

**IN THE MATTER OF THE BANKRUPTCY OF
Fuel Industries Inc.
of the City of Ottawa, in the Province of Ontario**

**TRUSTEE'S REPORT TO THE FIRST MEETING OF CREDITORS
ON PRELIMINARY ADMINISTRATION**

BACKGROUND

Fuel Industries Inc. (“**Fuel Industries**” or the “**Company**”) is an Ontario corporation formed in 2000. The Company, in cooperation with a related entity, Fuel Technologies Inc. (“**Fuel Technologies**” or together with Fuel Industries, the “**Companies**”) operated a full-service digital creative agency focused on connecting global brands with youth, millennial, and family audiences through innovative technology, including augmented reality and virtual reality experiences, immersive virtual worlds, mobile apps, social games, branded entertainment, interactive multi-screen experiences, interactive rich media advertising, and digital loyalty programs. The Trustee understands that Fuel Technologies did not carry on active business operations, as its assets consisted primarily of certain intellectual property and a share interest in an online gaming tournament service provider.

Although Fuel Industries and Fuel Technologies are distinct legal entities, they shared common management and back office support, occupied common head office space and were both liable under the Companies’ credit facilities with their secured lenders – Chou Associates Management Inc. (“**Chou**”) and Royal Bank of Canada (“**RBC**”).

As a result of a number of factors, including changing market conditions, increased competition and the failure to monetize certain research and development initiatives, the Companies’ financial results suffered, culminating in significant and sustained losses. These ongoing losses resulted in liquidity constraints that caused the Companies to be dependent on significant financing from Chou to continue operations. As a result of the Companies’ poor financial performance, the Trustee understands that the Companies’ management considered it prudent, as far back as 2015, to consider various strategic options, including the potential sale of the business.

Due to the Companies continuing losses, the Companies breached certain of their financial and other covenants under the Companies’ credit facilities with each of Chou and RBC and, in early 2017, RBC issued demand letters and Notices of Intention to Enforce Security pursuant to Section 244 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the “**BIA**”) to the Companies. The Companies and RBC agreed on the terms of a forbearance agreement (the “**RBC Forbearance Agreement**”), pursuant to which RBC agreed to forbear, subject to certain terms and conditions, from taking steps to proceed with enforcement of its security held in support of its loans until May 10, 2017 to grant the Companies further time to attempt to restructure and/or sell the business or secure alternative financing.

In order to assist the Companies avoid a receivership/liquidation of the business upon the expiration of the RBC Forbearance Agreement, the RBC indebtedness, including all loan agreements and security granted in support of same, were assigned to Chou. At the same time, Chou advanced further monies to the Companies, which additional funding was required by the Companies to pay certain critical obligations, including outstanding employee wages.

The Companies and Chou also agreed upon the terms of a forbearance agreement (as amended, the "**Chou Forbearance Agreement**"), pursuant to which Chou agreed to forbear from taking any enforcement steps until June 27, 2017 (the "**Forbearance Period**") to grant the Companies additional time to attempt to restructure their business, secure alternate financing or seek one final opportunity to pursue a sale of the business. Richter Advisory Group Inc. ("**Richter**") was engaged by the Companies during the Chou Forbearance Period to assist with these activities.

The Chou Forbearance Agreement was subject to two amendments that, among other things, extended the Forbearance Period to July 14, 2017. The Chou Forbearance Agreement expired on July 14, 2017 and was not extended. On July 17, 2017, Chou issued demand letters and Notices of Intention to Enforce Security pursuant to Section 244 of the BIA to the Companies.

On July 26, 2017, Fuel Industries and Fuel Technologies each filed a Notice of Intention to Make a Proposal ("**NOI**") pursuant to Section 50.4(1) of the BIA. Richter Advisory Group Inc. ("**Richter**") was appointed proposal trustee (the "**Proposal Trustee**") under each NOI. The primary objectives of the Companies' NOI proceedings included stabilizing and restructuring the Companies' operations, including the identification, on an expedited basis, of one or more interested parties interested in investing in and/or acquiring the Companies' business or assets.

As noted above, Richter was engaged by the Companies during the Chou Forbearance Period to assist the Companies in their restructuring efforts, including the facilitation of the potential sale of the business. Commencing in early June 2017, the Companies, with the assistance of Richter, initiated a sales and investment solicitation process (the "**SISP**") as a means of gauging interest in the Companies' business and/or assets and determining whether a transaction that would result in greater than liquidation value was available.

As per the terms of the Chou Forbearance Agreement, Chou was provided with regular updates on both the Companies' financial results and the status of the SISP. During the Forbearance Period representatives of the Companies, Chou and Richter engaged in discussions in connection with the potential acquisition of the Companies' business by Chou in the event no alternative purchaser (or investor) for the Companies' business and/or assets was identified. On July 14, 2017, when it became apparent that the SISP did not result in any interest in the Companies' business and/or assets, Chou and the Companies reached an agreement, in principle, for the acquisition of substantially all of the Companies' business and assets (the "**Transaction**") by a corporation controlled by Chou (the "**Purchaser**"). The Transaction was approved by the Court on August 2, 2017 and closed on August 4, 2017.

The consideration for the Transaction, which was primarily a credit bid, included the assumption by the Purchaser of certain secured amounts owed by the Companies to Chou (including the assigned RBC indebtedness) as well as a cash payment to satisfy certain other obligations of the Companies, including professional fees and other priority amounts.

The consideration, however, was insufficient to fully satisfy the Companies' secured indebtedness or support a distribution to the Companies' unsecured creditors. As each of the Companies' failed to present proposals to their respective unsecured creditors within the prescribed time period following the filing of their NOI's, on August 28, 2017, Fuel Industries and Fuel Technologies were deemed to have made assignments in bankruptcy. Richter was appointed trustee (the "**Trustee**") of each of the Companies' bankrupt estates.

On September 1, 2017, notice of the first meeting of creditors, a list of creditors, proof of claim form and proxy were sent to all known creditors of Fuel Industries and, on the same date, a notice of the bankruptcy and the first meeting of creditors was published in the Ottawa Sun.

The activities of the Trustee since its appointment have primarily consisted of statutory work in accordance with the provisions of the BIA.

CAUSES OF BANKRUPTCY AND FINANCIAL POSITION

The Companies operated in the digital advertising market which, in recent years, has become increasingly challenging due to increased competition and changing market conditions. These industry dynamics, along with the Companies' failure to monetize certain research and development initiatives, negatively impacted the Companies' operations and profitability, culminating in significant losses.

In connection with the foregoing, Fuel Industries (Fuel Technologies did not carry on active business operations) recorded losses totalling approximately \$3.8 million for the year ended December 31, 2015 and approximately \$1.6 million for the year ended December 31, 2016.

Due to the Companies' continuing losses, the Companies were dependent on funding from the Chou to continue operations. In addition, as noted previously, as a result of the Companies' continuing losses, in early 2017, the Companies breached certain financial and other covenants with their secured lenders, which financed the Companies' operating activities.

As noted previously in this report, following extensive negotiations, the Companies and RBC/Chou agreed on the terms and conditions of forbearance agreements, pursuant to which RBC/Chou agreed to forbear from taking steps to proceed with enforcement of their respective security to allow the Companies additional time to negotiate a consensual restructuring or recapitalization, or explore a sale of the Companies' business and assets.

The Companies' NOI proceedings facilitated the sale of substantially all of the Companies' business and assets. As the net proceeds realized from the Transaction were insufficient to fully satisfy the Companies' secured indebtedness or support a distribution to the Companies' unsecured creditors, the Companies were not in a position to present proposals to their respective creditors and, as a result, on August 28, 2017, the Companies were each deemed to have made an assignment in bankruptcy.

FINANCIAL POSITION/ASSETS

As detailed in the Company's Statement of Affairs, following the closing of the Transaction and as at the date of bankruptcy, the Company did not have any realizable assets.

Accordingly, it is not anticipated that there will be any funds available for distribution to unsecured creditors of the Company.

SECURED CREDITORS

According to the Company's Statement of Affairs, as at the date of bankruptcy, Chou is the only secured creditor of the Company owed approximately \$3 million.

In addition to Chou, the Trustee is aware of other registrations against the Company made pursuant to the *Personal Property Security Act* (Ontario) (the "PPSA") in favour of Dell Financial Services Canada Limited ("Dell") and LBEL Inc. ("LBEL") in respect of certain specific office equipment, as well as Dahavland Capital Corporation, in trust, in respect of historic debts which the Trustee understands are no longer outstanding. The Trustee understands that the registrations made pursuant to the PPSA against the Company in favour of Dell relate to agreements assigned to the Purchaser as part of the Transaction. The Trustee further understands that the registrations made pursuant to the PPSA against the Company in favour of LBEL relate to collateral in the possession of the Purchaser to be returned to the secured party.

With respect to the Companies' secured obligations to Chou that were assumed by the Purchaser as part of the Transaction, the Proposal Trustee obtained an opinion from Chaitons LLP ("Chaitons") that, subject to the usual and customary assumptions and qualifications noted therein, the security granted by the Companies in favour of Chou (and RBC) was valid and enforceable.

SECURITY FOR UNPAID WAGES – S.81.3 CLAIMS

As noted previously in this report, the consideration for the Transaction included a cash payment to satisfy, among other things, priority amounts owing to the Companies' creditors.

As part of the Transaction (and as the Companies had no employees following the closing of the Transaction), an estimate of the priority amounts payable to the Companies' former employees in accordance with Section 81.3 of the BIA (the "Priority Payments") in the amount of \$22,149 (the "Priority Funding") was forwarded to the Proposal Trustee for distribution to eligible former employees on behalf of the Companies.

As the Priority Payments due to the Companies' former employees were not finally determined until after the date of bankruptcy, the Priority Funding was transferred by the Proposal Trustee to the Trustee for distribution to eligible former employees on behalf of the Companies.

After confirmation of the Priority Payments due to the Companies' former employees, the Trustee distributed \$17,855 to the Companies' former employees in satisfaction of the amounts due to the Companies' former employees as per Section 81.3 of the BIA. The Trustee will be returning the overfunded Priority Funding (\$4,294) to the Purchaser.

In addition to the above, the Trustee, where applicable, will comply with the requirements of the *Wage Earner Protection Program Act*.

PREFERRED CREDITORS

The Company's Statement of Affairs indicates that there were no known preferred creditors as at the date of bankruptcy.

UNSECURED CREDITORS

The Company's Statement of Affairs indicates that there are 104 unsecured creditors with claims totalling approximately \$5.9 million, excluding any unsecured amounts owed to the Company's former landlord in respect of the Company's premises and the Company's former employees (which amounts were not calculated at the time of preparing the Statement of Affairs).

PROVABLE CLAIMS

As at 9:00 a.m. on the date of this report, the Trustee has recorded Proof of Claims filed, as follows:

	Claims Filed (#)	Amount (\$)	Proxies in Favour of Trustee (#)	Amount (\$)
Secured	1	26,976.38	Nil	Nil
Unsecured	10	1,022,078.87	4	11,904.53
TOTAL	11	1,049,055.25	4	11,904.53

PREFERENCE PAYMENTS AND TRANSFERS AT UNDER VALUE

The Trustee has not performed a review of the Company's books and records, with respect to potential fraudulent preferences, settlements or transfers at undervalue, as defined in the BIA. It is the intention of the Trustee to discuss the scope of its review with the Inspectors to be appointed at the first meeting of creditors.

TRUSTEE'S FEES

In consideration for consenting to act in these proceedings, the Trustee is in the process of negotiating an agreement with Chou to satisfy the Trustee's fees and disbursements, including the fees and disbursements of its legal counsel, should realizations from other sources be insufficient to cover these costs.

OTHER

Further information related to the Company's bankruptcy or NOI proceedings may be obtained from Richter's website at <https://www.richter.ca/Folder/Insolvency-Cases/F/Fuel-Industries-Inc>.

Dated at Toronto, Ontario, this 14th day of September, 2017.

RICHTER ADVISORY GROUP INC.

in its capacity as Trustee of the estate of
Fuel Industries Inc.
and not in its personal capacity



Adam Sherman, MBA, CIRP, LIT