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August 8, 2008

The Honourable Justice Arthur Pickup  
Supreme Court of Nova Scotia  
The Law Courts  
1815 Upper Water Street  
Halifax, Nova Scotia

My Lord:

**Re: Canadian Sailing Expeditions Inc. – *Companies' Creditors Arrangement Act*  
S.H. No. 297999**

I am scheduled to appear before Your Lordship on Wednesday, August 13, 2008 at 2:00 p.m. for an order approving a new debtor-in-possession loan facility to Canadian Sailing Expeditions Inc. (the "Company") and the approval of a claims bar process for the Company, all pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA") and prior orders of this Court issued June 27 and July 4, 2008.

Filed with this application is the affidavit of Douglas Prothero, President and Director of the Company. I understand that BDO Dunwoody Goodman Rosen Inc., court appointed monitor of the Company, will be filing a report directly with the Court.

Pursuant to paragraph 37 of the Order of Justice Moir issued June 27, 2008, this application has been brought on two clear days notice to GrowthWorks Atlantic Venture Fund Limited, Nova Scotia Business Inc., Caterpillar Financial Services Limited and National Marine and Fire Services Inc. Please note that Royal Bank of Canada was paid out by GrowthWorks Atlantic Venture Fund Limited and we have received correspondence from their solicitor that they are not to be notified of any further proceedings in respect to this matter. National Marine and Fire Services Inc. is an unsecured creditor of the Company which, through its counsel, has requested notice of all matters in respect to this proceeding.

**Robert G. MacKeigan, Q.C.**

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An Order issued July 4, 2008 in this proceeding provided for debtor in possession financing (the “DIP Facility”) for an amount not to exceed \$500,000. As noted by the cash flow projections attached as an exhibit to Mr. Prothero’s affidavit filed in connection with this application, the DIP Facility will be exhausted by the middle of August, 2008. Additional DIP financing is required by the Company to continue operations.

The CCAA does not specifically address the Court’s power to sanction debtor in possession financing (“DIP Financing”) and to grant it a priority over debts already incurred, be they secured or unsecured. However, such power has been recognized as part of the Court’s inherent and equitable jurisdiction under the CCAA. This was most recently noted by Justice A. David MacAdam in one of his rulings related to *Re Federal Gypsum Company* (2007 NSSC 347) where he cited with approval the legal principles cited by Justice C. Campbell in *Re Manderley Corp.* (2005) 10 C.B.R. (5<sup>th</sup>) 48 at para. 18:

The operative legal principles are set out in the following quotations from Houlden and Morrowitz’ *Bankruptcy and Insolvency Analysis* (Carswell, 2004), Section N16 – Stay of Proceedings – CCAA – at Page 18:

Although the CCAA makes no provision for DIP financing, it seems to be well established that, under its inherent powers, the court may give it priority for such financing and for professional fees incurred in connection with the working out of a CCAA plan.

For the court to authorize DIP financing, there must be cogent evidence for the benefit of the financing clearly outweighs the prejudice of lenders whose security is being subordinated to the financing: ...

The court can create a priority to the fees and expenses of a court – appointed monitor ranking ahead of secured creditors so long as they are reasonably incurred in connection with the restructuring of the debtor corporation and there

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is a reasonable prospect of a successful restructuring: ...

Justice MacAdam further went on to quote from Justice Glennie of the New Brunswick Court of Queen's Bench in *Re Simpson's Island Salmon Ltd.*, (2006), 18 C.B.R. (5<sup>th</sup>) 182, where the requirements for DIP Financing were summarized as follows:

16. In order for DIP financing with the super priority status to be authorized pursuant to the CCAA, there must be cogent evidence that the benefit of such financing clearly outweighs the potential prejudice to secured creditors whose security is being eroded. See *United Used Auto & Truck Parts Ltd., Re*, [1999] B.C.J. No. 2754 (B.C.S.C. [In Chambers]) affirmed [2000] B.C.J. No. 409 (B.C.C.A.).
17. DIP financing ought to be restricted to what is reasonably necessary to meet the debtors [sic] urgent needs while a plan of arrangement or compromise is being developed.
- ...
19. A court should not authorize DIP financing pursuant to the CCAA unless there is a reasonable prospect that the debtor will be able to make an arrangement with its creditors and rehabilitate itself ...

Justice MacAdam went on to order DIP financing after balancing the prejudice to the secured creditors with the benefit of providing financing to enable Federal Gypsum Company to pursue a plan of arrangement. The Court found that the requested DIP financing and resulting super priority were reasonably necessary to meet the Company's immediate needs and further found that there was a reasonable prospect that the Company would be able to make arrangements with its creditors and thereby rehabilitate itself.

We submit that the affidavit of Douglas Prothero, filed with this application, describes the need for the proposed DIP Financing. Without that financing, the affidavit indicates that the Company will not be able to continue its business while it pursues restructuring. The affidavit further notes that the Company is not proposing to continue operations unless bookings increase to make such operations commercially viable.

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The Company submits that the total amount of proposed DIP Financing (approx. \$810,000) remains modest even though increased when compared to the overall liabilities of the secured creditors and the information provided to the Monitor of the value of the Company's primary asset (the sailing vessel *Caledonia*). The Monitor's Second Report dated July 21, 2008 noted the requirement for increased DIP financing at paragraph 5.2. We anticipate that a further report from the Monitor will support the proposed increase in DIP financing when filed with the Court.

It is possible that some of the senior secured creditors may object to this application. It is submitted that the court must consider the interest of all stakeholders including the Company, its shareholders, employees and other creditors when considering any such objection. As noted by Wachowich, J. (as he then was) in *Hunters Trailer Marine Ltd, Re* (2001) 295 A.R. 113 (Q.B.) at para. 32: "if super priority cannot be granted without the consent of secured creditors, the protection of the CCAA effectively will be denied a debtor company in many cases." The fact that a significant secured creditor objects to the DIP Financing does not preclude, in our submission, the Court's ability to allow DIP Financing (See *Re Dylex Ltd.*, (1995) 31 C.B.R. (3d) 106 (Ont. C.J. Gen. Div.) [Commercial List]).

Since notice has only been provided to the senior secured creditors and one unsecured creditor, the proposed order exempts the leases and proceeds thereof of certain other secured creditors from the priority charge contemplated in the draft order (see paragraph 15 of the proposed order).


The affidavit of Mr. Prothero sets out the view that DIP Financing at this stage is necessary in order for the Company to proceed with its efforts to prepare a restructuring plan. We submit that the lack of DIP Financing will limit the prospects for the Company and all of its stakeholders because the Company will likely have to cease operations while it still has bookings. As such, it is submitted that the prejudice to the stakeholders as a whole outweigh any prejudice to a particular creditor at this stage.

In addition to seeking an increase in the DIP Facility, the Company is also applying for an order to set out the claims bar process. While the *Bankruptcy and Insolvency Act* has such a process incorporated as part of its statute in section 149, the CCAA does not expressly provide such a process. Given the importance for a restructuring under the CCAA to create finality, Courts have used their inherent jurisdiction to create an equivalent claims bar process by order (see *Blue Range Resource Corp., Re* (2000), 193 D.L.R. (4<sup>th</sup>) 314 (Alta. C.A.) additional reasons in (2001), 202 D.L.R. (4<sup>th</sup>) 523, leave to appeal refused [2001] SCR viii (SCC)). The Company submits that the creation of the claims bar process as outlined in the proposed order is reasonable and necessary for the Company to complete its restructuring.

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All of which is respectively submitted.

Yours respectfully,



for Robert G. MacKeigan

RGM/gj