

1817870 ONTARIO INC.
(formerly known as AFI HYDRO INC.)

SECOND REPORT OF THE RECEIVER

JULY 25, 2014

**ONTARIO
SUPERIOR COURT OF JUSTICE – COMMERCIAL LIST**

BANK OF MONTREAL

Applicant

- and -

1817870 ONTARIO INC.

Respondent

APPLICATION UNDER SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C. 1985, C. B-3, AS AMENDED AND SECTION 101 OF THE *COURTS OF JUSTICE*
ACT, R.S.O. 1990, c. C.43 AS AMENDED

**SECOND REPORT OF RICHTER ADVISORY GROUP INC.
IN ITS CAPACITY AS THE COURT-APPOINTED RECEIVER OF
1817870 ONTARIO INC. (formerly known as AFI HYDRO INC.)**

JULY 25, 2014

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APPENDICIES

APPENDIX “A” – ORDER OF THE HONOURABLE MR. JUSTICE WILTON-SIEGEL DATED FEBRUARY 24, 2014

APPENDIX “B” – FIRST REPORT OF RICHTER ADVISORY GROUP INC. DATED APRIL 25, 2014

I. INTRODUCTION

1. Pursuant to an application by Bank of Montreal ("**BMO**" or the "**Lender**") under section 243(1) of *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended, (the "**BIA**") and section 101 of the *Courts of Justice Act* R.S.O. 1990 c. C.43, as amended, and an order (the "**Appointment Order**") of the Ontario Superior Court of Justice (Commercial List) (the "**Court**"), dated February 24, 2014 (the "**Date of Appointment**"), Richter Advisory Group Inc. was appointed as Receiver ("**Richter**" or the "**Receiver**") without security over all the assets, undertakings and properties (the "**Property**") of AFI Hydro Inc. ("**AFI**" or the "**Company**"). A copy of Appointment Order is attached hereto as **Appendix "A"**.
2. On April 30, 2014, the Court issued an order (the "**Approval and Vesting Order**") approving the sale transaction contemplated by the asset purchase agreement dated April 25, 2014 between the Receiver and Andritz Hydro AFI, Inc. (the "**Purchaser**"), and vesting in the Purchaser the Purchased Assets as defined in the asset purchase agreement.
3. As contemplated by the Approval and Vesting Order, articles of amendment were filed changing the name of the Company from AFI to 1817870 Ontario Inc., effective as of May 15, 2014.
4. This report is the Receiver's second report (the "**Second Report**") to this Court. The Receiver's first report (the "**First Report**"), dated April 25, 2014, outlined among other things, the background on the Company, the activities of the Receiver since the Appointment Order, the results of the marketing and sales process undertaken by the Receiver, and the proposed sale transaction between the Receiver and the Purchaser. As certain pricing information was redacted from the First Report, on April 25, 2014, the Receiver filed a supplementary report with this Court on a sealed and confidential basis. A copy of the First Report, without appendices, is attached hereto as **Appendix "B"**.

II. PURPOSE OF REPORT

5. The purpose of this Second Report is to:
 - (a) report on the activities of the Receiver since the First Report;
 - (b) report on the Receiver's statement of receipts and disbursements for the period from February 24, 2014 to June 30, 2014;
 - (c) provide relevant background to BMO's application for a bankruptcy order in respect of the Company; and
 - (d) provide this Court with a summary of the security opinion prepared by Davies Ward Phillips & Vineberg LLP ("**Davies**"), independent counsel to the Receiver in this matter.

III. QUALIFICATIONS

6. In preparing this Second Report, Richter has relied upon unaudited financial information, the Company's books and records, financial information prepared by the Company and discussions with former management (collectively, the "**Information**").
7. In accordance with industry practice, except as described in this Second Report:
 - (a) Richter has not audited, reviewed, or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the Canadian Institute of Chartered Accountants Handbook; and
 - (b) future-oriented financial information relied upon in preparing this Second Report is based on management's assumptions regarding future events. Actual results achieved may vary from this information and these variations may be material.
8. Unless otherwise noted, all monetary amounts contained in this Second Report are expressed in Canadian dollars.

IV. ACTIVITIES OF THE RECEIVER

9. On April 30, 2014, the Receiver closed the Court-approved sale transaction with the Purchaser for substantially all of the Company's assets for total cash proceeds of \$5.9 million. Following closing, the only material assets not transferred to the Purchaser as part of the sale transaction were the Company's receivables and accrued revenue under its existing contracts with customers.

10. In addition to closing the sale transaction, the Receiver's activities since the First Report include:
 - (a) terminating consulting arrangements with former employees and contractors of the Company who assisted the Receiver in its administration, asset recovery and sales process;
 - (b) terminating the Company's lease at 6 Adams Street, Paris Ontario with Silverbridge Business Centre Limited;
 - (c) liaising with Service Canada on claims submitted by former employees of the Company under the *Wage Earner's Protection Program Act* ("WEPPA");
 - (d) corresponding with customers regarding the recovery of outstanding amounts owed to the Company;
 - (e) corresponding with Ontario Power Generation Inc. ("OPG") regarding the completion and delivery of work pursuant to certain contracts entered into between the Receiver and OPG;
 - (f) corresponding with construction lien claimants, and their respective counsels, regarding requests to lift the stay of proceedings in order to preserve and advance lien rights in respect of certain work at OPG's generating stations;
 - (g) discussions and correspondence with Davies on numerous matters, including security opinion, lien claims, and potential priority claim issues;
 - (h) corresponding with BMO on a regular basis on the status of the receivership; and

(i) responding to unsecured creditor and employee enquiries regarding the status of these proceedings.

11. To inform creditors and all other stakeholders, general information on these proceedings has been posted on the Receiver's website at www.richter.ca/en/insolvency-cases/a/afi-hydro-inc. The Receiver has also identified on its website a point of contact at Richter for any enquiries, including a telephone number and email address.

V. RECEIVER'S STATEMENT OF RECEIPTS AND DISBURSEMENTS

12. The Receiver's statement of cash receipts and disbursements for the period from the Date of Appointment to June 30, 2014 is set out below:

1817870 Ontario Inc. (formerly known as AFI Hydro Inc.)		
Statement of receipts and disbursement		
For the period February 24 to June 30, 2014		
Receipts		Note
Proceeds from sales process	5,900,000	
Accounts receivable collections	636,363	
Metal fabrication	55,428	
Customer accommodation agreement	288,786	1
Facility access agreement	99,361	2
Asset realizations	109,447	
Pre-filing HST refund	128,665	
Post-filing HST refund	6,681	
Other receipts	56,358	3
Total receipts	7,281,089	
Disbursements		
Rent	104,078	
Payroll for contract services	315,948	4
Material purchases	119,044	
Operating expenses	73,356	
Pre-filing source deductions	16,313	
Pre-filing pension remittances	60,765	5
HST remittance	12,312	
Professional fees	595,024	
Insurance	29,770	
HST paid on disbursements (I.T.C)	120,299	
Bank charges / other fees	181	
Total disbursements	1,447,090	
Cash on hand	5,833,999	
Notes:		
1. The Receiver entered into accommodation agreements with OPG for the completion and delivery of work on certain new or AFI existing projects.		
2. The Receiver entered into an arrangement with Kiewit-Alarie Partnership to facilitate the release of finished goods inventory related to the Lower Mattagami River Project.		
3. Other receipts include proceeds from scrap sale, refund of a legal retainer, interest etc.		
4. The Receiver engaged former AFI employees as independent contractors to assist with the Receivership.		
5. Payment of unremitted employee and employer contributions to the Company's defined contribution pension plan pursuant to section 81.6 of the <i>Bankruptcy and Insolvency Act</i> .		

13. As at June 30, 2014, the Receiver had total receipts of approximately \$7.3 million, the majority of which relates to proceeds received from the sale transaction with the Purchaser. Total disbursements over the same period were approximately \$1.4 million, for a net cash balance of approximately \$5.8 million.

14. As outlined in the table above, the Receiver collected \$636,363 from accounts receivable and accrued revenue owed to the Company, the majority of which is related to the Company's construction contracts with OPG, Manitoba Hydro or H2O Power Limited Partnership. As at the date of this Second Report, the Receiver continues to work with the Company's customers to collect any outstanding amounts still owed, however the Receiver does not anticipate significant realizations going forward.
15. The Receiver generated \$55,428 in new receipts, as well as collected approximately \$45,000 in pre-filing receivables, from one of the Company's customers for the completion of metal fabrication orders. In addition, the Receiver generated proceeds of \$109,447 from miscellaneous asset realizations, primarily related to the sale of intake stoplogs and a spreader beam associated with the BC Hydro Lajoie Dam Project to HMI Construction Inc. ("**HMI**") on an "as is, where is" basis pursuant to a bill of sale between the Receiver and HMI dated February 28, 2014.
16. As discussed in the First Report, the Receiver entered into an agreement with Kiewit-Alarie Partnership ("**KAP**"), to allow them, at their cost, access to the Company's facility and certain tooling and equipment in order to facilitate the release of finished goods inventory and related intellectual property related to the Lower Mattagami River Project. As part of the agreement, KAP agreed to pay the Receiver a fixed amount to cover the Receiver's costs as well a per diem to offset rent and operating costs for the Company's facility. Total receipts generated from this agreement were \$99,361.
17. The Receiver also entered into separate accommodation agreements with OPG, on a cost reimbursable basis, for the completion and delivery of a specific scope of work at each of Barrett Chute Generating Station ("**Barrett Chute**"), Alexander Generating Station ("**Alexander**") and Lower Notch Generating Station ("**Lower Notch**"). OPG had requested the Receiver's assistance with the completion of certain documentation and/or physical elements related to each of these projects to ensure critical milestones and timelines could be met by OPG during the sales process. For Lower Notch and Alexander, OPG agreed to advance funds into segregated bank accounts opened by the Receiver in order to fund costs related to these two projects. On a weekly basis, the

Receiver would submit a draw request to OPG for authorization to withdraw from the segregated accounts to pay costs incurred. Furthermore, as part of the Alexander agreement, OPG also agreed to pay a portion of the Receiver's ongoing overhead costs and expenses. The agreement for Barrett Chute was structured as a fixed fee to complete certain documentation and drawings related to work previously commenced by the Company. As at the date of this Second Report, the Receiver has completed its obligations under these agreements and is currently working with OPG to finalize any outstanding payments.

18. Since the Date of Appointment, the Receiver entered into consulting arrangements with certain former employees and contractors of the Company to assist the Receiver with fulfilling its obligations under the aforementioned agreements with KAP and OPG, as well as other matters such as administration of the receivership, asset recovery and the sales process. As at June 30, 2014, the Receiver had incurred costs of approximately \$315,948 relating to such consulting arrangements. As mentioned above, all of these consulting agreements have been terminated as at the date of the Second Report.
19. On or about June 4, 2014, the plan administrator (represented by a former employee of the Company) for the Company's defined contribution pension plan filed a proof of claim with the Receiver for \$60,764.81 in connection with unpaid pension contributions pursuant to section 81.6 of the BIA. This claim was accepted and paid to Manulife Financial on June 6, 2014 as directed by the plan administrator.

VI. PRIORITY CLAIMS

20. As outlined in the First Report, the Receiver understands that potential statutory deemed trust claims total approximately \$190,271 based on the Company's books and records, and are comprised of the following:

1817870 Ontario Inc. (formerly known as AFI Hydro Inc.)	
Potential deemed trust claims as at June 30, 2014	
Outstanding wages and vacation pay	184,274
Pre-filing source deductions	5,997
Total	190,271

21. As at the date of this Second Report, the Receiver has not received proof of claims in connection with outstanding wages and vacation pay, and the employee portion of pre-filing source deductions, but continues to work with Service Canada.
22. The Receiver has made BMO aware of these potential statutory deemed trust claims and has advised BMO that the Receiver will need to hold back an appropriate amount from any distribution.
23. The Receiver has also received notices from a few creditors asserting trust claims pursuant to applicable construction lien legislation against monies collected by the Receiver in connection with the Company's construction project receivables. Substantially all of these notices were related to the Lower Mattagami River Project, a project that the Receiver has not collected any accounts receivable owing to the Company. One of the notices received was in connection with the Company's project at OPG's McVittie Generating Station, where the Receiver collected a total of approximately \$18,000 (excluding taxes).

VII. BANKRUPTCY APPLICATION

24. The Receiver raised the issue with BMO that if the Receiver effects a distribution the Receiver may be exposed to personal liability pursuant to provisions of the *Income Tax Act*, the *Excise Tax Act* and similar provincial taxing statutes which impose liability upon a receiver if it distributes property of a debtor without first obtaining clearance certificates from the relevant taxing authority.
25. Based on the state of the Company's books and records it appears unlikely that the Receiver will be in a position to obtain such clearance certificates in a timely fashion, if at all.
26. Therefore, BMO took the decision to resolve this issue through a bankruptcy of the Company and, with the consent of the Receiver, brought an application for a bankruptcy order against the Company naming Richter Advisory Group Inc. as trustee. The Receiver notes that CRA and similar provincial taxing authorities that could be impacted by a bankruptcy of the Company have been served with a copy of this Second Report.

27. The Receiver understands that there were no outstanding amounts for harmonized sales tax (“HST”) or retail sales tax (“RST”) due as of the Date of Appointment but whether or not any liability may arise upon an audit remains unknown.
28. After the statutory deemed trust claims described above, Richter, in its capacity as trustee in bankruptcy of the Company’s estate, would have the next highest priority claim (pursuant to subsection 136(1) of the BIA) against the estate for the costs of administration thereof. Accordingly, it is expected that the costs of administration of the bankruptcy will be paid from proceeds in the Receiver’s possession.

VIII. SECURITY OPINION

29. The Receiver has obtained an independent legal opinion on BMO’s security from Davies. Davies has provided an opinion to the Receiver that the Company has granted valid security interests to BMO in the assets of the Company, which have been properly perfected pursuant to the Ontario *Personal Property Security Act*, subject to the standard assumptions, qualifications and limitations contained in the opinion. The opinion also confirms that there are no registrations prior in time to those of BMO.
30. As stated above, the Receiver had cash on hand of approximately \$5.8 million as at June 30, 2014. Subsequent to the bankruptcy of the Company (if the bankruptcy order is granted by this Court), the Receiver anticipates seeking this Court's approval to make an interim distribution to BMO subject to retaining an amount sufficient to pay any and all amounts that rank, or may rank, in priority to BMO, including professional fees subject to the Receiver’s Charge.
31. After accounting for payments from Export Development Canada to BMO on the insured letters of credits, the outstanding secured indebtedness is approximately \$13.1 million as at the date of this Second Report. As such, BMO will suffer a significant shortfall on its advances to the Company.

Dated the 25th day of July, 2014

RESPECTFULLY SUBMITTED,



Paul van Eyk, CIRP, IFA, CPA
Senior Vice-President

Richter Advisory Group Inc.
the Receiver of 1817870 Ontario Inc.
and not in its personal capacity