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October 29, 2008

HAND DELIVERED

The Honourable Justice A. David MacAdam
The Law Courts
1815 Upper Water Street
Halifax, NS B3J 1S7

My Lord:

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

I am scheduled to appear before Your Lordship on Monday, November 3, 2008 at noon for an order:

(i) granting preliminary approval of a Plan of Arrangement ("Plan") prepared by Canadian Sailing Expeditions Inc. (the "Company") for the purpose of presenting the Plan to the Company's creditors;

(ii) extending the stay of termination date set out in the initial order made by this Court on June 27, 2008 (the "Initial Order") as extended by subsequent orders of this Court; and

(iii) arrangements for additional debtor-in-possession ("DIP") financing to the Company pursuant to the CCAA.

Filed with this application is the Affidavit of Gavin MacDonald attaching the unsigned affidavit of Douglas Prothero, President and Director of the Company. I understand that Paul Goodman of BDO Dunwoody Goodman Rosen Inc., court appointed monitor (the "Monitor"), will be filing an affidavit with the Court in respect of this application. A sworn copy of Mr. Prothero's affidavit will be filed on or before the hearing of this matter.

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Pursuant to paragraph 57 of the Initial Order, this application has been brought on two clear days' notice to GrowthWorks Atlantic Venture Fund Limited ("GrowthWorks"), Nova Scotia Business Inc., Caterpillar Financial Services Limited ("Caterpillar") and National Marine and Fire Services Inc.

Preliminary Approval of the Plan

Although there is nothing in the CCAA which requires that Your Lordship approve the Company's proposed Plan prior to it being presented to creditors, the jurisprudence establishes that such approval is generally necessary prior to calling a meeting of such creditors. As set forth in the decision of this Court in *Re Federal Gypsum Company* (2007 NSSC 384) the standard that must be met to support the Plan of Arrangement at this stage is that the Plan must not be "doomed to failure" and have an "reasonable chance" of success. In *Federal Gypsum Company*, the Court cited Glube CJTD in *Fairview Industries Ltd., Re* (1991) 11 CBR (3d) 43 (NSSC (TD)), who held at para 80:

> "I have no hesitation in accepting a line of cases which are concerned with the concept of requiring a reasonable probability of success in the meetings to be held to deal with any proposals (see *Diemaster Tool*, supra, and *First Treasury Financial Inc. v. Cango Petroleums Inc.* (1991), 3 CBR (3d) 232 (ONT. Gen. Div.)). In my opinion, it would seem to be totally impractical and extremely costly to continue to prepare a Plan when there is no hope that it will be approved."
> [emphasis added]

The Company submits that its proposed Plan is not doomed to failure and has a reasonable chance of success. The Company has had significant discussions with its largest creditors – namely GrowthWorks and Caterpillar, who collectively represent more than half of the Company's debt. These discussions have not yet led to agreement on the Plan but the Company remains optimistic that agreeable compromises can be reached prior to the meeting of creditors once the Company has received either an offer to purchase the Caledonia or commitment for equity investment, a joint venture and/ or debt financing to allow the Company to exit CCAA. Furthermore, the Company proposes to retain all of its operating leases, which creates the expectation that the lease creditors will be supportive of the Plan. With respect to the unsecured creditors, the Company has had positive discussions with two of its largest unsecured creditors, Atlantic Canada Opportunities Agency and National Marine and Fire Services Inc., the Company is therefore optimistic that the required majority of unsecured creditors will respond favourably to the Plan. Given these

developments, the Company believes that the Plan stands a reasonable chance of success on its merits.

Classification of Creditors

The Plan sets out a proposed classification of creditors. The jurisprudence in respect of the CCAA provides that the classification of creditors must be based on a "commonality of interest". The Company submits that the proposed classification is based on: the type of security held by the relevant creditors, the opportunity under that security for conversion to equity (in the case of GrowthWorks), and the different compromises requested from those creditors.

The Creditors Meeting

As set out in the draft Plan, the Company has not set a specific date at the moment for the proposed meeting of creditors. As noted in the Affidavit of Douglas Prothero, there is not presently either an offer to purchase the Caledonia or other commitment to present so the creditors can have an informed vote upon the Plan. It is the intention of the Company to hold such a meeting as soon as those circumstances change. It is noted that sections 4 and 5 of the CCAA state,

> "4 Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the Court may, on the application in a summary way of the Company, or any such creditor or of the trustee-in-bankruptcy or a liquidator of the Company, order a meeting of the creditors or class of creditors and, if the Court so determines, of the shareholders of the Company, to be summoned in such a manner as the Court directs.
>
> 5. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the Court may, on the application in a summary was of the Company or any such creditor or of the trustee-in-bankruptcy or liquidator of the Company, order a meeting of the creditors or class of creditors, and, if the Court so determines, of the shareholders of the Company, to be signed in such manner as the Court directs."

We submit that the language of the sections is permissive and allows the Court latitude in how to establish the meeting date. It is the Company's intention that both alternatives outlined in the Plan are in the best interests of all stakeholders based on the current economic reality and in light of the liquidation alternative to proceeding with a reorganization under the CCAA. Given CCAA sections 4 and 5, the Company submits that the Court has latitude to give preliminary approval of the Plan in the form presently contemplated.

With respect to meeting procedure, the proposed form of Order follows closely the order issued in *Re Federal Gypsum, supra.* However, the required notice by advertisements has been reduced after consultation with the Monitor to one insertion in the Chronicle Herald (provincial edition) given that all creditors have previously been notified through the claims bar process in these proceedings.

Extension of Stay of Proceedings

In the event that Your Lordship approves the Plan for purpose of presentation to the Company's creditors, the Company is seeking to extend the Stay Termination Date as set out in the Initial Order to January 30, 2009 in order for the Company to:

(a) Relocate the vessel to a southern U.S. port, which the Company believes will increase the likelihood of a successful sale of the vessel rather than leaving it in its current port of Lunenburg, Nova Scotia;

(b) Continue to pursue the active opportunities it is investigating for obtaining additional equity and debt financing to fund the proposed plan of reorganization; and

(c) Continue to list the vessel in order to maximize the likelihood of obtaining a successful offer to purchase.

Paragraph 11(4) of the CCAA sets out the jurisdiction of the Court to consider the Company's application:

> (4) Other than initial application court orders – A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

> (a) staying until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection 1;
>
> (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
>
> (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Pursuant to section 11(6) of the CCAA, the burden of demonstrating to the Court that it is appropriate for it to grant the requested extension rests with the Company. Section 11(6) reads as follows:

> (6) Burden of proof on application – The court shall not make an order under subsection (3) or (4) unless
>
> (a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
>
> (b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted and is acting, in good faith and with due diligence.

In *Re Federal Gypsum Company* (2007 NSSC 347) at paragraph 16, Justice MacAdam cited Justice Glennie of the New Brunswick Court of Queen's Bench in *Re Cansugar Inc.*, 2004 NBQB 7 in summarizing the requirements to order an extension of a stay termination date as follows:

> (a) the circumstances exist to make the order appropriate;
>
> (b) that the applicant has acted and continues to act in good faith; and
>
> (c) that the applicant has acted and continues to act with due diligence.

Justice Farley in *Lehndorff General Partners Ltd., Re,* (1993) 17 CBR (3d) 24 (Ont. Gen. Div. [Commercial List]) in connection with the principles to be reviewed in such applications commented at para 6 as follows:

> The CCAA is intended to provide a structured environment for the negotiation of compromises between the debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so *and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA*... [emphasis added]

These comments of Justice Farley were quoted with approval by Justice Glennie of the New Brunswick Court of Queen's Bench in *Re Simpson's Island Salmon Ltd.* 2006 NBQB 6 at para 27.

Justice Glennie further wrote in *Re Cansugar Inc.*, supra at para 9:

> In my opinion, the requirements of section 11(6) of the CCAA have been satisfied in this case. The continuation of a stay is supported by the overriding purpose of the CCAA, which is to allow an insolvent company a reasonable period of time to reorganize and propose a plan of arrangement to its creditors and the court, and to prevent manoeuvres for positioning among creditors in the interim.

Also quoted in *Re Federal Gypsum Company*, supra, was the decision *Re San Francisco Gifts Ltd.*, 2005 ABQB 91 at para 28 on the supervisory role of the court in applications to extend stays of proceeding:

> The court's role during the stay period has been described as a supervisory one, meant to: "*preserve the status quo and to move the process along to the point where an arrangement or compromise is approved or it is evident that the attempt is doomed to failure.*" That is not to say that the supervising judge is limited to a myopic view of balance sheets, scheduling creditors meetings and the like. On the contrary, this role requires attention to changing circumstances

> and vigilance in ensuring that a delicate balance of interest is maintained. [emphasis added]

The Company contemplates that negotiations with respect to the final form of Plan will continue and that its proposed course of conduct has a minimum cost for all parties involved in the restructuring. The Company does not propose to operate other than the minimum necessary to preserve the value of its principal asset and to place that asset in a location, which the Company believes, will maximize the potential of a successful sale of the vessel. The Company submits that it requires additional time in order to present the creditors with a plan that can be implemented and that it is too early to draw any conclusions as to whether the ultimate plan will be a successful restructuring or a sale of the vessel.

Approval of Additional DIP Financing

The Company's final request is approval of additional DIP financing in order to fund its proposed minimal operations for the balance of the requested stay period. The Company has received an offer for such financing from Growthworks, its current DIP lender, on terms substantially similar to those outlined in the prior orders of this Court. The Company's cash flow projections note the requirement for additional financing notwithstanding the minimal outlays projected.

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 in *Re Federal Gypsum Company* (2007 NSSC 347 and 2007 NSSC 384) where the Court cited with approval the legal principles cited by Justice C. Campbell in *Re Manderley Corp.* (2005) 10 C.B.R. (5th) 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 is a reasonable prospect of a successful restructuring: ...

The Court in *Re Federal Gypsum Company* 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. (5th) 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 ...

In *Re Federal Gypsum Company* the Court authorized 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 task before the Court in this further request for DIP financing is to engage in "the balancing act that is the hallmark of DIP financing", as declared by C. Campbell J. in *Manderley* (supra) at para 27, weighing the benefits and prejudices referred to by Glennie J. in *Re Simpson's Island Salmon Ltd.* (supra). We note that Justice Glennie determined that, where the inevitable result of denying the application for further DIP financing would be to doom any attempt at rehabilitation, even the additional prejudice to creditors inherent in granting the order was outweighed by the overarching benefit to both the debtor and the creditors of continued progress in formulating and presenting a form of plan and ultimately successfully restructuring the Company. In short, while a reasonable chance of rehabilitation remains, the Company under CCAA protection should be afforded what measures are available to aid that rehabilitation to despite the some prejudice to creditors.

It is submitted that the additional financial requested is modest given the proposed use for minimal operations of the Company. Without such financing, the Company will not be able to maintain its principal asset in any form and will have to cease operations. It is also noted that, were the vessel not under the Company's control through the CCAA, it would be likely under the control of one of the significant secured creditors through a receivership and that the proposed operating costs would be incurred in any event. Such costs would be added to the principal debt of such creditor and would have a necessary prejudicial effect on creditors with security subordinate to that of the creditor pursuing the receivership. For this reason, it is submitted that the DIP financing should be approved notwithstanding the objection of some of the secured creditors of the Company. The relevant consideration continues to be the Court's jurisdiction to allow the Company a reasonable chance to restructure its affairs.

The Company respectfully submits that it has demonstrated a basis upon which to grant each of the requests sought. Its Plan has a reasonable chance of success and is not doomed to failure and so should be approved for the purpose of presenting it to its creditors. A creditors' meeting should be called but not until there is a sufficient factual basis to allow the Plan to be implemented subsequent to such a meeting. In order to move towards that eventual vote, the Company requires additional DIP financing. In addition to the foregoing,

it is efficient for the Court to consider at this time extending the stay of proceedings beyond the current Stay Termination Date since it is highly unlikely that the Company will be in a position to hold the creditors' meeting prior to November 28, 2008.

All of which is respectfully submitted.

Yours Respectfully,

for Robert G. MacKeigan

RGM/GDFM/gj