

Estate No. 31-396479

CANADA 3000 INC. – A BANKRUPT

TRUSTEE'S PRELIMINARY REPORT TO CREDITORS

May 15, 2002

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

TRUSTEE'S PRELIMINARY REPORT

(MAY 15, 2002)

I BACKGROUND

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.") or (the "Company") 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").

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").

On November 30, 2001, the Trustee sought and received an order from the Court postponing the first meeting of creditors. This order was sought primarily in connection with the bankruptcies of Airlines, C3 Leisure Limited ("Leisure") and Canada 3000 Sales Limited ("Sales"). The first meeting of Inc.'s creditors was set for the same date as that of the Parent Companies so that all the meetings would occur at the same time.

D&T and PwC, in their respective capacities have filed several reports to the Court dealing with the history of the Parent Companies and their subsidiaries, a summary of the events leading to the bankruptcy filing, various conservatory and protective measures undertaken and the Trustees' activities. Copies of the Trustees' previous reports to the Court may be obtained at the following web-site address:

www.pwcglobal.com/brs-canada3000

Inc. was formed in 1995. At the date of bankruptcy, the Company was the holding company for the Group, and was the publicly traded entity. The Company was a vertically integrated company that owned an airline, tour operators and travel agencies. The Company owned Airlines, Royal, Leisure, and Holiday Travel Consultants Ltd. (“Holidays”). It also owned, through its subsidiaries, Canada 3000 Airport Services Limited, Sales, and Royal Handling Inc. Attached as Schedule “A” is a copy of the Company’s organizational chart.

The Company purchased the shares of Royal on March 22, 2001. On May 1, 2001, the Company purchased the assets of Canjet (2001) Limited.

The chief cause of bankruptcy was the inability of Airlines to support the significant cash injection of \$40 million required to satisfy outstanding obligations and support the operations of its newly acquired subsidiary, Royal. This situation was exacerbated by the significant downturn in air travel experienced by the airline industry subsequent to the September 11, 2001 terrorist attack on New York City and the launch of a new discount carrier by Air Canada.

On November 7, 2001, the Parent Companies determined that they would need to file for protection under the CCAA in order to preserve their assets while they formulated a restructuring plan. The CCAA order was obtained on November 8, 2001 and Section 304 proceedings were initiated by the Monitor under the United States Bankruptcy Code to prevent the seizure of assets located outside of Canada.

Despite the filings, five planes were seized in the evening of November 8, 2001, at which time the directors made the decision to cease operations. On November 11, 2001, an Order was granted to the Monitor to file assignments in bankruptcy.

II CONSERVATORY & PROTECTIVE MEASURES

The Trustee took the following steps to protect the assets of the Company:

- Attended at the Company’s premises;
- Notified the Company’s bankers and froze all bank accounts;
- Took possession of books and records and other related computer data; and
- Ensured that I.T. systems were adequately backed up and access restricted to authorized personnel.

III ASSETS

The assets, as shown in the draft Statement of Affairs prepared by D&T in its capacity as Trustee in Bankruptcy, are summarized as follows:

	<i>Book Value</i>
Due from subsidiaries	\$38,831,801
Accounts receivable	47,838
Deposits in financial institutions	755,000
Future taxes	500,000
Total Assets	<u>\$40,134,639</u>

The amounts due from subsidiaries are not estimated to realize anything for the estate due to the bankruptcy of the subsidiaries.

Accounts receivable in the amount of \$47,838 are possible refunds due with respect to Goods and Services Tax (“GST”) and Harmonized Sales Tax (“HST”). These recoveries will be subject to audit by governmental departments and may be offset by claims due to Canada Customs and Revenue Agency (“CCRA”).

Deposits in financial institutions in the amount of \$755,000 represent funds on deposit with Royal Bank of Canada (“RBC”), as at the date of the bankruptcy. The Company has guaranteed the indebtedness of its subsidiaries to RBC. As a result, RBC has frozen this account, and may claim an offset with respect to the debt owing from the subsidiaries.

Future taxes of \$500,000 represents potential recoveries as a result of operating losses incurred by the Company’s subsidiaries. This claim will be the subject of a future audit by CCRA.

IV LIABILITIES

The following summary of liabilities is from the draft Statement of Affairs prepared by D&T:

	<i>Book Value</i>
Unsecured Creditors	\$ 660,333
Contingent Liability	15,000,000
Total Liabilities	<u>\$15,660,333</u>

Unsecured creditors consist generally of trade credit amounts due.

The contingent liability in the amount of \$15 million represents a claim, for a bond posted by the Company for operations of the subsidiaries. The Canadian Transport Agency's ("CTA") regulations required that Airlines post a bond to cover unearned revenue generated from charter flight sales. The final claim, if any, will be determined when CTA files its claim. An underwriter, The Guarantee Company of North America ("GCNA"), supplied the bond. In the event that CTA makes a claim to the underwriter, it is expected that the GCNA will be entitled to file a claim in the bankruptcy estate of Inc. It was Inc. who provided an indemnity for Airlines obligations to CTA under the bond.

V CLAIMS

The following is a summary of claims filed to May 13th, 2002 with the Trustee:

	<i>Claims Filed</i>	<i>Claims Filed and Admitted to Date</i>
Secured Creditors	\$84,000	To be determined
Preferred Creditors	23,837	Nil
Unsecured Creditors	1,160,037	To be determined
Contingent Liability	Nil	Nil
Total	\$1,267,874	-

VI REVIEW OF BOOKS AND RECORDS

The Trustee is in the process of examining the Company's books and records for reviewable transactions, preferences and settlements. To date, the Trustee has not found any transactions that were out of the ordinary course of business. The Trustee will report the final results of its review to the Inspectors.

VI LEGAL

Subject to the approval of the Inspectors, the Trustee retained McMillan Binch as estate solicitor. McMillan Binch was conflicted from providing the Trustee with an opinion on RBC's rights to offset the funds in its possession or against the obligations of Inc.'s subsidiaries to RBC. Consequently, the Trustee engaged Davis & Company ("Davis") to provide such an opinion. Davis is in the process of reviewing Inc.'s guarantee of Airlines' and Leisure's obligations to RBC. Otherwise, RBC has no security interest.

VIII RECEIPTS AND DISBURSEMENTS

The Trustee has had no receipts or disbursements since its appointment.

IX ESTIMATED REALIZATIONS & DISTRIBUTIONS

If RBC offsets the \$755,000 of cash on hand in the RBC bank account, there may be no realizations available to any other creditors in Inc.

A potential realization is the sale of the Company's shares in Royal for the possible tax losses of Royal. The Trustee continues to investigate this potential asset and will discuss with the Inspectors the best course of action in order to utilize the tax losses.

In August 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.

X TRUSTEE'S FEES & CONFLICT OF INTEREST

The Trustee reports that no conflicts of interest exist, and that it has not received any guarantee of its fees or disbursements. D&T's fees as Trustee of Inc. total \$70,611 and have not been paid. These fees are before the Court for approval.

The Trustee respectfully submits to the creditors this, its Preliminary Report.

Dated this 15th day of May 2002.

Yours very truly,
PRICEWATERHOUSECOOPERS INC.
Trustee of the Estate of
Canada 3000 Inc.

Hazel C. Claxton
Senior Vice-President