

**REVISED**

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DATE: 20070430

**SUPERIOR COURT OF JUSTICE - ONTARIO****RE:** 3791351 CANADA INC. c.o.b. as "Cu-Connect" – CCAA Application**BEFORE:** Ground J.**COUNSEL:** *Margaret Sims*  
for the Applicant*Roger Jaipargas*  
for the KPMG Inc.*Richard Finn*  
for Alternative Recoveries Inc.**HEARD:** April 19, 2007**ENDORSEMENT**

[1] The motions before this court are brought within the CCAA Application of 3791351 Canada Inc. c.o.b. as "Cu-Connect" (the "Applicant"). The assets and business of the Applicant were sold pursuant to an asset purchase agreement dated January 9, 2007 between the Applicant and Threshold Financial Technologies Inc. for a purchase price of approximately \$2,200,000. The remaining funds in the hands of the applicant total approximately \$1,167,000. The liabilities of the Applicant are estimated to be as follows:

- (a) secured indebtedness owing to Cu-Connection Limited, the Applicant's parent company (the "Parent"), in the principal amount of \$1,250,000 plus interest of approximately \$650,000 although there appears to be some confusion as to whether any part of such interest has been paid;
- (b) unsecured indebtedness to North York Community Credit Union Limited ("NYCCU") in the amount of \$5,250,000;
- (c) unsecured indebtedness to Kawartha Credit Union ("Kawartha") in the amount of \$1,100,000;

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- (d) unsecured indebtedness to the Receiver of Jaws Inc. in the amount of \$1,200,000 plus accrued interest of \$500,000; and
- (e) unsecured indebtedness to trade creditors in the amount of approximately \$240,000.

[2] It is to be noted that NYCCU and Kawartha, together with Pace Savings and Credit Union Ltd. ("Pace") which has merged with Kawartha, hold 83.4% of the shares of Parent.

[3] The reports of KPMG Inc. as Monitor of the Applicant (the "Monitor") and the forensic report of BDO LLP commissioned by counsel to the Applicant contain a litany of horrors with respect to the manner in which the business of the Applicant was carried on, the total disarray of the Applicant's books and records and the disappearance of some \$6,750,000 which cannot be accounted for, including \$6,200,000 which appears to have been received by the Applicant from NYCCU and Kawartha.

[4] It is the opinion of BDO and the Monitor that it would be virtually impossible and/or prohibitably expensive to reconstruct books and records of the Applicant or to perform any account reconciliations to trace the missing funds. The bank account used by the Applicant for its operations (the "1017 Account") was in fact an account of Parent and, although BDO could find no direct evidence of payments out of the 1017 Account to Parent, the records with respect to that account show payments of approximately \$380,000 out of that account to numbered bank accounts and there is no evidence as to whose accounts they were.

[5] All of the parties agree that the CCA proceeding should be terminated and the monitor and Mr. Terry Chapman, the Chief Restructuring Officer ("CRO"), discharged and the Applicant assigned into bankruptcy in order that the various claims against the Applicant can be dealt with in the course of the bankruptcy proceedings. The parties also agree that there should be an amount reserved for the fees and disbursements of the Trustee in Bankruptcy and that there should be a charge in favour of the Trustee securing such amount ranking in priority to all claims of creditors of the Applicant including Parent.

[6] The principal dispute between the parties is whether a distribution should now be made of the funds on hand with the Applicant, less administrative expenses and the reserve for the Trustee's fees and disbursements, to Parent on account of the indebtedness owing to Parent or whether the balance of the funds on hand should be transferred to the Trustee and the Parent required to prove its claim and its security in the course of the bankruptcy proceedings. The Monitor does not support the recommendation of the Applicant that a distribution be made to Parent at this time in view of the lack of information as to the recipients of the \$380,000 paid out of the 1017 Account, serious concerns about the conduct of Mr. Blair Gagnon, the former CEO of the Applicant and of Parent and his involvement in the operation of the 1017 Account, and the inability to account for \$2,745,000 that appears to have been transferred from NYCCU and Kawartha's vault cash accounts into the 1017 Account. In addition, although it found no evidence of payments to Parent, in view of the inappropriate transfers of funds into the 1017 Account and the unaccounted transfers from that account, the Monitor questions whether it can conclude with reasonable certainty that

funds were not disbursed from that account for the benefit of Parent. The Monitor on the hearing of this motion also pointed out that it had not conducted a detailed review of the transaction that gave rise to the granting of security to Parent in the October, 2000 transaction which established the Applicant as an operating company.

[7] Although it is clearly impossible to compile a complete factual history of the Applicant and of its transactions with Parent, the Credit Unions and third parties, certain facts relevant to the issue on this motion as to the payment of an immediate distribution appear to be established. The business and assets transferred to the Applicant in the October 2000 transaction valued as between the parties at something in excess of \$4,000,000. As part of such transaction, a promissory note in the amount \$2,250,000 was issued by the Applicant to Parent. Such promissory note has subsequently been paid down to \$1,250,000. There is no record anywhere of any payment to Parent on the remaining balance of \$1,250,000 owing on the promissory note. It is not clear whether any interests payments have been made on the promissory note since the pay down to \$1,250,000 principal. The Parent claims approximately \$650,000 in unpaid interest. The funds available for distribution, after payment of administrative expenses and after a reasonable reserve, which I would limit to \$60,000, for the Trustee's fees and disbursements, is likely to be only slightly in excess of \$1,000,000. NYCCU and Kawartha held 76.6% of the subordinated claims against the Applicant and do not oppose the distribution to Parent. Even if all of the \$380,000 undetermined payments out of the 1017 Account had gone to Parent, it would still be owed \$870,000 principal plus an undetermined claim of \$650,000 for interest. The diminished business and assets of the Applicant were sold in a negotiated arms length transaction in 2007 for approximately \$2,200,000.

[8] Although the Monitor has raised concerns with respect to the involvement Mr. Gagnon and other Parent company employees in the operation of the 1017 Account and questions whether payments may have been made through that account to Parent, there is no evidence before this court to substantiate such concerns. The Monitor has also questioned the *bona fides* of the transaction in October 2000 whereby the business and assets of the Applicant were transferred to the Applicant for something in excess of \$4,000,000. The evidence before this court is that the Monitor has received an opinion of independent counsel as to the validity of the security held by the Parent and that the diminished business and assets were sold to an arms length third party in the year 2007 for \$2,200,000 which would seem to support the valuation of the business and assets at something in excess of \$4,000,000 in October 2000. There is no evidence before this court to question such valuation.

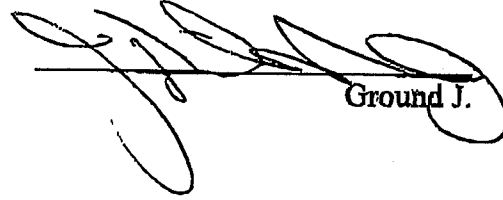
[9] Accordingly, in my view, a fair and equitable resolution of the dispute as to a distribution to Parent at this time would be to order a distribution to Parent of 75% of the amount of funds on hand with the Applicant, after the payment of administrative expenses and the setting aside of a \$60,000 reserve for the Trustee's fees and disbursements, and that the balance of the funds on hand be transferred to the Trustee in Bankruptcy of the Applicant and the balance of the claim of Parent with respect to principal and interest on the promissory note held by it and the claims of all unsecured creditors of the Applicant be determined in the bankruptcy proceeding.

[10] Accordingly, an order will issue:

- (i) approving the activities of Terry Chapman as CRO of the Applicant as set out in his affidavit sworn April 11, 2007;
- (ii) approving the activities of the Monitor as set out in its Fourth Report;
- (iii) that the report of BDO LLP dated April 5, 2007 be kept under seal pending further order of this court and that the information referenced in such Report need not be posted on the Monitor's website;
- (iv) disallowing the D & O claim filed by CDSL Canada Limited pursuant to the directors' and officers' claims bar order;
- (v) authorizing and directing the Applicant to pay the fees and disbursements of its counsel Miller, Thomson LLP, the Monitor and the Monitor's counsel Borden, Ladner, Gervais LLP upon approval of such fees and disbursements by the CRO;
- (vi) authorizing and directing the CRO of the Applicant to file an assignment in bankruptcy on behalf of the Applicant;
- (vii) authorizing KPMG Inc. to act as Trustee in Bankruptcy of the Applicant;
- (viii) discharging the CRO upon the filing of the assignment in bankruptcy;
- (ix) extinguishing the Directors' Charge provided for in the Initial Order;
- (x) extinguishing the Administration Charge provided in the Initial Order upon the Monitor filing a certificate certifying that professional fees have been paid;
- (xi) discharging KPMG Inc. in its capacity as Monitor of the Applicant upon the filing of such certificate;
- (xii) that, after payment of the unpaid professional fees in satisfaction of the Administration Charge and setting aside a reserve of \$60,000 for the fees of disbursements of the Trustee, the Applicant make a distribution to Parent to be applied to the indebtedness to Parent, in an amount equal to 75% of the funds on hand in the Applicant's estate;
- (xiii) that the balance of the funds on hand in the Applicant's estate and any property of the Applicant including the books and records of the Applicant be turned over to the Trustee;

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- (xiv) that the Trustee shall be entitled to retain the \$60,000 reserve to be applied against its proper fees and disbursements as approved by this court and shall be entitled to a charge on such amount (the "Trustee's Charge") ranking in priority to all other charges against the assets of the Applicant/Bankrupt including the charge in favour of Parent; and
- (xv) that forthwith upon the filing of the assignment of bankruptcy the CCAA proceedings be terminated.



Ground J.

Released: April 30, 2007