

**Court File No. 31-396479**

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
IN BANKRUPTCY**

**IN THE MATTER OF THE BANKRUPTCY OF CANADA 3000 INC.,  
of the City of Toronto, in the Province of Ontario**

**AND IN THE MATTER OF THE BANKRUPTCY OF CANADA 3000 AIRLINES  
LIMITED/LIGNES AÉRIENNES CANADA 3000 LIMITÉE  
of the City of Toronto, in the Province of Ontario**

**AND IN THE MATTER OF THE BANKRUPTCY OF ROYAL AVIATION INC.  
of the City of Toronto, in the Province of Ontario**

**SECOND REPORT OF THE TRUSTEE  
PRICEWATERHOUSECOOPERS INC.**

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# The Trustee's Second Report to the Court

## Index of Defined Terms

<b>Term</b>	<b>Definition</b>
23 Fasken	23 Fasken Drive
31 Fasken	31 Fasken Drive
Agreement	Acceptance Agreement
Airlines	Canada 3000 Airlines Limited
Amtec	Amtec Corporation
BIA	Bankruptcy and Insolvency Act
BMO	Bank of Montreal
Cara	Cara Operations Limited
Cargo	Canada 3000 Cargo Inc.
CCAA	Companies Creditors Arrangement Act
CCRA	Canada Customs & Revenue Agency
CIBC	Canadian Imperial Bank of Commerce
Container Care	Container Care Inc.
Court	Ontario Superior Court of Justice – Commercial List
D&T	Deloitte & Touche Inc.
Davis	Davis & Company
Equipment	Aircraft, engines & related equipment
FSB	First Security Bank
Furniture	IT equipment, furniture & fixtures
GSA	General Security Agreement
GTAA	Greater Toronto Airports Authority
Handling	Royal Handling Inc.
Holidays	Holiday Travel Consultants Ltd.
IBA	IBA Group
Inc.	Canada 3000 Inc.

## INTRODUCTION

1. By order of the Ontario Superior Court of Justice, Commercial List (the “Court”), an application by Canada 3000 Airlines Limited (“Airlines”), Canada 3000 Inc. (“Inc.”) and Royal Aviation Inc. (“Royal”) (the “Parent Companies”) pursuant to the provisions of the *Companies’ Creditors Arrangement Act* (the “CCAA”) was granted on November 8, 2001 and Deloitte & Touche Inc. (“D&T”) was appointed to monitor the business and affairs of the Parent Companies (the “Monitor”).
2. On November 11, 2001, D&T was appointed trustee in bankruptcy of the Parent Companies pursuant to the *Bankruptcy and Insolvency Act* (the “BIA”). Subsequently, on November 30, 2001, PricewaterhouseCoopers Inc. (“PwC” or the “Trustee”) was substituted as trustee in bankruptcy by the Court, with effect from December 3, 2001 (the “Substitution Date”).
3. PwC was appointed Trustee over the following companies within the Canada 3000 group:

<b>Company</b>	<b>Date of Bankruptcy</b>
C3 Aventure Limitee/ C3 Leisure (doing business as Canada 3000 Holidays)	November 16, 2001
Holiday Travel Consultants Ltd. (doing business as Canada 3000 Tickets)	November 16, 2001
Canada 3000 Sales Limited	November 16, 2001
Canada 3000 Airport Services Limited	November 16, 2001
Royal Handling Inc.	November 16, 2001
Air Pax Inc.	December 4, 2001

## **PURPOSE OF REPORT**

4. By order of the Court dated November 30, 2001, the requirement for holding of the First Meetings of Creditors of the Parent Companies was suspended until further order of the Court. As will be discussed later in this report, the Trustee intends to hold the First Meetings of Creditors on or before May 15, 2002. As there are no inspectors to approve the activities of the Trustee, the Trustee is reporting to the Court with respect to its activities.
  
5. This is the second report of PwC as Trustee of Inc., Airlines and Royal. The purpose of this report is to seek the approval of the Court with regard to the following:
  - the Agency Agreement relating to the orderly transition of the administration of the estates from D&T to PwC;
  - the transfer of assets to Toronto for the purpose of sale;
  - the Trustee's activities for the period ending January 31, 2002;
  - the sale of assets to Maynards Industries Limited ("Maynards");
  - the sale of the property located at 31 Fasken Drive, Toronto;
  - the Trustee's sale process for the remaining assets owned by Airlines; and
  - the Trustee's fees and those of its counsel for the period ending January 31, 2002.
  
6. This report deals primarily with the activities of the Trustee or its agent, D&T, from the Substitution Date.

7. The specific matters dealt with in this report are set out under the following headings:

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## **I. BACKGROUND**

8. In conjunction with the filing of this report, D&T has filed a separate report dealing with the history of the Parent Companies and their subsidiaries, a summary of the events leading to the bankruptcy filing and various conservatory and protective measures it took upon its appointment as Trustee. Previously, D&T had filed with the Court eight reports covering various matters in its capacity as Monitor. Where appropriate, certain background information has been repeated herein for context.

## **II. STATUS OF RELATED BANKRUPTCY ESTATES**

9. PwC is acting as Trustee for the Parent Companies as well as various subsidiaries. A table identifying the companies in the Canada 3000 group over which PwC has been appointed Trustee and their primary activity is set out below.

<b>Company</b>	<b>Primary Activity</b>
Canada 3000 Inc.	Holding Company
Canada 3000 Airlines Limited/Lignes Aeriennes Canada 3000 Limitee	Airline
Royal Aviation Inc.	Airline
C3 Aventure Limitee/ C3 Leisure (doing business as Canada 3000 Holidays)	Tour operator
Holiday Travel Consultants Ltd. (doing business as Canada 3000 Tickets)	Travel agent
Canada 3000 Sales Limited	General sales agent for Canada 3000 Airlines
Canada 3000 Airport Services Limited	“Ground side” services (curb to passenger loading)
Royal Handling Inc.	“Air side” services (aircraft servicing in Toronto)

10. The Trustee is administering the activities of the various estates separately, to the extent that it is feasible to do so. Due to the interrelationship among the entities in the group, the Trustee has carried out certain functions on a joint basis, particularly those relating to customers who did not receive travel services and the return of leased aircraft. This is discussed in further detail later in the report.
11. The head offices of C3 Aventure Limitee/C3 Leisure (“Leisure”) and Holiday Travel Consultant Ltd. (“Holidays”) were located in Vancouver, British Columbia and the Trustee’s Vancouver office is administering these estates. First meetings of creditors in these estates were also postponed and are now scheduled to be held on or before May 15, 2002. A Court hearing on the Trustee’s activities to date with respect to Leisure and Holidays is scheduled for March 8, 2002 in the British Columbia Supreme Court. The first reports to the Court on the Leisure and Holiday estates filed in connection with this hearing are attached to this report for reference purposes as Appendices A and B, respectively.
12. The First Meeting of Creditors in the estate of Canada 3000 Sales Limited (“Sales”) has been postponed until further order of the Court and is now planned for on or before May 15, 2002.
13. The Trustee held First Meetings for the Creditors of Royal Handling Inc. (“Handling”) and Airport Services Limited (“Services”) on December 7, 2001. At that time, the Trustee reported on its activities to date. The Trustee is updating the inspectors and creditors of these estates in the normal course.

### **III. AGENCY AGREEMENT**

14. The rationale for PwC substituting D&T as Trustee of the Parent Companies was set out in D&T's seventh report to the Court as Monitor dated November 24, 2001. To ensure an orderly transition of the administration and that no material incremental costs were incurred as a result of such change, D&T and PwC established a working plan involving the separate allocation of specific duties to each firm. It was agreed that prior to the Substitution Date, D&T would engage the services of PwC as its agent for certain matters and that following the Transition Date, PwC would engage D&T as its agent for the completion of certain matters in the administration of the estate.
15. An executed Agency Agreement dated as of January 30, 2002 evidencing the matters to be completed by each of PwC and D&T during the transition is attached as Appendix C.
16. The Trustee requests approval of the Agency Agreement.

### **IV. APPOINTMENT AS RECEIVER**

17. On December 21, 2001, PwC was appointed as Receiver (the "Receiver") of Royal by Canadian Imperial Bank of Commerce ("CIBC") pursuant to its security which includes a general security agreement ("GSA") over all of Royal's assets and a hypothec. The Trustee's independent legal counsel, McMillan Binch (Ontario) and Donahue, Ernst and Young (Quebec), have provided opinions concerning CIBC's

secured claim and ranking its interest in priority to the Trustee's. We do not anticipate that Royal's assets charged by CIBC's security will satisfy CIBC's secured claim of \$6.3 million at this time. CIBC's GSA does not cover a hangar owned by Royal. Accordingly, it appears that there may be limited realizations available to the unsecured creditors.

## **V. ONGOING CONSERVATORY AND PROTECTIVE MEASURES**

### **Security and Access**

18. PwC has continued the security measures implemented by D&T. These include but are not limited to the following:
  - Posting of security personnel at those locations containing valuable assets;
  - Securing of aircraft in accordance with industry requirements;
  - Continuing insurance coverage and, in certain cases, expanding coverage;
  - Changing of building and premises access codes;
  - Ensuring that IT systems were adequately backed up and access restricted to authorized personnel; and
  - Ensuring that accounting records and other company records were adequately secured.
  
19. The various measures employed are discussed in greater detail throughout the report in the relevant asset section.

**Security of Sensitive Documents and Items**

20. Documentation located in Canada and the United States (“US”), such as training, security and operations manuals were secured, as were any other documents that were perceived to be potentially harmful should they be obtained by unauthorized persons. The Trustee also took reasonable steps to secure uniforms or marked articles of clothing or accessories, and certain types of ticketing or baggage tags, stickers or stock.

**Insurance**

21. The Trustee has in place five insurance policies to cover various anticipated risks. A schedule detailing the current policies is attached as Appendix D. A summary of these policies is set out below:

<b>Policy Type</b>	<b>Cost</b>
Aircraft - Ground Risk Only	Variable <sup>1</sup>
Aircraft - General Aviation Liability	US\$62,500/ quarter
Property	C\$37,100/ quarter
Commercial General Liability	C\$6,500/ quarter
Vehicles	C\$7,500/ month

<sup>1</sup> Ground risk insurance is reduced as aircraft depart. Accordingly, the cost each month is not fixed. As noted in Appendix D, the prepaid cost as at December 31, 2001 was approximately US\$200,000.

22. Airlines previously maintained nine different insurance policies, a number of which expired on November 30, 2001. The Trustee entered into 30-day extensions for all the aircraft-related policies to ensure that sufficient insurance was in place while it reviewed its requirements.

23. Willis Corroon Aerospace of Canada Limited (“Willis”) was Airlines’ aircraft insurance broker at the date of bankruptcy. Upon the advice of Willis, the Trustee agreed to fund the 30-day extension of the General Aviation Policy with premium refunds projected to arise from pre-bankruptcy unearned premiums resulting from overestimations of revenue passenger miles and the war surcharges, which are based on estimated passenger flights. The Trustee subsequently discovered that the Transamerica Insurance Finance Corporation (“Transamerica”) originally financed the policy premiums and that it will claim a prior secured interest in any refunds to the extent of their funding. Transamerica has filed a claim against Airlines for US\$219,000.
24. The Trustee subsequently cancelled, or allowed to expire four of Airlines policies that it determined were no longer required due to the fact that the airline was no longer operational. These policies included the Aircraft General Aviation Policy that covered hull risks and equipment and a war surcharge that is based on the number of person miles flown.
25. As most aircraft have been returned to lessors, the Trustee has negotiated with Willis an agreement whereby credits will be applied for any unearned revenues resulting from premiums prepaid on those aircraft that were returned to aircraft lessors during the period.
26. The Trustee has put in place a General Aviation Long-Tail Liability policy for a 12-month period pursuant to an order of the Court made December 13, 2001. This policy covers future liabilities that may relate to preservation steps undertaken with respect to

aircraft while in the possession of the Trustee. The Trustee expects to renew this policy for an additional year upon its expiration. Pursuant to an order of the Court dated January 9, 2002, the cost of this insurance is an expense of the bankrupt estates.

### **Physical Asset Counts**

27. D&T initiated and the Trustee has completed a comprehensive physical count of all Airlines' assets located in Canada. Our detailed comments regarding the physical counts are set out in the report in the respective asset categories.
28. The Trustee consolidated the assets in an effort to reduce its occupancy and payroll costs and maximize realizations. The Trustee has shipped various assets from Halifax, Calgary, Edmonton, Vancouver, Montreal and St. John's to Toronto. The Trustee requests approval for the relocation of assets to Toronto.
29. The Trustee has determined that Airlines had leased and owned assets located in several offshore locations. Where leased assets have been located and the Trustee has no interest in the assets, the Trustee has advised the lessors to collect their assets. With respect to owned assets located in the US, the Trustee has performed asset counts and is liquidating non-aviation assets where they are situated. Aircraft parts are being shipped to Toronto.
30. Based on the findings in the US and the preliminary review conducted by D&T, the Trustee has determined that it is not economically feasible to the estate for the Trustee to take any further steps to realize on assets in overseas locations. The Trustee has

released leased assets located offshore to the possession of the respective lessors on an “as is where is” basis.

## **VI. OPERATIONS**

### **Employees**

31. The Trustee has prepared approximately 3,100 Records of Employment, and 5,100 Canada Customs and Revenue Agency (“CCRA”) T4 and Releve I forms. As the bankruptcy terminated the employment of all the employees, the Trustee has a statutory obligation to process these documents.
32. In addition, the Trustee has prepared retention letters for approximately 97 employees whose services the Trustee determined were critical in order to ensure an orderly and efficient wind down of the operations of the Companies. To date, the Trustee has terminated approximately 67 of those employees. At the present time, approximately 30 employees remain in its employ. As employees are terminated, the Trustee will prepare additional Records of Employment.

### **Leased Premises**

33. Pursuant to an order of the Court dated February 8, 2002, the Trustee has disclaimed 35 leases and entered into three short-term occupation agreements with respect to premises used by Airlines. We summarize the locations still occupied and their respective uses below:

Location	Requirement and Use
27 Fasken Drive	Storage of aircraft records
Hangar 4 at the Millard Air Hangar	Storage of rotables and consumables inventory
Units 10 through 15 at 7040 Torbram Road	Storage of bonded, domestic and catering inventory and storage of galley equipment

34. In addition to the leased premises discussed above, the Trustee is in possession of two premises owned by Airlines in Toronto, as discussed later in the report.

### **Communications with Creditors and Other Interested Parties**

35. Pursuant to an order of the Court dated November 30, 2001, the Trustee conducted a national advertising campaign to advise ticketholders (“Ticketholders”), creditors and former employees that it established a website and a call centre. This website also allows the Trustee to obtain contact information from customers who did not receive travel services. Contact information obtained from the website and call centre has allowed the Trustee to communicate with these parties with respect to their claims. Prior to establishing these communication channels, PwC, D&T, travel agents, provincial regulators of travel services and the Superintendent of Bankruptcy had been receiving numerous inquiries from members of the public with respect to the status and the timing of the creditor claims process. It was in the best interest of all concerned that advertisements be published and the website and call centre be made operational in order to allow these calls to be channelled and handled in the most timely, effective and efficient manner possible.

36. The Trustee's communication strategy was developed in conjunction with a public relations firm, National Public Relations Limited, who were integral in ensuring that key messages to the public and creditors were appropriate in the circumstances.
37. The call centre was operational fourteen hours each day, five days each week for the month of December. During that period, the Trustee processed as many as 2,600 calls each day with the average number of calls being 1,050 each day. In order to effectively operate the call centre, the Trustee hired approximately 50 former employees.
38. In January 2002, the Trustee reduced the call centre's hours of operation to twelve hours each day, five days each week. During this month, call volumes averaged 550 calls each day with a high of 1,000 and a low of 340 calls in any given day. The Trustee had reduced the call centre personnel by 76% to 12 employees by the end of January. As of January 31, 2002, the Trustee has received approximately 30,000 calls.
39. In addition to the call centre volumes, The Trustee has received approximately 159,000 visits to its web site. A summary of the various pages visited and the number of visits follows:

<b>Web Page Visited</b>	<b>Number of Visits</b>	<b>Percentage of Total Visits</b>
	<b>(units)</b>	<b>(%)</b>
Home	82,170	52
Customer	31,834	20
Travel Agent	15,100	9
Employee	10,138	6
Trade Creditor	7,366	5
Shareholder	3,601	2
Other Information	8,898	6

<b>Total Visits</b>	<b>159,107</b>	<b>100</b>

## VII. ASSETS

40. As at the date of bankruptcy, the accounting records of Airlines listed the following significant assets, having the following book values. The Trustee notes that, with the exception of cash and short-term investments, these book values do not reflect current market values or expected realizations:

<b>Asset</b>	<b>Net Book Value</b>	<b>Net Book Value</b>
	(C\$ millions)	(C\$ millions)
<b>Aviation Assets:</b>		
Aircraft Parts – Rotables and Consumables	35.0	
Ground Equipment	2.4	
Security Deposits	35.5	
Bonded, Domestic and Catering Product	2.2	
Galley Equipment	1.4	
<b>Total Aviation Assets:</b>		76.5
<b>Non-aviation Assets:</b>		
Cash and Short-Term Investments	29.8	
Land and Buildings	8.8	
Leasehold Improvements	5.6	
Office Furniture & IT Equipment	10.3	
Third-Party Receivables	21.0	
Inter-company Receivables	43.9	
Prepaid Expenses	9.5	
Other Assets	13.2	
<b>Total Non-aviation Assets</b>		142.1
<b>Total Assets</b>		<b>218.6</b>

41. The assets, as set out above, are largely comprised of two main categories; aviation and non-aviation assets. Our discussions throughout this report segregate the assets on this basis. Our detailed comments on these assets are set out below.

## Aviation Assets

### Aircraft

42. On the date of bankruptcy, Airlines was in possession of 25 leased aircraft. We attach as Appendix E a listing of these aircraft which sets out the status of the aircraft and the related records. A summary of the status of the aircraft is as follows:

Entity	Category	Location on the date of bankruptcy	Current Status	Number
Airlines	Leased	In Canada	Returned to lessor	22
Airlines	Leased	In Europe	Returned to lessor	3
Total				25

43. On November 13, 2001, D&T in its capacity as Trustee advised the Court that it intended to cause Airlines' maintenance staff to perform necessary preservation procedures on the Company's fleet to mitigate the stakeholders' risk of loss while a protocol for the return of the aircraft was determined. Members of Airlines' maintenance staff performed the required preservation procedures, including running the aircraft engines, exercising various components, ensuring that adequate fuel and oil was on board and other steps.
44. In addition, the Trustee met with representatives from Transport Canada ("Transport") to review the requirements to preserve the aircraft. Transport is the Canadian

overseeing authority for aviation-related operations and safety. Transport encouraged the Trustee to make arrangements to have Airlines' maintenance staff perform short-term preservation procedures in an effort to preserve the aircraft's condition and ultimate safety by applying the programs provided by the aircraft manufacturer and approved by Transport. In addition, Transport agreed with the Trustee's plan to retain a third-party technical advisor to ensure the preservation procedures performed by Airlines were appropriate. The Trustee retained IBA Group from London, England ("IBA") to act in this capacity.

45. The IBA technicians also undertook inspections of the aircraft with the lessors when they were in the process of being returned in order to provide the Trustee with a record of the condition of each aircraft upon its return.
46. The Trustee negotiated security arrangements with the Greater Toronto Airport Authority ("GTAA") and with Transport to ensure that the Trustee and its representatives had access, as required, to the secured areas of the airport in order to carry out the preservation procedure. This negotiation required that the Trustee meet with GTAA's legal, operational and security departments to agree on the acceptable protocol with respect to the movement and preservation of the aircraft and ground equipment. The Trustee was required to become an issuing agent for airport passes with respect to all individuals to whom airfield access was granted and has an obligation to keep records with respect to all individuals holding airport passes.
47. Immediately after the order providing for the assignment in bankruptcy of Airlines, the Trustee and its legal counsel began the process of determining whether the estate had

any interest in or right to possess the aircraft, engines and related equipment (collectively, the “Equipment”) comprising its fleet.

48. The first step in this process involved the creation of a detailed inventory of all of the documents in the possession of Airlines relating to the Equipment. Once the initial inventorying process was complete, the Trustee’s counsel sent requests to the lessors and financiers of the Equipment requesting any further documentation that was required for the purpose of determining whether the estate of Airlines had any interest in or right to possess the relevant equipment. Once it had obtained all of the required documentation relating to particular Equipment, the Trustee’s counsel then reviewed the various agreements to which the Equipment was subject in order to determine whether such agreements constituted so-called “true leases”. If they did, the lessors of such Equipment would be entitled to retrieve their respective items of Equipment on the basis that they were the owners. If the agreements constituted financing arrangements, the financiers would have to show that they held a perfected security interest in the subject Equipment entitling them to repossess such Equipment, subject to the respective estates’ rights to receive any surplus proceeds from the disposition of such Equipment.
49. The Trustee and its counsel reviewed a total of 37 aircraft leases, two aircraft sale or conditional sale agreements and 14 engine leases.
50. An early complication that was encountered in the determination of the various parties’ rights in the Equipment was the common airline industry practice of pooling engines and parts across their fleets. For example, an engine from airframe A, which was subject to a “true” lease might be attached to airframe B, which was subject to a

financing arrangement with another party. In order to release the assemblage of airframe and engines to each of the relevant parties, the Trustee had to either (i) determine that the Equipment of each of the parties was releasable, so that the Trustee could release the entire assemblage, or (ii) obtain the consent of the party which held an interest in the non-releasable Equipment to the de-installation of such Equipment, so that the Trustee could relinquish possession of the Equipment.

51. Prior to releasing any Equipment, the Trustee required that the lessors or secured financiers of the Equipment enter into a form of acceptance agreement with the Trustee which set forth the rights of the parties and allocated the costs and liabilities associated with the preservation of the Equipment.
52. The Acceptance Agreements (the “Agreement”) contained the following provisions:
  - A commitment to reimburse the Trustee for costs incurred in the preservation and maintenance of the Equipment;
  - Acceptance of the Equipment and records on an “as is, where is” basis;
  - The institution of a mechanism to deal with parts discovered missing subsequent to the release of the Equipment by the Trustee;
  - The allocation of liability with respect to the preservation and care of the Equipment and responsibility for its future airworthiness; and
  - A mutual acknowledgement that both parties have the right to pursue future claims.
53. In addition to the basic form Agreement, the Trustee was required to develop additional forms of the Agreement to deal with scenarios where an assemblage

consisting of an airframe and engines was to be released to more than one Equipment lessor.

54. In those instances where Equipment belonging to one party was attached to Equipment being returned to another party, all parties were required to sign the Agreement. If one or more of the parties was not willing to sign the Agreement or if the Trustee was not in a position to release the Equipment, that party was required to sign a consent allowing the Trustee to detach that Equipment from the Equipment being released.
55. In respect of Equipment not subject to “true” leases, the financier of such Equipment, provided that the Trustee had determined that such party had a perfected security interest in the Equipment and was entitled to its possession, would be provided with an Agreement which provided that the Trustee reserve its right to require an accounting of any surplus proceeds arising from the disposition of the Equipment.
56. To date, the Trustee and its counsel have prepared and settled with various Equipment lessors a total of 32 Agreements relating to aircraft or aircraft and engines and 10 Agreements relating to engines only. The Trustee and its counsel are currently in the process of negotiating seven further Agreements, two of which relate to Royal’s aircraft and the remaining seven to aircraft engines in which Equipment financiers have a valid security interest.
57. In respect of Equipment that had never been in the Trustee’s possession, such as aircraft located in England and France on the date of the bankruptcy, the Trustee provided a short-form letter agreement to the lessors or financiers of such Equipment relinquishing its interest in the Equipment, subject to any rights it may have in surplus

proceeds from the disposition of the Equipment, and asked that the parties repossessing the Equipment acknowledge that they assumed full responsibility and liability for such Equipment. To date, the Trustee and its counsel have prepared and settled five such short-form letter agreements.

58. In certain cases Equipment lessors requested that the Trustee provide normal course of business representations upon the return of Equipment, including non-incident statements and statements as to the use of the Equipment. The Trustee did not have the direct knowledge to do so and therefore returned all components to Equipment lessors on an “as is where is” basis. In certain instances the Equipment lessors received the required representation directly from former employees
59. The Trustee has billed lessors for its out-of-pocket expenses and payment was a condition of the aircraft release. These expenses consisted primarily of parking, insurance and fuel. There are certain costs that have been estimated as the expense of accounting for the material or time would exceed the actual cost. Notwithstanding the estimates, the Trustee was careful to ensure the majority of the costs relating to the care and custody of leased and third-party property were to the account of the property owner and not the Estate. The Trustee has not allocated any of its professional fees to the third party property owners and lessors. The Trustee has recovered approximately \$1.7 million in out-of-pocket costs from third party property owners and lessors, of which \$1.1 million relates to Airlines’ aircraft and \$0.6 million to Royal. The disbursements and recoveries from owners and lessors in respect of out-of-pocket costs are shown in the Trustee’s Statement of Receipts and Disbursements for Airlines.

60. Upon the return of an aircraft or part, it is standard industry practice to provide the related records. The value of an airplane or part can be significantly compromised if the records are not complete. These records reflect maintenance, the origin of parts and modifications to the aircraft or parts. Accordingly, the Trustee retained 17 records clerks to assist the third-party property and lessors organize their respective aircraft records. The number of records staff has been reduced to three as aircraft have been released. Lessors or third-party property owners requiring records research are being charged \$250 for each day a records clerk is utilized in order to recover the estate's cost.

#### **Security Deposits and Maintenance Reserves**

61. In the normal course of business, aircraft lessees pay lessors security deposits (the "Deposits") and maintenance reserves (the "Reserves"). At the date of bankruptcy, Airlines' accounting records indicated Deposits of \$35.5 million and Reserves of US\$69.0 million paid to lessors. As a condition of the Agreement noted above, aircraft lessors were required to provide the Trustee with an accounting of funds relating to the Deposits and Reserves. To date, the Trustee has not received sufficient information from the lessors, with respect to their accounting for these funds, and will seek further direction from the Court. The Trustee is working with its counsel and has retained counsel in the United States to review its position with respect to the Deposits and Reserves. Subject to this review, the Trustee may initiate proceedings to recover certain of the Deposits and Reserves.

#### **Aircraft Parts - Rotables and Consumables**

62. Rotable and consumable parts inventory (“Parts”) consist of the various parts required to support an aircraft, including the following:
- Airframe Parts;
  - Engine Parts;
  - Tooling; and
  - Other miscellaneous parts.
63. At the date of bankruptcy, Airlines’ accounting records indicated approximately \$67.9 million in Parts, at cost, and \$35.0 million at depreciated book value. A separate inventory system maintained by Airlines’ parts department indicated approximately \$46.6 million at cost. The Trustee has discussed this difference with members of Airlines’ former management team who have advised that the inventory system and the general ledger have not been reconciled.
64. In order to gain comfort with the estimated realizations and conform to the requirements of the Superintendent’s directives under the BIA for inventory counts, the Trustee has undertaken a comprehensive physical count of the Parts. This involved counting approximately 43,000 different line items in 10 different locations across Canada. We summarize Airlines’ Parts by location, category and recorded value, as per the stores department inventory system, at the date of bankruptcy below:

<b>Location</b>	<b>Rotables</b>	<b>Consumables</b>	<b>Total Cost</b>
	<b>(C\$’000)</b>	<b>(C\$’000)</b>	<b>(C\$’000)</b>
Toronto	28,088	8,431	36,519
Vancouver	6,812	459	7,271
Halifax	1,324	265	1,589
Calgary	407	127	534
Edmonton	367	139	506

Winnipeg	102	77	179
Ottawa	20	5	25
St John's	8	0	8
<b>Total</b>	<b>37,128</b>	<b>9,503</b>	<b>46,631</b>

Note: The figures shown above represent the original cost of the Parts, as recorded in Airlines' system, and do not reflect current market values. The costs differ from those shown on the balance sheet as the information is extracted from an operations system that is different than the information in the accounting system.

65. The Trustee has expended significant effort and time in consolidating Parts from nine stations throughout Canada to a single site in Toronto. This was done so as to more efficiently offer the assets for sale and to reduce occupancy costs. Teams largely comprised of former Airlines' employees were dispatched to locations where, in most instances, landlords and labour were co-operative in assisting the Trustee. In addition to collecting and packing the Parts for shipment to Toronto, the teams ensured security sensitive documents were collected and secured in accordance with industry practice, as noted earlier in this report.
66. The Trustee has experienced significant resistance from a landlord in Halifax. Despite the existence of an occupation agreement between the landlord and the Trustee, the landlord took steps which frustrated the Trustee's ability to carry out its duties and resulted in the Trustee remaining on the site seven days longer than the anticipated three days. The landlord removed aircraft records from the Trustee's control which belonged to US Airways, contrary to US Airways' instructions. The records were subsequently returned to the estate. The landlord continues to hold a significant amount of computer equipment. To date, the landlord has refused to allow the Trustee an opportunity to inspect and inventory these assets, despite numerous written requests and a legal opinion that clearly identifies the assets as belonging to Airlines. The Trustee has retained counsel in Nova Scotia to provide advice concerning the dispute.

67. The Trustee completed the physical inventory counts of the Parts during the month of February. A detailed listing of the locations counted is attached as Appendix F.
68. The Trustee is organizing certificates and history that needs to be shipped with the Parts when they are realized on. This is a critical component in the marketing of aircraft parts in order for them to be considered airworthy and serviceable. Without these documents, the Parts will only realize a fraction of market value and require re-certification of the Part by the purchaser. This process has required a significant investment in personnel and time.
69. IBA's technicians have audited, on a sample basis, the Parts certificates for Airlines and reported that the Trustee should have no material documentation problems.
70. In addition to the physical counts, the Trustee has derived a counting system to positively identify each Part with a unique number that provides the details needed to locate the Parts certification documents, identify the aircraft type to which the Part relates and the province the Part was located in on the date of bankruptcy. All certification documents are located in Toronto. This process is time consuming and required a significant effort by the Trustee and its staff. However, it will significantly enhance realizations as well as provide protection to various Personal Property Security Act registrants while not restricting the Trustee's ability to prepare the assets for sale.
71. The Trustee intends to advertise the Parts for sale during the month of March 2002. Advertisements will be placed in a national newspaper as well as industry publications.

In addition, the Trustee intends to circulate the Parts listings to certain mid-sized airlines.

72. The Trustee has commissioned appraisals of the Parts and IBA expects to have this completed by mid March 2002. The appraisals will be used as a benchmark for any offers received through the above noted sales process.
73. The Trustee has also been in discussions with several Parts dealers and other industry players to pre-market the assets and build awareness.

### **Aircraft Parts - Ground Equipment**

74. At the date of bankruptcy, the net book value of Airlines' ground equipment was approximately \$2.4 million, comprised of approximately 220 line items. The significant components are as follows:
- Tow bars;
  - Ground Power Units; and
  - Baggage handling equipment.
75. The Trustee has completed physical inventory counts of the ground equipment. The Trustee intends to advertise the equipment for sale by mid March 2002 and has commissioned appraisals for the equipment.

### **Bonded, Domestic and Catering Product**

76. Airlines operated an onboard duty-free shopping network and offered its passengers alcohol, tobacco and other sundry items. At the date of bankruptcy, the book value of Airlines' bonded, domestic and catering product (the "Product") was approximately \$2.2 million. The Trustee has determined the existence of Product with a book value of approximately \$2.4 million based on its physical counts. Approximately \$149,000 of this equipment is located offshore. Attached as Appendix G is a detailed listing by location of the Airlines Product. A summary is set out below:

<b>Inventory Category</b>	<b>Book Value</b>	<b>Number of Locations</b>
	<b>(C\$'000)</b>	
Bonded	1,381	6
Domestic	110	7
Catering	942	19
<b>Total</b>	<b>2,433</b>	

77. At the date of bankruptcy, Airlines maintained Product in twelve locations across Canada and seven locations overseas. Product located outside of Ontario was maintained at third-party warehouses. The Trustee enlisted the services of the third parties to perform the physical counts, and the Trustee through its agent D&T, reviewed the count procedures and performed test counts. The Trustee was ultimately satisfied with the counts provided by the third parties. Former Airlines' employees performed physical counts of the Product located in Toronto.
78. As discussed later in this report, a significant portion of the Product was subject to thirty-day goods claims pursuant to section 81.1 of the BIA. In order to obtain accurate counts of the Product in the Canadian locations, assess its value, complete an assessment of thirty-day goods claims and prepare the inventory for sale, the Trustee arranged for former Airlines employees and the third-party personnel to gather the product from approximately 1,000 bar and duty-free carts.
79. The Trustee has determined that Airlines maintained Product in locations throughout the world, including India, England, Hawaii, and Australia. Based on its analysis, the Trustee is of the opinion that it is more cost effective to abandon a portion of this Product rather than to attempt to retrieve it. The Trustee has been working with the

CCRA with respect to determining what duty, if any, needs to be paid on disposal of the duty-free items. In addition, the Trustee has requested the information necessary to make an application for duty draw-backs related to duties and taxes paid on Product sold offshore from the former Airlines customs brokers and will make an application as soon as the information is received. The Trustee anticipates that any refunds received will be minimal.

80. The Trustee has contacted approximately 30 airlines and informed them of the Trustee's intent to dispose of Product belonging to Airlines and Royal and requested that they notify the Trustee if they have an interest in receiving detailed listings of the items for sale. To date, the Trustee has received favourable responses from approximately 10 airlines.

### **Galley Equipment**

81. Airlines offered full food service and owned all the serving and catering equipment associated with this activity. In some cases, equipment was customized, like the catering carts that carried non-standard meal trays, to meet Airlines' operating requirements. The accounting records indicated the existence of galley equipment with a net book value of approximately \$1.4 million. The Trustee has undertaken a physical count of the galley equipment and determined the existence of approximately \$2.2 million. Approximately \$189,000 of this total value is located offshore.
82. The Trustee has completed physical inventory counts of the galley equipment located in Canada and is in the process of assessing its options with regard to the retrieval and disposal of equipment located offshore.

83. The Trustee intends to dispose of the galley equipment using the same process as that of the bonded, domestic and catering product discussed above and, in addition, has commissioned appraisals of the galley equipment.

## Non-Aviation Assets

### Cash and Short-term Investments

84. As at the date of bankruptcy, the accounting records of Airlines indicated approximately \$29.8 million in cash and short-term investments in various bank accounts. The Trustee has determined that there is approximately \$32.4 million in cash on deposit in various operating bank accounts. Of this total, approximately \$29.1 million was held at RBC Financial Group (“RBC”) and the remaining \$3.3 million was held in other bank accounts.

85. A breakdown of the cash balances and subsequent transactions is summarized below:

	(C\$ millions)	(C\$ millions)
<b>RBC Funds:</b>		
Wage arrears funded	6.3	
Monitor/Trustee Funding	3.1	
Short-term investments	6.3	
Frozen funds	13.4	
Total RBC Funds	29.1	29.1
Funds held by Other Institutions		3.3
<b>Total Cash held as at the date of bankruptcy</b>		<b>32.4</b>

86. By order of the Court dated November 15, 2001, RBC agreed to make available to the Trustee up to \$6.5 million to fund the payment of wage arrears, up to \$500,000 to fund the miscellaneous expenses of the CCAA Applicants incurred up to November 13,

2001 and up to a further \$3.0 million to fund expenses in the CCAA and the restructuring or bankruptcy proceedings. As at the date of this report, RBC had made available \$6.3 million in respect of wage arrears and \$3.1 million in funding to the Trustee. D&T is still in possession of approximately \$500,000 of the \$6.3 million that was approved by the Court for the payment of payroll costs, pending the final reconciliation of payroll amounts to be paid and the payment thereof.

87. RBC is holding short-term investments of \$6.3 million as cash collateral in connection with \$6.3 million in LCs issued by RBC on behalf of Airlines. As of the date of this report, \$4.3 million of the \$6.3 million in LCs have been drawn upon. However, RBC advises the Trustee that it has not yet applied any of the cash collateral to the LCs that have been drawn.
88. The balance of the funds in RBC accounts of \$13.4 million is being held by RBC pursuant to the charge over these funds arising from its GSAs.
89. Of the remaining \$3.3 million held by other financial institutions, the Trustee has recovered approximately \$1.0 million and has issued demands to the other banks to retrieve the remaining funds. The various banks are holding approximately \$1.4 million of the remaining \$2.3 million as security for potential credit card chargebacks. The Trustee has issued several demands to collect the remaining \$900,000 but is encountering numerous delays from the respective banks

## **Land and Buildings**

90. The Trustee has determined that the buildings located at 23 Fasken Drive (“23 Fasken”) and 31 Fasken Drive (“31 Fasken”) in Toronto are owned by Airlines.
91. Both buildings were offered for sale and a deadline for offers was set for February 11, 2002. The Trustee advertised the buildings for sale in a national newspaper and distributed 20 information packages to potentially interested parties. The Trustee also had numerous discussions with real estate agents and brokers encouraging them to submit offers from any interested parties. Following this process, the Trustee received three offers each for the buildings at 23 and 31 Fasken.
92. The highest offer received for 31 Fasken was from Skyservice Airlines Inc. (“Skyservice”) in the amount of \$2.733 million and the Trustee has accepted this offer subject to Court approval. The Skyservice offer is less than the appraised value of the property but the Trustee believes that, given the exposure of the property to the market and the fact that the configuration of the building makes it attractive to a fairly narrow range of users, this offer represents the highest value that can be achieved and is therefore commercially reasonable. In addition, the Trustee has negotiated occupation terms with Skyservice and will enter into a formal occupation agreement upon closing, which will enable it to occupy the premises rent free until May 31, 2002 and provide for a sharing of utility costs.
93. Appraisals with respect to 31 Fasken and a copy of the other offers received have not been attached to this report so as not to prejudice future negotiations concerning the sale of this property in the event that the sale to Skyservice is not successfully completed. This material will be made available to the Court should the court wish to review it and in that event the Trustee will seek an order sealing this material from the

public record. The Trustee will also make available to the court, should it wish to review it, a copy of the marketing information package prepared by the Trustee in connection with this property.

94. The property at 31 Fasken is the subject of a first mortgage in favour of Sun Life Assurance Company of Canada (“Sun Life”), a second mortgage (as collateral security to a first mortgage which Sun Life holds on 23 Fasken) and two lien claims. The Trustee proposes that the proceeds of the sale to Fasken be held by the Trustee pending further order of the Court or agreement between the Trustee, Sun Life and the lien claimants as to their disposition.
95. The Trustee requests that the Court approve the sale of 31 Fasken to Skyservice and make an order vesting in Skyservice, as it may direct, all of the right, title, claims and interest of Airlines in 31 Fasken.
96. The sale process did not result in any acceptable offers being received for 23 Fasken. The Trustee is considering its position with respect to this property and will report to the Court at a future date with respect to its plans.
97. The Trustee received an unsolicited en bloc offer for both the buildings, the intellectual property, computers, tooling and Airbus A320 parts, from Angus Kinnear (“Kinnear”), the former President of Airlines. Kinnear subsequently advised the Trustee that he would not be proceeding with the re-launch of an airline and, therefore, withdrew his offer.

#### **Office Furniture and IT Equipment**

98. These assets are largely made up of:
- Furniture;
  - Computers; and
  - Photocopiers and fax machines.
99. The Airlines accounting records indicate approximately \$10.3 million in office furniture and IT equipment (“Furniture”) at depreciated book value.
100. The Trustee has completed physical counts of all Furniture. Furniture located outside of Toronto, with the exception of Halifax as referenced above, is being offered for sale in a competitive bid process in its local market. In Toronto, certain assets are being removed from leased premises and stored in trailers in an effort to reduce occupancy costs until realization. Airlines, as noted in the premises section of this report, had equipment located in six main locations in Toronto. It is the Trustee’s view that consolidating the Equipment from Toronto would result in a higher realization than multiple fragmented sales.
101. The Trustee intends to sell all of the Furniture in the coming month. The Trustee placed an advertisement in a national newspaper on February 26, 2002, which ran for two days. The sale process should be substantially complete by the end of March 2002.
102. The Trustee advertised certain Furniture located at 23, 27 and 31 Fasken for sale during the month of January 2002. The Trustee received six offers and accepted the highest, which was a net minimum guarantee arrangement received from Maynards. The Trustee requests that the Court approve the sale transaction with Maynards and

make an order vesting in Maynards, or as it may direct, all of the right, title and interest of Airlines in the assets which are the subject of this transaction.

103. In addition, the Trustee is in the process of removing all data from computers and returning them to their original configuration in preparation for their disposal. This process is designed to protect the privacy of the former employees who used the computers as well as ensure the Trustee does not inadvertently convey licensed software to which it does not have rights.
104. The Trustee returned certain furniture, including desks, chairs and workstations which were subject to a demand for repossession pursuant to section 81.1 of the BIA, to Lev'rmark Inc, the original supplier of the furniture. The estimated value of the items returned to Lev'rmark is approximately \$1.0 million.
105. The Trustee is in the process of returning the Uninterruptible Power Supply ("UPS") and other supporting equipment authorized for release to FM & Engineering Inc. by the Court on February 8, 2001. These pieces of the equipment were the subject of a section 81.4 claim for return of property.
106. As noted later in this report, the Trustee has received a significant number of property proofs of claim relating to IT equipment. With the assistance of its legal counsel, the Trustee is assessing the validity of these claims and, where appropriate, returning the equipment. This process is ongoing. In the event claims have been or will be disputed by the Trustee, the Trustee will wait the 15 days after mailing the notice of dispute required under the BIA before disposing of these assets.

## Vehicles

107. At the date of the bankruptcy, the accounting records of Airlines reflected six vehicles valued at approximately \$99,000 at depreciated book value . Airlines wrote off fully depreciated vehicles from its books which results in a low aggregate capital cost in the records.
108. After satisfying third-party claims, 41 vehicles remain in Airlines estate. Of these 41 vehicles, six are classified as Ground Service Equipment and will be disposed of with the other similar aviation assets. The Trustee intends to dispose of these vehicles during the month of March 2002. Advertisements were placed in a national newspaper during the week of February 25, 2002 for those vehicles located in Toronto. All other vehicles will be disposed of locally.
109. To date, the Trustee has disposed of three vehicles, two of which were located in Halifax and one in Calgary. The Trustee has realized approximately \$34,000 from these sales. The Trustee seeks the Court's approval for the vehicle sales.

## Third-Party Receivables

110. At the date of bankruptcy, Airlines' books and records indicated a net book value of approximately \$21.0 million for third-party receivables. The significant third-party receivables are summarized below:

<b>Debtor</b>	<b>Value</b>
Aircraft Lessors – maintenance charges	(C\$ millions) 9.7

Airline Marketing Group	2.5
Commodity Taxes	1.7
Computerized Reservation System (“CRS”)	1.9
Tour Operators	1.4
Insurance Claims	1.1
Other	2.7
<b>Total:</b>	<b>21.0</b>

111. As at February 28, 2002, the Trustee has recovered approximately \$297,000 of which approximately \$92,000 relates to a Workers Compensation Board of British Columbia refund . The remaining \$205,000 has been received from various parties. The Trustee’s recovery of funds is being hampered by claims of set-off against the majority of the receivable balances. The Trustee is currently assessing its ability to recover these balances.
112. The receivable of \$9.7 million due from aircraft lessors represents costs incurred by Airlines, prior to the bankruptcy, on behalf of the lessors to maintain the aircraft. These amounts may be set off by claims resulting from the early termination of the leases.
113. There is an additional unrecorded potential recovery of \$2.5 million from Transport in respect of the Government of Canada Compensation Program relating to the September 11, 2001 incident. In October 2001, Airlines received 75% of their claim or \$7.4 million. The entire claim, including supporting documentation, is subject to review by the Trustee who will submit a recommendation to the Court or its inspectors as to its course of action.

### **Intercompany Receivables**

114. The books and records of Airlines indicate that among Airlines, Inc., and Royal, the following related party balances exist:
- Airlines is due \$6.3 million from Royal; and
  - Inc. is due \$27.5 million from Royal.
115. The remaining \$10.1 million is due from the other related companies.
116. Inc. holds a GSA against Royal, ranking subsequent to CIBC's GSA.
117. As indicated later in this report, Royal's first secured creditor, CIBC, is not expected to fully recover its loans. Inc. has security over the same assets as CIBC and, thus, is not expected to have any recoveries pursuant to its GSA. It should be noted that pursuant to a sale of Canada 3000 Cargo Inc. ("Cargo") approved by Court order on February 8, 2001, any outstanding related party debt with Cargo has been extinguished. Cargo is a joint venture in which Royal held a 50% interest. As indicated in the Trustee's first report to the Court, dated February 8, 2002, pursuant to its GSA, RBC appointed PwC as its agent with respect to the sale of the intercompany account owing by Cargo to Airlines. PwC, in its capacity as agent for RBC, is currently reviewing the status of the intercompany account between Airlines and Cargo in order to finalize the allocation of the purchase price of \$2.2 million as between Airlines and Royal, which sold its 50% interest in Cargo as part of the sale.
118. In August of 2001, Inc. issued a claim in the Court against Group Royal Aviation Inc. ("Group Royal"), Michel Leblanc ("Leblanc") and Roland Blais ("Blais"). The claim seeks damages of approximately \$45 million arising from fraudulent and negligent misrepresentations allegedly made in connection with the acquisition of the shares of

Royal. Leblanc, Blais and Group Royal have also commenced proceedings in the Quebec Superior Court against Inc. claiming in excess of \$25 million. The Trustee's counsel is currently reviewing these claims and will provide the Trustee with advice as to how the Trustee should deal with them.

## Prepaid Expenses

119. As at the date of bankruptcy, the accounting records of Airlines listed approximately \$9.5 million in prepaid assets. A summary of the major items comprising the balance is as follows:

<b>Item Prepaid</b>	<b>Net Book Value (C\$'000)</b>
Commission – Customer Reservation System (“CRS”)	1,870
Fuel Consortium	1,220
Uniforms	1,077
Insurance	666
CCAA Legal and Accounting Fees	650
Rent	465
Deposits	376
Aircraft Lease	276
Realty Taxes	116
Other Prepaid Expenditures	2,835
<b>Total Prepaid Expenses</b>	<b>9,551</b>

120. CRS commissions are prepaid to travel agents in respect of bookings made for future travel. The Trustee is currently reviewing this balance to determine the potential recovery, if any, from travel agents who have provided full refunds to their customers. The Trustee does not anticipate that it will realize a significant portion of the \$1.9 million that has been prepaid.
121. Fuel Consortium represents prepaid fuel deposits and inventory for the aircraft fleet. The Trustee expects a significant portion of the \$1.2 million that has been prepaid, to be offset by monies owed to the respective fuel suppliers.

122. The Trustee has concluded that there will be no realizations from uniforms.
123. The Trustee is utilizing approximately \$1.5 million in prepaid insurance, rent and realty taxes to reduce its operating costs.
124. The prepaid legal and accounting fees are comprised of a retainer of \$350,000 to D&T and a retainer of \$300,000 paid to Cassels, Brock and Blackwell, Airlines' counsel. These funds will be utilized to pay professional fees once the fees are approved.
125. Deposits relate to amounts paid to various vendors, which may have an offset in trade payables owing to these vendors. The Trustee is in the process of reviewing the listing of deposits to determine the magnitude of potential recovery.
126. The Trustee is in the process of evaluating the other prepaid expenditure balance. At the present time, it appears that there will be limited realizations, if any, on these items.

**Other Assets**

127. Included in the other asset category are goodwill of approximately \$7.3 million, intercompany loans of approximately \$1.9 million and other current assets of approximately \$4.0 million. The Trustee does not anticipate any realizations from these assets.

### **Corporate Income Taxes Recoverable**

128. The Trustee has reviewed the accounting records of Airlines for the taxation period beginning August 15, 2001 to November 10, 2001 (deemed taxation year end due to bankruptcy), and has determined that Airlines will incur a net operating loss for tax purposes of approximately \$35.0 million. A portion of the net operating loss can be carried back to the April 30, 2001 taxation year to claim a refund estimated at \$5.5 million in federal income taxes paid, and \$1.5 million in provincial income taxes paid.
129. The provincial tax authorities have not yet assessed Airlines for the April 30, 2000 or the April 30, 2001 taxation years. A review of the provincial tax returns filed for these years indicates a provincial tax refund due of approximately \$2.8 million.
130. The Canada Customs and Revenue Agency has reassessed Airlines for outstanding income taxes, GST, and payroll taxes of approximately \$5.4 million. Consequently, the above-noted federal refund of \$5.5 million may be offset by these federal tax liabilities. Similarly, the above-noted provincial refunds totaling \$4.3 million may be offset by provincial reassessments of income and capital taxes.

## VIII. CLAIMS

131. The Trustee anticipates that it will receive claims from third parties, valued at approximately \$75.0 million. A breakdown of the anticipated claims and the respective creditor and/or claim category has been summarized below:

<b>Claim</b>	<b>Approximate Value</b>	
	<b>(C\$'000)</b>	
Secured Creditors	Est	17,200
30-day Goods		4,200
Property	Est	3,000
Trade Creditors		21,500
Employees		15,000
Ticketholders <sup>1</sup>		14,000
CCAA	Est	100
<b>Total Claims</b>		<b>75,000</b>

<sup>1</sup> Net of \$10 million in visa chargeback claims for which RBC is claiming as secured.

132. As discussed below, RBC is also advancing a secured claim against Airlines in respect of an anticipated shortfall on its claim against Leisure.
133. In addition to the above, Equipment lessors may assert claims relating to termination of Equipment leases.

### **Secured Creditors**

134. Royal Bank of Canada ("RBC") has separate GSAs over the assets of Airlines, Leisure and Sales. The Trustee's counsel, McMillan Binch, was conflicted from providing the Trustee with an opinion on the validity and enforceability of RBC's security.

Consequently, the Trustee engaged Davis & Company (“Davis”) to provide the opinion. Davis has advised the Trustee that RBC’s security with respect to Airlines, is valid and enforceable as against the Trustee for personal property assets located in Ontario and assets located outside of Ontario covered by RBC’s registration of its security in Ontario. Davis has also provided the Trustee of Leisure and Sales with an opinion indicating that RBC’s security is valid and enforceable as against the Trustee.

135. RBC’s potential claim against Airlines, secured by its security, is comprised of the following components:

<b>Component</b>	<b>Value</b>
	<b>(C\$ millions)</b>
Letters of Credit	6.3
Payments re. RBC Customer Loyalty Programs	0.8
Cheque Chargebacks	Est. 0.1
Visa Chargebacks	Est. 10.0
Shortfall on recoveries from Leisure	TBD
<b>Total*</b>	<b>17.2</b>

\* (Not including costs incurred in realizing on security and other recoverable costs)

136. As at the date of bankruptcy, RBC had issued LCs totalling \$6.3 million. As at the date of this report, RBC advises that, of this amount, LCs with a face value of approximately \$4.3 million have been called. The Trustee has concluded that there is no issue concerning the validity of RBC’s claim with respect to the LCs, to the extent that they are validly drawn upon prior to expiry. The Trustee has not yet taken a position on the other components of RBC’s claim, but expects to do so shortly with respect to the claims relating to RBC’s Customer Loyalty Program and cheque clearing chargebacks. Once inspectors are appointed, the Trustee will seek instructions

concerning the position of the estate on the components of RBC's claim relating to Visa chargebacks.

137. RBC's claims against Airlines with respect to RBC Customer Loyalty Programs relate to payments made to Airlines for travel services not provided. RBC would buy travel services through an agency called Memberworks and provide them to its customers as part of a customer rewards program. RBC's customers may have paid for a portion of their trip and would have claims against Airlines for this portion to the extent such travel services were not provided.
138. As will be discussed below with respect to Ticketholder claims, Airlines' unearned revenue relating to future travel services not provided totalled approximately \$24 million as at the date of bankruptcy. Of this amount, \$17.5 million related to sales in Canada representing approximately 40,000 passengers; the balance of \$6.5 million related to sales outside of Canada. Of the sales in Canada, for which details of the method of payment are known, approximately 60% were paid for using one of four credit cards: Visa, Mastercard, American Express or Diners.
139. RBC was the Visa Merchant Bank for Airlines as well as for Leisure, Holidays and Sales. According to RBC, when a Visa credit cardholder used its Visa credit card to pay for travel services purchased from Airlines and the payment was processed using Airlines' Visa merchant number, RBC would credit Airlines for the amount of the transaction.
140. According to RBC, in certain circumstances specified in the Visa merchant agreement with RBC, including where the service to be provided was not satisfactory, RBC is

entitled to reverse the amount of the credit given. It is this process that gives rise to the Visa chargebacks in respect of customers who paid by Visa but did not get the service for which they paid. Identifying the chargebacks and processing these chargebacks is a time consuming and ongoing process.

141. Moneris Solutions Corporation (“Moneris”) acts as agent for RBC with respect to processing Visa transactions. The Trustee is advised by Moneris that it expects to have processed the majority of claims for refunds from Visa Ticketholders of Airlines by the end of March 2002. RBC advises that these claims are expected to total approximately \$10 million after resolution of various reconciling items.
  
142. The final component of RBC’s claim is the anticipated shortfall on its claims of approximately \$26 million against Leisure. These claims also relate to Visa chargebacks. Leisure has non-trust assets as well as trust assets that will cover a portion of RBC’s claims in this respect. However, there are insufficient assets on hand and anticipated recoveries therefrom to fully satisfy RBC’s claim against Leisure. As indicated in the Leisure Trustee’s report, attached as Appendix A, the Trustee is estimating recoveries, before professional fees, on the non-trust assets of approximately \$5 million (mid-point of range). This would leave a claim of \$21 million to be satisfied from RBC’s share of the trust funds. Leisure has trust funds on hand of approximately \$24 million. These funds represent monies received on behalf of travellers, but the claims of travellers are expected to materially exceed the funds on hand. RBC’s claim of \$21 million, after recoveries from non-trust assets, will be reduced by any recoveries from the trust funds. The actual amount of this recovery has yet to be determined. RBC advances these claims against Airlines on the basis of an agreement under which Airlines is to indemnify RBC with respect to claims by RBC

against Leisure and under guarantees granted by Airlines in respect of these claims against Leisure.

143. With respect to its claims against Airlines for Visa chargebacks (either directly or under the indemnity), RBC asserts that its Visa chargeback claims are secured as a result of the provisions of its GSA, which purports to cover all obligations, indebtedness or liabilities, however incurred. Once inspectors are appointed, the Trustee will seek instructions concerning the position of the estate as to whether such claims are secured.

#### **Asset Liens**

144. Cara Operations Limited (“Cara”) stored certain Airlines bonded product and catering supplies in their warehouses across Canada. Cara filed a storage lien valued at approximately \$57,000 representing outstanding storage costs dating back to July 2001. The lien was reviewed by the Trustee’s counsel and deemed to be valid.
145. The book value of the product stored in the various Cara locations is approximately \$2.3 million. The Trustee determined that it would be beneficial to the Estate to remit the lien payment of \$57,000. The Trustee remitted the payment on January 4, 2002 and has subsequently claimed possession of all product stored at Cara.
146. The Trustee has been advised that Container Care Inc. (“Container Care”) has placed a Repairers and Storage Lien on 133 baggage cargo containers. The containers were on hand at Container Care’s premises for assembly. Container Care is owed

approximately \$93,000 and the original cost of the containers is approximately US\$120,000.

147. The Trustee’s counsel has validated Container Care’s right to lien the product and is in the process of coordinating with their counsel to have the containers disposed of and to ensure that Container Care submits a comprehensive accounting of the proceeds received to the Trustee.

### 30-day Goods Claims

148. The Trustee has received claims from suppliers for the repossession of goods pursuant to Section 81.1 of the BIA valued at approximately \$4.2 million. Detailed schedules of the claims received are attached as Appendix H, and a summary of the claims is set out below:

Claim Status	Value (C\$'000)	Claims
Accepted	1,783	48
Rejected	2,325	13
In Process	121	3
<b>Total Claims Received</b>	<b>4,229</b>	<b>64</b>

149. Of the total accepted claims, Lev’rmark Inc. (“Lev’rmark”), who filed a demand to repossess certain pieces of office furniture, represents approximately \$1.0 million. The Trustee agreed to allow Lev’rmark to repossess a portion of the furniture, which was installed and in use by Airlines in exchange for Lev’rmark agreeing to allow the Trustee short-term use of furniture it required for its call centre.

150. Of the total rejected claims, the largest was from Irving Oil for approximately \$600,000. Irving Oil made a claim for the repossession of fuel supplied to Airlines. The Trustee rejected the claim on the basis that it was not possible to specifically identify the fuel that Irving Oil had delivered.
151. The Trustee is in the process of reviewing three remaining claims valued at approximately \$121,000.

### Property Claims

152. The Trustee has received 85 non-vehicle property claims to date. Detailed schedules of the claims received are attached as Appendix I and a summary is set out below:

<u>Claim Status</u>	<u>Claims</u>
Accepted	36
Rejected	13
In Process <sup>1</sup>	<u>36</u>
<b>Total Claims Received</b>	<b><u><u>85</u></u></b>

<sup>1</sup>Of the In Process claims, 15 of these relate to the Parts. The Trustee estimates that these claims will be resolved by March 31, 2002.

153. The Trustee has received property claims for various types of IT equipment including, computers, printers, and photocopy machines, as well as claims for vending machines, software programs and maintenance tools.

154. The process of establishing the validity of the property claims has required that the Trustee undertake numerous procedures including the following:
- Review of the lease, license or other agreements, delivery, and other supporting documentation to establish ownership of the property;
  - Determination of the current status of the property; and
  - Determination of the location of the property and organizing its return to the beneficial owner.
155. In the case of maintenance tools and other aviation property, the Trustee has had to undertake additional procedures including the following:
- Locating the particular item, (either in stores, out for repair or installed in an aircraft);
  - Tracking engines, reviewing log books, service bulletins, and engine manuals; and
  - Utilizing engine mechanics and other personnel to track the history of the property.
156. The Trustee is working with parts claimants on the identification, validation and if appropriate return of their parts. This is a complex process that the Trustee intends to complete as quickly as possible.
157. The Trustee has received approximately 101 vehicle claims. Schedules detailing the claims received have been attached as Appendix J. A summary of these claims is set out below:

<b>Status of Claim</b>	<b>Number of Claims</b>
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Vehicles released to the Lessor	95
Review in progress	6
<b>Total Claims</b>	<b>101</b>

### Trade Creditors

158. The Trustee has mailed approximately 1,700 Proofs of Claim forms to the trade creditors of Airlines reflected in the books and records as having claims of approximately \$21.5 million. To date, the Trustee has received approximately 361 claims.

### Employee Claims

159. The Trustee has reviewed the employee claims of Airlines and Royal through a combined process that was deemed to be more efficient than an independent review by estate. Our comments with respect to the employee claims reflect that of both the Trustee of Airlines and Royal.

160. As at the date of bankruptcy, Airlines and Royal had over 3,100 employees, as summarized in the table below:

<b>Company</b>	<b>Union</b>	<b>Non-Union</b>	<b>Union Certified*</b>	<b>Total</b>
Airlines	382	837	899	2,118
Royal	666	340	0	1,006
<b>Total</b>	<b>1,048</b>	<b>1,177</b>	<b>899</b>	<b>3,124</b>

161. On December 18, 2001, the Trustee brought an application in Court seeking relief from certain of the requirements of the BIA, including but not limited to, employee claims.
162. The modifications sought and approved by the Court were the modification of the claims process provided for in the BIA as it relates to the notification and filing of proofs of claim by the employees so as to allow the Trustee to:
- accept one claim filed by each of the unions on behalf of all employees who are union members;
  - with respect to non-union employees, work with the former human resources and payroll personnel to calculate each employee's claim amount and insert each employee's name, address, contact number, the amount claimed (the "Specified Amount"), the priority (preferred and/or unsecured) and the type of claim (unpaid wages, vacation pay, severance, expenses, bonus, etc.) in a pre-printed proof of claim form accompanied by a schedule summarizing the components of the claim and the total amount;
  - recognize a claim in the employee's name for the Specified Amount and enable the Trustee to process the employee's claim as a preferred and/or unsecured claim, unless the employee advises the Trustee that the Specified Amount is incorrect; and
  - amend the Specified Amount, where an employee claims the Specified Amount is incorrect and has forwarded the proof of claim form, together with supporting documentation, for an amount that is different than the Specified Amount.

163. In accordance with the Court approved employee claims process, the Trustee has completed calculating the various employee entitlements to severance, termination and vacation pay. This was an extensive exercise involving a review of each province's labour legislation and the Canada Labour Code ("CLC"). This was required as four of the companies in the group were federally regulated and one was provincially regulated.
164. In addition, the Trustee was required to review five different union agreements and one association agreement, which were in place at the date of bankruptcy. Employee entitlements under each union agreement were reviewed and compared to the CLC as required under the agreement.
165. The Trustee, with the assistance of former Airlines employees, was required to calculate vacation pay entitlements based on information gathered from the individual department managers as the information was not previously kept by the payroll department. After accumulating the data, the preferred portion of the pay had to be identified to ensure that it did not extend beyond the six-month period as detailed under the BIA.
166. The Airlines payroll department was also required to finalize three different employer payrolls for Airlines, Royal and Inc., issue Records of Employment within the required time and issue separate T4's and Releve 1 for all employees.
167. The Trustee estimates the cumulative employee liability will be in the region of \$15.0 million, with \$2.0 million remaining in preferred claims after the Court approved payment of the outstanding payroll at the date of bankruptcy. This is discussed in

further detail further in the report. Attached below is a summary of the calculated claims:

<b>Company</b>	<b>Preferred Claim</b>	<b>Unsecured Claim</b>	<b>Total Claim</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>
Airlines	1,700	9,300	11,000
Royal.	200	3,800	4,000
<b>Total Claims</b>	<b>1,900</b>	<b>13,100</b>	<b>15,000</b>

168. D&T, in the capacity as Monitor, paid certain amounts for outstanding wages and benefits for the period ending November 10, 2001 to its employees.

### **Ticketholders**

169. As at the date of bankruptcy, Airlines had unearned revenue relating to future travel services not provided of approximately \$24 million. This represented approximately 52,000 tickets.

170. A breakdown of this amount by geographic region, is set out below:

<b>Location of Ticket Sale</b>	<b>Tickets Sold</b>	<b>Value</b>
	<b>(units)</b>	<b>(C\$'000)</b>
Canada	39,793	17,541
Australia	2,659	2,113
U.S.A.	4,810	2,056
Great Britain	2,338	1,080
New Zealand	1,621	919
Portugal	394	117
Spain	98	59
India	57	57
France	55	25
<b>Total</b>	<b>51,825</b>	<b>23,967</b>

171. Additional detail has been provided in Appendix K.
172. As indicated at the outset of this report, with the Court's approval, the Trustee set up a call centre and web site to facilitate communications with the thousands of Ticketholders who did not receive travel services, as well as other creditors. This was done to channel the numerous phone calls which were being received by travel agents, travel regulators, the Superintendent in Bankruptcy and the Trustee. In addition, Airlines' records did not contain sufficient details to allow the Trustee to correspond with Ticketholders to advise them of the bankruptcy. Consequently, it was necessary to get Ticketholders to contact the Trustee and provide such details to allow for subsequent communications with respect to a Ticketholder's claim.
173. For Ticketholders located outside of Canada, the Trustee took additional steps to advise these Ticketholders of the bankruptcy of Airlines. These steps included the following:
- Contacting over 1,000 travel agencies;
  - Sending emails to over 3,200 ticket holders who had originally ordered tickets over the web; and
  - The setting up of a website.
174. In conjunction with the application brought on December 18, 2001 by the Trustee in connection with employee claims, the Trustee also sought modifications to the requirements of the BIA with respect to the handling of Ticketholder claims (the "Ticketholder Claims Process"). Specifically, the following modifications were sought:

- Approval to insert the Ticketholder’s name, address, contact number and amount claimed (the “Specified Amount”), the priority of their claim and the type of claim (non-performance, lost baggage, special costs, etc.) in a pre-printed claim form, which would be forwarded by the Trustee to the Ticketholder; and
  - Approval to recognize a claim in the Ticketholder’s name for the Specified Amount, without having received a signed claim form from the Ticketholder, unless the Ticketholder notifies the Trustee that the Specified Amount is incorrect and provides evidence in support of a different amount.
175. As with employee claims, the primary rationale for seeking the above modifications was to streamline the claims process. Specifically, the Trustee had determined that there was sufficient information, either extracted from Airlines’ systems or gathered by the call centre, to allow the Trustee to validate the majority of Ticketholder claims without supporting documents having to be provided by the Ticketholder. As a result, the Trustee could validate the Ticketholder’s claim amount without asking the Ticketholder to return a completed claim form. This would eliminate the costs of administering a claim form from each of the thousands of potential Ticketholders and the costs associated with a review of incomplete, inaccurate or invalid claims returned to the Trustee for review and processing.
176. To date, the Trustee has received approximately 12,000 claims from Ticketholders totalling approximately \$9 million and representing approximately 17,000 passengers.
177. The Trustee continues to receive claims from Ticketholders on a daily basis.

178. In the interests of easing the burden of the demise of Airlines and related entities to Ticketholders and to assist in streamlining the Trustee's claims process relating to Ticketholders, the four credit card companies noted below were advocates of using the refund mechanism to refund monies to Ticketholders. If such refunds were to occur, the credit card companies wanted to be subrogated to the rights of Ticketholders with respect to any claims against Airlines, to the extent of such refunds.
179. As indicated earlier, Moneris acts as agent for RBC with respect to processing Visa transactions. It performs the same role on behalf of Bank of Montreal ("BMO") with respect to Mastercard. In conjunction with an application to the Court by the Trustee on December 18, 2001 relating to the Trustee's claims process, Moneris brought an application for an order that Moneris, BMO, RBC, Amex Bank of Canada and Citibank Canada (the merchant bank for Diners) are subrogated to Ticketholders of Airlines if the Ticketholders received credits to their credit card accounts for travel services not provided by Airlines and the credit card companies bear the cost of such credits. Moneris' application also related to Ticketholders of Leisure, Holidays and Sales.
180. The Court granted the order sought by Moneris (the "Subrogation Order") on December 18, 2001.
181. The rights of RBC as the Merchant Visa bank to settle chargebacks under its contracts with Airlines are separate and distinct from whatever subrogated rights it may hold from the Ticketholders under the Subrogation Order. RBC has agreed that the claims it acquires by virtue of the Subrogation Order are not secured by its security.

182. In addition to the Visa chargeback claim by RBC discussed above, there will be unsecured chargeback claims advanced by the other credit card companies.
183. In discussions among the Trustee and the credit card companies leading up to the December 18, 2001 Court hearing on the claims process, it was agreed that it was imperative for all concerned to co-ordinate their respective documentation requirements to substantiate claims so as to minimize the burden placed on Ticketholders when the Ticketholder or their subrogee sought recoveries from various sources. These sources included the credit card companies, the Trustee and the provincial compensation funds in Quebec, British Columbia and Ontario, represented by the Office de la Protection du Consommateur (the “Quebec OPC”), the Travel Registrar of British Columbia (the “BC Registrar”) and the Travel Industry Council of Ontario (“TICO”), respectively.
184. The Trustee has held numerous meetings and/or discussions with the credit card companies, Moneris, the BC Registrar and TICO regarding documentation requirements. The Trustee has provided Moneris, American Express and Citibank Canada, on behalf of Diners, with detailed listings, by method of payment, of Ticketholder claims that the Trustee considers valid. These listings are being used to facilitate the processing by the card companies of refunds to Ticketholders who paid by credit card. The Quebec OPC is proceeding separately from the Trustee, with respect to processing Ticketholder claims. Accordingly, the Trustee has had only limited discussions with them.
185. In addition, the Trustee has agreed with TICO and the BC Registrar that, for the most part, they will rely on information provided to them by the Trustee and will not require

additional documentation from Ticketholders who make a subsequent claim against their respective compensation funds.

186. The Trustee is advised by the credit card companies that the majority of refunds to Ticketholders who paid by credit card should be finalized by March 31, 2002 . When complete, the Trustee is to receive detailed listings of claims paid from the credit card companies so that the Trustee can update the master list of Ticketholder claims (the “Master Claimants List”).
187. The Ticketholders Claim Process requires that the Trustee correspond with all Ticketholders who lodge claims, including those who received refunds from their credit card companies. The purpose of such communication would be to advise the Ticketholder of the Specified Amount of their claim and to determine if the Ticketholder has any additional claims for which they did not receive a refund.
188. The Trustee is currently preparing information packages to be mailed to all Ticketholders who have contacted the call centre and lodged a claim. In these instances, the Trustee has sufficient contact details to enable a mailing. A significant number of claims have not been lodged with the Trustee because the Ticketholders have sought and have received or will be receiving refunds from their credit card companies.

### **Claims Arising during CCAA Period**

189. There are various creditors who supplied goods or services to the bankrupts during the days of November 8 and 9, 2001, at the outset of the CCAA proceedings. Given that the bankruptcies occurred on November 11, 2001, most of these parties were not paid, as there was insufficient time for the bankrupts to carry on their business in the ordinary course to pay the debts that accrued during that time period.
190. Some of the parties that provided goods or services to the bankrupts during the CCAA proceedings have made requests of the Trustee for payment of their accounts. One of these parties is NavCanada which is seeking payment of an amount in excess of \$100,000. The Trustee expects that there are other parties in a similar position and expects that prior to a distribution to creditors, the Trustee will bring a motion to the Court for advice and directions in respect of the claims arising during the CCAA period.

### **IX. RECEIPTS AND DISBURSEMENTS**

191. A detailed Statement of the Trustee's Receipts and Disbursements as at February 3, 2002 has been attached as Appendix L. A summary of Airlines receipts and disbursements is provided below:

<b>Cash Receipts:</b>	<b>(\$'000)</b>	<b>(\$'000)</b>	
RBC Funding	3,050		
Recoveries from aircraft lessors	1,592		
Business Tax Refunds	626		
Repatriation of Foreign Cash	1,008		
Payroll Refunded	727		
Realization of Assets	660		
Collection of third party receivables	297		
Fuel Tax Refunds	112		
Other	196		
Total Cash Receipts		8,268	<b>A</b>
<b>Cash Disbursements:</b>			
Payroll	1,999		
Rent	541		
Operating Expenses	537		
Telephone	279		
Security	236		
Other	813		
		4,405	<b>B</b>
<b>Net Cash Inflow</b>		<b>3,863</b>	<b>C= A-B</b>

192. Upon its substitution as Trustee, D&T transferred funds in its possession to PwC. PwC subsequently opened a new Trustee bank account at RBC.
193. In addition to the activities detailed above, D&T has approximately \$500,000 of the \$6.3 million made available for the payment of outstanding salaries and benefits in its possession.

## X. REALIZATIONS

194. The Trustee has realized approximately \$850,000 from the disposal of galley equipment, parts and the deposit on the sale of 31 Fasken. A summary of the Trustee's asset realizations to date is set out below:

<b>Asset</b>	<b>Purchaser</b>	<b>Realization Proceeds (C\$'000)</b>
Building at 31 Fasken (deposit)	Skyservice Airlines Inc.	416
Galley Equipment and seats	International Lease Finance Corporation	266
Seats	GATX Corporation	128
Towbars	Various	10
Vehicles	Various	34
<b>Total Realizations to date</b>		<b>854</b>

195. Approximately \$190,000 of the total realizations to date, set out above, has not yet been collected, resulting in realizations received to date of approximately \$660,000. The Trustee expects to receive these funds shortly.
196. The Trustee intends to dispose of the remaining assets by way of soliciting offers in three tranches, as follows:

<b>Tranche</b>	<b>Assets Included</b>	<b>Circulation Date</b>	<b>Deadline for Submission of Offers</b>
1	Buildings - 23 & 31 Fasken Dr Building contents – 23, 27 & 31 Fasken Dr	January 25, 2002	February 11, 2002
2	IT equipment Vehicles Catering supplies Miscellaneous office furniture & supplies Various other non-aviation assets	February 25, 2002	March 14, 2002
3	Aviation assets Other unsold assets	March 4, 2002	April 15, 2002

197. The Trustee has accepted offers, subject to Court approval from Maynards for the building contents and from Skyservice for the building located at 31 Fasken. The closing date for the building at 31 Fasken is April 1, 2002.
198. As previously mentioned, the Trustee has not received any acceptable offers for the building at 23 Fasken.
199. As previously discussed, the Trustee has commissioned appraisals on the assets in the remaining two tranches. The Trustee expects to receive appraisals on these assets shortly.
200. The Trustee intends to dispose of the aviation assets in lots organized by aircraft and fleet type. This sale process is scheduled for the second week of March 2002. The Trustee will place advertisements in recognized aviation magazines during the second week of March 2002. In addition, the Trustee intends to approach between fifty and

one hundred airlines directly. Attached as Appendix M are details of its advertising campaign.

201. The Trustee and the Receiver have combined the advertising for Royal's assets with the advertising for Airlines in order to generate greater demand and also for efficiency and economy.
202. The Trustee anticipates applying to Court for approval for these sales and, if approved, closing these transactions during the first week of May 2002.
203. Depending upon the outcome of the sale of the assets and the determination of the extent of RBC's secured claims (both its direct claim against Airlines and any claim arising pursuant to Airlines' guarantee of any shortfall RBC may suffer with respect to Leisure), there may be limited realizations or no realizations for the unsecured creditors.

## **XI. ROYAL AVIATION INC.**

204. As earlier indicated, the Trustee's legal counsel has provided an opinion supporting CIBC's secured claim and ranking its interest in priority to the Trustee's and that the Trustee does not anticipate that Royal's assets will satisfy CIBC's secured claim of \$6.3 million at this time. CIBC's GSA does not cover a hanger owned by Royal. Accordingly, it appears that there may be limited realizations available to the unsecured creditors. Accordingly, we limit our commentary in this report to those assets where the Trustee of Royal undertook certain activities prior to the appointment of PwC as Receiver.

205. As at the date of bankruptcy, the accounting records of the Royal listed the following significant assets at book values (which do not reflect current market values or expected realizations):

Asset	Cost	Net Book Value
	(C\$'000)	(C\$'000)
Aircraft	99,489	
Rotables, Consumable Parts and Ground Equipment	8,670	
Land and Buildings	5,824	
Leasehold Improvements	1,627	
Office furniture & IT equipment	7,158	
Accumulated Depreciation	(30,092)	
Net Fixed Assets	92,676	92,676
Cash		2,073
Third-Party Receivables		8,326
Inter-company Receivables		15,634
Deferred Income Taxes		18,188
Investment in subsidiaries		3,340
Other Assets		16,601
<b>Total Assets</b>		<b>156,838</b>

## Aircraft

206. On the date of bankruptcy, Royal was in possession of 22 aircraft. A summary of the status of the aircraft is shown below:

Entity	Category	Location on the date of bankruptcy	Current Status	Number
Royal	Leased	Canada	Returned to lessor	9
Royal	Leased	Europe	Returned to lessor	2
Royal	Conditional Sales Contract	Canada	Valuation completed and no equity to the Estate – see below	2
Royal <sup>1</sup>	Owned	Canada	Subject to the Receiver's sale process	9
<b>Total</b>				<b>22</b>

<sup>1</sup> The owned aircraft are comprised of four DC 6, three DC 4 and two Boeing 737-200 combi aircraft. We note that none of these aircraft are currently airworthy. In addition, an aircraft located in St. John's is the subject of an insurance claim as it was involved in an incident and will likely result in scrap value, if any. This hull has not been included in the analysis above.

207. The Trustee's preservation procedures have been discussed earlier in the report.

208. Two Boeing 737-200 aircraft remain in possession of the Trustee of Royal. Both are subject to conditional sales contracts; one from First Security Bank ("FSB") and the other from Amtec Corporation ("Amtec") (collectively the "Lenders"). The Trustee of Royal and the Receiver have determined that neither has an interest in paying out the Lenders, as the debt against the aircraft will likely exceed realizations.

209. The Trustee has requested the Lenders pay preservation costs totalling approximately \$100,000 and take possession of their aircraft. The Lenders are concerned that the aircraft have limited, if any, value and that the liens asserted by both the airport authorities and Nav Canada exceed the aircraft's value. Both Lenders have indicated that they are not in a position to recover their aircraft and pay the Trustee the

preservation costs. The aircraft require ongoing maintenance and may have limited value in the current used aircraft market. In this regard, in the interest of protecting the estate from its exposure to ongoing preservation costs, the Trustee has requested that the Lenders make an offer to Nav Canada and the airport authorities to compromise their respective positions so the Trustee can release the aircraft and receive payment of its costs.

210. In the event the Lenders, the airport authorities and Nav Canada do not reach a compromise in a reasonable time, the Trustee will make an application to this Court for an order to (i) unilaterally de-register the aircraft to remove the responsibility for the aircraft from the estate, (ii) cease ongoing maintenance, and (iii) recover costs from Nav Canada, the airport authorities or the Lenders, depending on who is in possession of the two Boeing 737s at the time.
211. Removing an aircraft unilaterally from a civil registry can create a ‘gap’ in the aircraft’s registration history that may signify to the market that the aircraft has been outside of an approved overseeing system such as the safety system provided by Transport. The effect of this can be material on the value of the aircraft.
212. The nine aircraft that are owned by Royal are subject to CIBC’s security and will be sold by the Receiver. These aircraft are located in Quebec City.

#### **Rotables, Consumable Parts and Ground Equipment**

213. As at the date of bankruptcy, the accounting records of Royal indicated rotatable parts, consumable parts and ground equipment of approximately \$8.7 million.

214. The sale of any of Royal's Parts will be conducted by its Receiver.

### **Land and Buildings**

215. Royal owns three hangars that were used by Conifair, which is a division of Royal. Conifair was primarily a maintenance facility. The primary hangar is located in Ste-Foy just outside Quebec City. The building is approximately 48,000 square feet and is located on approximately 339,000 square feet of land leased from the Quebec airport authority. Royal entered into a 40-year lease for the building, which expires on June 30, 2028, and is renewable. Royal has the first right of refusal on an adjacent lot of similar size. The building is considered to be in excellent condition and has been appraised at approximately \$2.2 million.

216. There are two other military style World War two hangars in Mont Joli and St. Jean sur le Richelieu, Quebec. Both of these buildings are approximately 60 years old and subject to land lease agreements with the Canadian Federal Government. The Mont Joli hangar is approximately 48,000 square feet in size and is located on approximately 117,900 square feet of land. The building is reported to be in poor condition and has an appraised value of zero. The St. Jean Hangar is approximately 46,700 square feet in size and is located on approximately 153,850 square feet of land. The building is also in poor condition and has been appraised at approximately \$50,000. The above buildings are unencumbered.

### **Office Furniture and IT Equipment**

217. As at the date of bankruptcy, the books and records indicated Furniture with a cost of approximately \$7.1 million.
218. Royal's Furniture is located at the Conifair maintenance facility in Quebec City and the Dorval main hangar location. At the date of bankruptcy, Royal had Furniture located at the Dorval and Mirabel Airports. The Receiver has since consolidated this Furniture at the Dorval hangar.
219. The sale of any of Royal's Furniture will be conducted by its Receiver.

### **Cash**

220. As at the date of bankruptcy, the accounting records of Royal indicated approximately \$2.1 million in cash on deposit in various operating bank accounts. The Trustee has determined that, after processing outstanding entries, the cash balance at the date of bankruptcy is approximately \$467,000. At the date of bankruptcy, these funds were held by RBC but have subsequently been transferred to CIBC to the Receiver's possession.

### **Third-Party Receivables**

221. At the date of bankruptcy, Royal's books and records indicated a net book value of approximately \$8.3 million for third-party receivables. It is expected that the third-

party receivables will be subject to significant offsets. The significant third-party receivables are summarized below:

<b>Debtor</b>	<b>Royal</b>
	<b>(C\$'000)</b>
Commodity Taxes	879
Tour Operators	2,993
Insurance Claims	1,387
Conifair's	2,261
Other	806
<b>Total</b>	<b>8,326</b>

### **Intercompany Receivables**

222. The Trustee does not expect to have any recoveries from the intercompany receivables.

### **Claims**

223. The Trustee has received claims from various third parties. The claims received to date have been summarized below:

<b>Claim</b>	<b>Value</b>
	<b>(C\$ millions)</b>
Secured Claims	6.3
30-day Goods Claims	Note 1
Property Claims	Note 1
Trade Creditors	16.7
Employee Claims	Note 1
<b>Total Claims</b>	<b>23.0</b>

Note: These claims have been included in the discussion with Airlines earlier in the report. For efficiency, the Trustee has processed these claims on a combined basis.



## Receipts and Disbursements

224. As a result of the Receiver taking possession of the assets, there has been limited activity in the Trustee's bank accounts.

## XII. CANADA 3000 INC.

225. As at the date of bankruptcy, the accounting records of Inc. indicated the following significant assets shown at book values do not reflect current market values or expected realizations:

<u>Asset</u>	<u>Value</u>
	<u>(C\$'000)</u>
Intercompany Loans	38,509
Intercompany Receivables	538
Investment in subsidiaries	76,859
Prepaid – Royal	1,840
Cash	755
Other	1,007
<b>Total</b>	<b>119,508</b>

226. Approximately \$27.5 million of the intercompany loans shown above is with respect to Royal. As indicated earlier, Inc. is not expected to recover any of this amount.
227. The Trustee does not expect any recoveries on the remaining loan or receivable balances, the prepaids relating to Royal, nor any of Inc.'s investments in subsidiaries, all of which are bankrupt.

### **XIII. COURT PROCEEDINGS**

228. As reported by D&T, in its report to the Court in its capacity as Monitor, an application was brought pursuant to s.304 of the United States Bankruptcy Code for an ancillary proceeding. An order was made granting a preliminary injunction in conjunction with the CCAA proceedings.
229. When the CCAA proceedings came to an end, given that certain assets of the bankrupt companies existed in the United States and there was a possibility that unsecured creditors would act to seize those assets, it was prudent to maintain the preliminary injunction provided that the stay of proceedings contained therein conformed to the stay of proceeding provided by the BIA. Accordingly, the Trustee brought an application for the modification of the preliminary injunction so as to provide that the stay of proceedings contained therein would not prevent a secured creditor from realizing or otherwise dealing with its security in the same manner as if the preliminary injunction had not been issued unless otherwise specifically ordered by the Canadian Bankruptcy Court. An order modifying the preliminary injunction was made on January 7, 2002.
230. The order modifying the preliminary injunction also provided that it would have no effect on any person upon whom it is not served by mail, overnight mail, fax or personal delivery. The preliminary injunction and the order modifying the preliminary injunction were served by personal mail on the service list to these proceedings. A motion will be brought for the extension of the preliminary injunction, which expires March 20, 2002. Certain of the aircraft lessors have asked for language to be included

in the preliminary injunction so that such order is consistent with the agreements reached with the Trustee in the aircraft acceptance agreements and it is anticipated that the order will be so modified as part of the extension order.

#### **XIV. PROFESSIONAL FEES**

231. As indicated earlier, PwC acted as D&T's agent pursuant to the Agency Agreement in order to effect an orderly transition of the administration of the estates. In this capacity, PwC incurred fees and costs of approximately \$224,000.

232. From the Substitution Date to January 31, 2002, PwC incurred fees and expenses of approximately \$2.2 million and D&T incurred fees and costs of approximately \$707,000 in its capacity as PwC's agent, again pursuant to the Agency Agreement. To date, PwC has not incurred any fees or expenses as Trustee of Inc. Fees and expenses have been allocated among the estates of Airlines and Royal as follows:

<b>Estate</b>	<b>PwC as Agent for D&amp;T (C\$'000)</b>	<b>PwC as Trustee (C\$'000)</b>	<b>D&amp;T as Agent for PwC (C\$'000)</b>	<b>Total Fees (C\$'000)</b>
Airlines	192	1,757	603	2,552
Royal	32	130	104	266
Call Centre	0	313	0	313
<b>Total</b>	<b>224</b>	<b>2,200</b>	<b>707</b>	<b>3,131</b>

233. The Trustee's fees and expenses incurred in respect of the Call Centre will be allocated among the various estates, primarily on the proportion of Ticketholder claims relating to the respective estates.

234. McMillan Binch acted as independent counsel to D&T, in its capacity as Monitor and as the former Trustee and continued in this role on behalf of PwC, after the Substitution Date. McMillan Binch’s fees and expenses in this capacity total approximately \$910,000 to January 31, 2002. Fees of McMillan Binch are allocated as follows:

<b>Estate</b>	<b>Total Fees</b>
	<b>(C\$’000)</b>
Airlines	796
Royal	114
<b>Total</b>	<b>910</b>

235. The Trustee’s counsel was required to retain the services of various agents. The estates have incurred fees and expenses of approximately \$6,000 and US\$69,000 for professional services rendered by the agents.

236. As indicated earlier, McMillan Binch was conflicted with respect to providing the Trustee with an opinion on RBC’s security. Accordingly, the Trustee retained Davis to provide the opinion. Davis’ fees in this respect were approximately \$8,000. In addition, D&T retained the services of Chaiton and Chaiton (“Chaiton”) to review certain leases as McMillan Binch was again conflicted. Chaiton’s fees and expenses in this respect are approximately \$19,000. PwC retained the services of US counsel, Vedder Price, to review the Trustee’s position with regard to Deposits and Reserves paid by Airlines. Vedder Price’s fees in this respect are approximately US\$23,000.

237. Details of all of the above noted fees and expenses, with the exception of D&T's fees and expenses, are set out in Appendix N. Details with respect to D&T's fees and expenses are set forth in D&T's report to the Court filed concurrently with this report.
238. The Trustee requests approval of the Court of professional fees incurred by the estates for the period ended January 31, 2002.

## **XV. SUMMARY**

239. The Trustee seeks the approval of the Court with regard to the following:
- the Agency Agreement relating to the orderly transition of the administration of the estates from D&T to PwC;
  - the transfer of assets to Toronto for the purpose of sale;
  - the Trustee's activities for the period ending January 31, 2002;
  - the sale of assets to Maynards Industries Limited ("Maynards");
  - the sale of the property located at 31 Fasken Drive, Toronto;
  - the Trustee's sale process for the remaining assets owned by Airlines; and
  - the Trustee's fees and those of its counsel for the period ending January 31, 2002.
240. All of the above is respectfully submitted by PricewaterhouseCoopers Inc. in its capacity as trustee in bankruptcy of Airlines, Royal and Inc.

March 8, 2002

**PRICEWATERHOUSECOOPERS INC.**, as  
Trustee in Bankruptcy of Canada 3000 Inc.,  
Canada 3000 Airlines Limited/Lignes Aériennes  
Canada 3000 Limitée and Royal Aviation Inc.

Per: \_\_\_\_\_

# The Trustee's Second Report to the Court

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