November 2005 (13 December 2005); C-187, Zelstoff Celgar Ltd., Monthly Report December 2005 (13 January 2006).

B. Mercer's Acquisition of the Celgar Mill, 2004-2005

38. Mercer presently owns and operates the Celgar industrial plant, through its wholly-owned subsidiaries, Zellstoff Celgar Limited and Zellstoff Celgar Limited Partnership.

39. On October 22, 2004, Mercer incorporated Zellstoff Celgar Limited ("ZCL"), a BC corporation, to act as the acquiring company for the purchase of the Celgar mill.²⁵ At all relevant times, Mercer (or its predecessor, the business trust), has wholly-owned and controlled ZCL.²⁶

ZCL's registered address is as follows:

925 West Georgia Street
Suite 1000
Vancouver, BC
V6C 3L2
Canada

40. On February 14, 2005, ZCL acquired the land and all the assets of the Celgar mill from Stone Venepal for US\$210 million.²⁷

41. Zellstoff Celgar Limited Partnership ("ZCLP") is a partnership registered under British Columbia law on January 10, 2006.²⁸ On January 10, 2006, ZCL entered into a limited partnership agreement, with itself as the general partner, to form ZCLP.²⁹ Through a series of

²⁵ On October 22, 2004, Mercer incorporated a BC corporation, 0706906 BC Ltd. to act as the acquiring company for the purchase of the Celgar mill. *See* C-156, Central Securities Register, "Zellstoff Celgar Limited." Mercer wholly-owned this company. *See* C-156, Central Securities Register, "Zellstoff Celgar Limited." On February 14, 2005, 0706906 BC Ltd. changed its name to Zellstoff Celgar Limited. *See* C-197, British Columbia Ministry of Finance Corporate and Personal Property Registries, Certificate of Change of Name, No. BC0706906 (14 February 2005).

²⁶ *See* C-156, Central Securities Register, "Zellstoff Celgar Limited."

²⁷ ZCL paid an additional US\$16 million for Stone Venepal's defined working capital. *See* C-55, Mercer International Inc., 2012 Form 10-K (15 February 2013) at 7.

²⁸ C-198, Zellstoff Celgar Limited Partnership, Certificate of Limited Partnership (10 January 2006), ¶ 10.

²⁹ C-54, Limited Partnership Agreement Between Zellstoff Celgar Limited and Zellstoff Celgar Holdings, Ltd. (10 January 2006).

transactions, ZCL transferred the Celgar Mill to ZCLP on March 1, 2006.³⁰ ZCL retained legal title to the land, which it holds in trust for ZCLP.³¹ ZCLP was created for tax efficiency purposes as part of a restructuring of the way Mercer held the Celgar Mill's assets.³² ZCL is the sole general partner, and receives 0.10 percent of the partnership's profits in consideration for acting as general partner.³³ Mercer is the sole limited partner, and owns 100 percent of ZCLP's capital and receives 99.90 percent of its profits.³⁴

C. Mercer Finances Celgar Green Energy Project Through Recession

42. In 2006, Celgar commissioned [REDACTED] to conduct a PINCH analysis, which is a systematic procedure for investigating the energy flows in a given industrial process,

³⁰ Zellstoff Celgar Holdings Ltd. ("ZCHL") was incorporated under BC law on August 9, 2005. C-267, British Columbia Registrar of Companies, Certificate of Incorporation for Zellstoff Celgar Holdings, Ltd., No. BC0732008 (9 August 2005). From January 10, 2006 to April 4, 2006, it held 2,697,739 limited partnership units of ZCLP, comprising 100 percent of such units. C-268, Unitholders Register for Zellstoff Celgar Limited Partnership (4 April 2006). ZCHL continued transferred its corporate seat from British Columbia to Delaware on March 1, 2006. C-271, Letter from Registrar of Companies to Cheryl Cruickshank re the continuation of Zellstoff Celgar Holdings Ltd. to the jurisdiction of Delaware (1 March 2006). ZCHL filed a Certificate of Domestication, pursuant to which it provided certain information, referenced the consents and contemporaneously filed a Certificate of Incorporation that complied with Delaware requirements. C-274, Certification of Harriet Smith Windsor that the Certificate of Incorporation and Certificate of Domestication of Zellstoff Celgar Holdings were filed on March 1, 2006. Mercer International Inc. acquired its units of ZCLP on April 4, 2006, through amalgamation with ZCHL. C-268, Unitholders Register for Zellstoff Celgar Limited Partnership (4 April 2006). For a brief period of time on March 1, 2006, ZCHL owned all of the mill assets (with the exception of legal title to the lands which remained with ZCL) as it acquired the same from ZCL and then subsequently transferred such assets to ZCLP. C-270, Declaration of Trust (Lands) for Zellstoff Celgar Limited and Zellstoff Celgar Holdings Ltd. (1 March 2006); C-275, Asset Transfer Agreement between Zellstoff Celgar Limited and Zellstoff Celgar Holdings Ltd. (1 March 2006); C-276, Asset Transfer Agreement between Zellstoff Celgar Holdings Ltd. and Zellstoff Celgar Limited Partnership (1 March 2006).

³¹ C-270, Declaration of Trust (Lands) for Zellstoff Celgar Limited and Zellstoff Celgar Holdings Ltd. (1 March 2006).

³² Under a partnership structure, income is attributable at the partner level, rather than being earned and taxed at the operations level and again when dividends are distributed.

³³ C-198, Zellstoff Celgar Limited Partnership, Certificate of Limited Partnership (10 January 2006), ¶ 10.

³⁴ C-198, Zellstoff Celgar Limited Partnership, Certificate of Limited Partnership (10 January 2006), ¶ 10.

in order to identify steam savings opportunities. The PINCH study identified six projects that had the potential to reduce Celgar's steam utilization by 15 percent.³⁵ At the same time, Celgar had been studying the potential of retrofitting its existing power boiler to burn more hog fuel and create additional steam production. With the higher pulp production volumes that Celgar was achieving at that time, the Mill had significant quantities of surplus steam that were being vented to the atmosphere. [REDACTED] at Celgar prepared a preliminary cost estimate, and calculated benefits for a project that would use the surplus steam to power a 35 MW condensing turbine. This project was named the Green Energy Project.

43. Based on this preliminary analysis, Mercer approved the engagement of an engineering firm, [REDACTED] to confirm project feasibility and establish plus or minus 10 percent cost estimates required for a Board decision. With the feasibility and cost estimates complete, we officially engaged [REDACTED] to prepare the detailed engineering required to execute the project.

44. In a meeting in November 2007, the Mercer board reviewed a Business Case on the energy project. The project at this time included five of the previously identified PINCH projects, the power boiler upgrade, and the installation of a new 48 MW condensing turbine. With an estimated power sales price of [REDACTED] the analysis showed a simple payback of around three years. At this meeting, the Board gave approval to proceed with the critical path items in the project to manage risk and achieve the earliest possible operational date for the energy project. The Board also gave approval to order the turbine, which constituted the critical path. At the time of approval, the Board was advised the turbine order would expose Mercer to

³⁵ C-180, Zellstoff Celgar, Celgar Green Energy Project: Green Transformation Program (GTP) Project Application (15 September 2009) at 3.

cancellation costs of [REDACTED] in the unlikely event we cancelled the order. At its February 2008 meeting, the Board received an update on the status of the work completed on the project during the quarter. The final project as presented for board approval had an estimated capital cost of [REDACTED] and the Board fully approved the project in full on May 1, 2008.³⁶

45. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]. In October 2008, we agreed on terms for a [REDACTED] with a [REDACTED] percent interest rate. [REDACTED] expressed interest in syndicating the deal with [REDACTED]. Then, in 2008, as Bank of America began to grapple with the global financial crisis, the process slowed down. In December 2008, we learned that the entire team at Bank of America who had been working on our loan were terminated as part of Bank of America's 30,000 employee layoff plan. The bank backed away from our transaction.

46. Along with the global financial meltdown, by the second quarter of 2008, pulp commodity prices had fallen dramatically. [REDACTED]

[REDACTED]

[REDACTED]

47. [REDACTED]

[REDACTED]

[REDACTED]

³⁶ See C-181, Zellstoff Celgar, Project Performance Analysis: Zellstoff Celgar Limited Partnership Capital Project Review (24 January 2012); C-264, Memorandum from B. Merwin, to the Mercer Board of Directors, re: Celgar Energy Project (20 April 2008).

[REDACTED]

[REDACTED]

[REDACTED]

48. By May 2009, Mercer had invested some [REDACTED] [REDACTED] in the Green Energy Project. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

49. With strong support from Export Development Canada, Mercer continued for some time to seek a lender for the project. The crisis state of the lender community was such, however, that originating financing during that time frame proved unworkable. With no financing in place, and no real prospect of financing, we had no other choice but to announce the suspension of the Green Energy Project in May 2009.

50. During this period, Canada, through Natural Resources Canada and other Federal government departments, was very interested in our project, and engaged with Mercer/Celgar regarding its challenges during the financial crisis. We specifically advised Canada that we had suspended the Green Energy Project until financing was in place and that we were not committing to any on-site work or further financial obligations. [REDACTED]

[REDACTED]

[REDACTED] We further advised Canada that, at that stage, we had a “shovel ready” project capable of creating 145 full-time equivalent jobs for 8 months between August and March 2010. [REDACTED]

[REDACTED]

[REDACTED]

51. In addition to our individual engagement, the pulp and paper industry as a whole was engaging with Canada regarding the debilitating effects the United States' renewable fuels tax credit program (which, beginning in 2007, provided billions of dollars in subsidies each year to U.S. kraft pulp mills based on the volume of their black liquor production) was having on Canada's pulp and paper industry.³⁷ We were very fortunate that, in part as a result of our engagement, the Canadian government decided to initiate the Pulp and Paper Green Transformation Program (PPGTP). This subsidy program was available equally to all NBSK pulp mills in Canada, based on the volume of black liquor produced over a specified time period, and ultimately provided the financing necessary for us to restart our Green Energy Project.

52. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

³⁷ See C-265, B. Ivry and C. Donville, *Black Liquor Tax Boondoggle May Net Billions for Papermakers*, Bloomberg (17 April 2009) available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=abDjfGgdumh4>.

and our power trader, NorthPoint, [REDACTED]
[REDACTED]

53. Electricity sales contracts, facilitated by the agreement with FortisBC, could have generated significant electricity sales revenues for Celgar and allowed Mercer to avoid suspending the Green Energy Project. With this revenue, Celgar also would have been a much more attractive candidate for financing.

VI. THE BC PULP AND PAPER JOINT TASK FORCE

54. The BC Pulp and Paper Joint Task Force was created in March 2007. It was a joint initiative between the BC Pulp and Paper Industry and the BC government with the overarching purpose of working on policy and hosting conditions for the long-term sustainability of the industry.³⁸ Some of the early work of the Task Force included overseeing the preparation of (i) an Economic Impact Study to help educate government and policymakers regarding the economic relevance of the industry to BC, and (ii) a study to assess the competitiveness of the industry and to identify gaps and opportunities. In this body of work, we focused intensely on the need to develop and support energy policies that could provide opportunities for biomass-based energy produced by the pulp and paper sector.

55. In November 2007, the Pulp and Paper Joint Task Force submitted a position paper to the BC government on electricity conservation and self-generation issues. Mercer chaired that group. The task force prepared this largely in response to the announcement of a proposed upcoming BC Hydro Biomass Power Call. We were successful in convincing the Province and BC Hydro to take the time necessary to put a proper framework in place to ensure that pulp and paper mills would be able to participate in the eventual Bioenergy calls for power.

³⁸ C -176, BC Pulp and Paper Task Force, Terms of Reference (23 March 2007).

56. We were moderately successful in educating BC Hydro and the Province about the possible unintended consequences of a poorly structured biomass call. These possible consequences including the risk that stand alone power plants would exhaust the wood chip feedstock supply for the pulp and paper plants, foreclosing their ability economically to produce pulp and forcing shutdown. Prior to our engagement on this issue, it was clear that neither BC Hydro nor the Province had any idea how far-reaching the impacts on fibre supply could be on supply and demand balance between pulp mills and sawmills.

57. As part of our discussion with government, the Task Force had demonstrated that, from an infrastructure, human resources, and environmental point of view, the facilities of the pulp and paper sector were the most logical places to create incremental green energy. Thus, it was important to ensure that the power call did not jeopardize the ability of those facilities to operate. At this time, many of the BC pulp mills foresaw energy projects as a key part in rebuilding the Pulp and Paper sector in BC.

VII. THE BC WORKING GROUP ON PULP & PAPER SELF-GENERATION SALES POLICY

58. The BC Pulp and Paper Task force had been engaging with Province not only on the issue of the BC Hydro Bioenergy call but also in an effort to ensure that the pulp and paper sector received fair value for its self-generated energy. This engagement culminated in a December 2007 meeting with then Forest Minister Rich Coleman. At the meeting, Minister Coleman expressed a commitment to working with the industry to ensure a fair price for its self-generated electricity.

59. In keeping with this commitment, Minister Coleman encouraged the Province to form a Working Group on Pulp & Paper Self-Generation Sales Policy (“Working Group”), comprised the members of the Pulp & Paper Task Force, provincial representatives, members of

the solid wood (lumber) sector, including the Council of Forest Industries (COFI) and BC Hydro. Assistant Deputy Ministers from the Ministries of Energy and Forests co-chaired the working group and reviewed options for pulp and paper self-generation. The Province did not invite FortisBC to participate.

60. The Working Group met on several occasions in 2008, including in February, March, June, and October. The draft minutes of the June 24, 2008 meeting reflect that, with respect to self-generated electricity, the “Government {wa}s firm that incremental generation is, and should be priced on the margin but that neither re-pricing of existing generation nor arbitrage against heritage power prices is acceptable.”³⁹ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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61. Other than communicating this general viewpoint, the BC Government took no steps to formalize its pronouncement in the form of a binding rule of law, it issued no guidance on how to distinguish between “existing supply” and “new” or “incremental supply,” or after what point in time generation would be treated as “new” or “incremental,” and it implemented no procedures to ensure consistent treatment among self-generators seeking access to embedded cost power while selling their own electricity. And, of particular interest to Celgar, neither the BCUC nor the Government had provided any information on whether or how any of this self-generator policy, which appeared to be aimed at BC Hydro, and focused on arbitrage against BC

³⁹ C-135, Pulp and Paper Sales Policy Working Group, Draft Meeting Minutes (24 June 2008).

⁴⁰ C-136, Ministry of Energy, Mines and Petroleum Resources, Briefing Note for Information, Progress Report on the Working Group on Pulp & Paper Self-Generation Sales Policy (23 September 2008).

Hydro charges for Heritage Resource power (only BC Hydro is subject to the Heritage Contract), substantively or procedurally, applied in FortisBC's territory.

* * * *

The information furnished above is faithful and true in its entirety and was developed on the basis of my best knowledge.

In Vancouver, British Columbia, on the 28th day of March, 2014.

David Gandossi