

COURT FILE NUMBER 1401-05914
COURT COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE CALGARY
APPLICANT CP ENERGY MARKETING LP
RESPONDENT KYOTO FUELS CORPORATION
DOCUMENT THIRD REPORT OF THE RECEIVER

APRIL 24, 2015

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS
DOCUMENT

RECEIVER

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TABLE OF CONTENTS

1. INTRODUCTION 2

2. TERMS OF REFERENCE 2

3. BACKGROUND 3

4. PELICAN SALE TRANSACTION 3

5. 186 SALE TRANSACTION 4

6. RECEIPTS AND DISBURSEMENTS 5

7. PROPOSED SCHEME OF DISTRIBUTION 6

8. RECOMMENDATIONS..... 7

APPENDICES

1866768 Alberta Ltd. Purchase and Sale Agreement "A"

Interim Statement of Receipts and Disbursements "B"

INTRODUCTION

1. On April 30, 2014, the Court of Queen's Bench of Alberta ("Court") issued an order ("Initial Order") granting Kyoto Fuels Corporation ("Kyoto" or the "Company") protection pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") (the "CCAA Proceedings"). Ernst & Young Inc. ("EY") was appointed monitor ("Monitor") under the Initial Order.
2. The Initial Order was granted upon the application of T&E Ventures Inc. ("T&E"), a secured creditor of Kyoto.
3. Kyoto's CCAA Proceedings were terminated and on May 29, 2014, the Court issued a Receivership Order appointing EY as Receiver (the "Receiver") of the property, assets, and undertakings (the "Property") of Kyoto.
4. The Receivership Order authorized the Receiver, *inter alia*, to carry on the business of Kyoto, to sell, convey, transfer, lease or assign the Property out of the normal course of business, subject to Court approval for transactions in excess of \$500,000 individually and \$1,000,000 in aggregate and to make such arrangements or agreements as deemed necessary by the Receiver. The Receivership Order also authorized the Receiver to borrow up to \$600,000 by way of Receiver's Certificates which amount was subsequently increased to \$850,000 by order of this Honourable Court granted October 24, 2014.
5. The purpose of this third report of the Receiver (the "Third Report") is to:
 - (a) Provide this Honourable Court with an update on the Pelican Sale Transaction as defined and described in the second report of the Receiver dated January 21, 2015 (the "Second Report");
 - (b) Provide this Honourable Court with an update on the Receiver's actions in respect of re-marketing the Property for sale; and
 - (c) Respectfully recommend that this Honourable Court grant an order approving the 186 Sale Transaction (as defined below).

TERMS OF REFERENCE

6. In developing this Third Report, the Receiver has relied upon unaudited financial information previously prepared by Kyoto's management, Kyoto's books and records and discussions with its former management. The Receiver has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information in a manner that would wholly or partially comply with Generally Accepted Assurance Standards pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Monitor expresses no opinion or other form of assurance in respect of the information. Future orientated financial information relied upon in this report is based on assumptions regarding future events and actual results achieved will vary from this information and the variations may be material.
7. Unless otherwise noted all currency references in this Third Report are in Canadian dollars.
8. Capitalized terms not defined in the Third Report are as defined in the Receivership Order.

BACKGROUND

9. Kyoto's plan was to become a commercial producer of biodiesel fuel, a fuel made from feedstock such as plant oils or animal fats. Kyoto's biodiesel plant is located near Lethbridge, Alberta and is the second largest biodiesel plant in Canada, with production capacity of 79 million litres per year (the "Plant").
10. The Plant never operated at commercial production capacity. The Plant operated briefly in the fall of 2013 to test the production process and produced a small amount of biodiesel. The Plant never operated subsequent to the test production process.
11. The Receiver understands that additional investment would have been required for the Plant to be able to produce biodiesel commercially including funding additional test production, specification testing of such production, and completion of the Plant's testing lab.
12. Kyoto's major secured creditors are as follows:
 - (a) T&E has a first priority position for \$200,000 (plus accrued interest and costs) for the debtor in possession financing ("DIP") it provided to fund the CCAA Proceedings;
 - (b) Agriculture Financial Services Corporation ("AFSC") has a second priority position pursuant to the issuance of Receiver's Certificates totalling \$850,000 (plus accrued interest);
 - (c) CP Energy Marketing LP ("CP") and AFSC ranking pari passu pro-rata to the amounts advanced and interest thereon having a third priority position, for approximately \$11.2 million (together, the "Senior Secured Lenders"); and
 - (d) T&E has a fourth priority position of approximately \$3.9 million.
13. Background and other information regarding these receivership proceedings have been posted on the Receiver's website at: www.ey.com/ca/kyotofuels.

PELICAN SALE TRANSACTION

14. On January 27, 2015, this Honourable Court approved the Pelican Sale Transaction and granted a sale approval and vesting order.
15. On February 19, 2015, the Receiver was advised by Pelican that it did not have sufficient financing in place to close the Pelican Sale Transaction despite the Pelican Sale Transaction not being subject to financing. As a result, the Receiver, with the concurrence of the Senior Secured Lenders, negotiated an extension agreement for the Pelican Sale Transaction (the "Extension Agreement") as outlined below:
 - (a) The closing date for the Pelican Sale Transaction was extended to April 17, 2015;
 - (b) Pelican pay to the Receiver an additional sum of \$50,000 on or before March 5, 2015 immediately releasable to the Receiver (the "First Extension Fee");

- (c) Pelican pay the sum of \$50,000 on or before March 23, 2015 (the "Second Extension Fee") as follows:
 - (i) \$15,000 to the Receiver to be applied toward costs relating to the extension;
 - (ii) \$25,000 as an increase to the initial deposit received to be credited against the purchase price; and
 - (iii) \$5,000 to legal counsel of each of the two Senior Secured Lenders in respect of their costs related to the extension.
 - (d) The initial deposit of \$500,000 received from Pelican would become immediately releasable to the Receiver without recourse by Pelican; and
 - (e) The Receiver would be allowed to undertake marketing activities in respect of the Kyoto assets to address the risk that the Pelican Sale Transaction may fail to close.
16. On March 5, 2015, Pelican paid the Receiver the First Extension Fee.
 17. On March 9, 2015, the Receiver made a partial payment in the amount of \$200,000 to T&E from the released Pelican deposit.
 18. On March 23, 2015, Pelican advised that it required until April 17, 2015 to close and requested a waiver of the Second Extension Fee. The Receiver advised Pelican that it would not waive the Second Extension Fee.
 19. On March 24, 2015, after allowing Pelican one additional day to provide the Second Extension Fee, and after Pelican's failure to pay the Second Extension Fee, the Receiver advised Pelican that the Pelican Sale Transaction had failed to complete and was terminated.

186 SALE TRANSACTION

20. Prior to terminating the Pelican Sale Transaction, the Receiver directed that Avison Young, its real estate agent, contact parties who were previously interested in the Kyoto assets to determine if they remained interested.
21. After the Pelican Sale Transaction was terminated on March 24, 2015, Avison Young actively solicited new offers on the Kyoto plant.
22. By April 9, 2015, Avison Young had sourced three expressions of interest from which it sourced two indicative offers. The Receiver; therefore, set a deadline of April 13, 2015 at 5:00 PM for the parties to submit their best offers (the "Offer Deadline"). The Receiver indicated all offers were to be unconditional other than the requirement for Court approval and provide a reasonable deposit of at least 10% of the offer price.
23. On the Offer Deadline, three offers were submitted to the Receiver as follows:
 - (a) 1866768 Alberta Ltd. ("186") in the amount of \$2.4 million, a \$300,000 deposit and no conditions other than approval of this Honourable Court (the "186 Offer");

- (b) 1886792 Alberta Ltd. ("188") in the amount of \$3.2 million, a \$500,000 deposit and a financing condition in addition to the approval of this Honourable Court (the "188 Offer"); and
 - (c) Beacon Resources Inc. ("Beacon") in the purported amount of \$20 million that was unsigned and provided no fixed cash payment, nor any deposit (the "Beacon Offer"). The Beacon Offer noted that the purchase price would be paid out based on a percentage of future cash flow from the Kyoto plant. The Receiver specifically instructed Beacon that its offer must include an upfront cash payment and a deposit of at least 10% of its purchase price; however, Beacon indicated it would not modify its offer.
24. The Receiver is of the view that the Beacon Offer is not viable as a result of not only the lack of upfront cash payments, and the lack of a deposit, but the fact that there is no certainty of any payments whatsoever as payments are to be based on positive cash flows.
25. The Receiver, after consulting the Senior Secured Lenders with a view to maximizing recoveries, worked with Avison Young to have 186 agree to either; i) hold its offer open for a short period of time until 188 could waive its financing condition or ii) consider increasing its unconditional offer. 186 subsequently increased its unconditional offer to \$3.0 million with a \$300,000 deposit.
26. The Receiver recommends this Honourable Court approve the sale of the Property to 186 (the "186 Sale Transaction") as:
- (a) The Property was extensively marketed through the CCAA and Receivership proceedings and the 186 Offer represents the best bid received when considering the conditionality of the 188 Offer;
 - (b) The Receiver believes that 186 has the wherewithal to close the sale;
 - (c) The Receiver continues to incur ongoing costs to oversee the Property which will cease upon closing;
 - (d) The sale price will provide for full repayment of the financing provided during the CCAA Proceedings (presently \$200,000 plus accrued interest and costs) and the Receiver's Certificates (\$850,000 plus accrued interest); and
 - (e) The sale is supported by the Senior Secured Lenders who are the only creditors that will receive any repayment in respect of their security (other than those parties who provided the CCAA DIP loan and the Receiver's Certificates).
27. A purchase and sale agreement was fully executed on April 14, 2015 (the "186 PSA"). A copy of the 186 PSA is attached as Appendix "A".

RECEIPTS AND DISBURSEMENTS

28. Attached as Appendix "B" is an interim statement of receipts and disbursements for the period May 29, 2014 to April 20, 2015.

29. The Receiver is authorized, as described above, to borrow up to \$850,000 by way of Receiver's Certificates. This amount has been fully drawn.
30. The Receiver has billed and been paid \$361,025 (inclusive of GST) to date. The Receiver has current unbilled time of approximately \$30,000.
31. The Receiver's legal counsel has billed and been paid \$158,709 (inclusive of GST) to date. It currently has unbilled time of approximately \$15,000.
32. The Receiver has cash on hand of approximately \$220,000. If the Proposed Sale Transaction is not approved by this Honourable Court, the Receiver estimates it will have insufficient funds to continue oversight of the Property beyond September, 2015.

PROPOSED SCHEME OF DISTRIBUTION

33. Should the 186 Sale Transaction be approved by this Honourable Court, and following the closing of the 186 Sale Transaction, the Receiver estimates it will hold approximately \$3 million. From the funds it will hold the Receiver proposes to make the following distributions:
 - (a) Repayment of the remaining balance of the funds owed to T&E under the Interim Financing Facility Commitment Letter approved in connections Kyoto's CCAA proceedings (including principal, accrued interest and costs). The Receiver understands that AFSC takes the position that interest on the financing provided by T&E does not take priority over the Senior Secured Lenders. The Receiver disagrees with AFSC's position;
 - (b) Repayment of the \$850,000 (plus accrued interest) advanced by AFSC by way of Receiver's Certificates and secured by the Receiver's Borrowing Charge; and
 - (c) Payment of \$450,000 to each of CP and AFSC as an interim distribution.
34. The Receiver proposes to hold back the remaining sale proceeds in connection with i) purchase price adjustments; ii) ongoing operating costs that will be incurred up to the 186 Sale Transaction closing date; iii) ongoing professional fees; iv) the aggregate maximum potential claim of \$126,000 of National Leasing Group Inc. and Thermo Fisher Scientific Inc. in respect of leased equipment over which title is claimed (these claims were described in detail in the Monitor's Second Report); and v) the remainder of the sale proceeds pending resolution between AFSC and CP of the appropriate allocation to be made to each under their pari passu arrangement.
35. Receiver's legal counsel has opined that the security held by the Senior Secured Lenders, subject to the assumptions and qualifications contained therein, which ranks pari passu, is valid and enforceable and ranks in priority to all other debts of Kyoto other than amounts outstanding under the Administration Charge, the CCAA Charges, and the Receiver's Borrowing Charge. The Receiver understands; however, that CP and AFSC have not reached an agreement as to the outstanding balance of their respective loans for the purposes of allocating distributions between them.

36. The Receiver will not make any further distributions of funds other than to address outstanding professional fees and administrative costs until such time as the Senior Secured Lenders have reached an agreement in respect of their loan balances and advised the Receiver of same in writing, or a further Order is obtained.

RECOMMENDATIONS

37. Based on the foregoing, the Receiver respectfully recommends that this Honourable Court grant an order providing the relief detailed in Paragraph 5(c) of this Third Report.

* * *

All of which is respectfully submitted this 24th day of April, 2015.

ERNST & YOUNG INC.

**in its capacity as Receiver and Manager of Kyoto Fuels Corporation
and not in its personal or corporate capacity**



Robert J. Taylor, FCA•CIRP, CFE
Senior Vice-President

ASSET PURCHASE AGREEMENT

DATED this 14th day of April, 2015, among:

ERNST & YOUNG INC., in its capacity as receiver and manager (the "Receiver") of the current and future assets, undertakings and properties of **KYOTO FUELS CORPORATION ("KFC")**

- and -

1866768 ALBERTA LTD., a corporation incorporated under the laws of the Province of Alberta (the "Purchaser")

WHEREAS:

A. On May 29, 2014, the Court of Queen's Bench of Alberta in Action Number 1401-05914 (the "Receivership Proceedings") granted a receivership order (the "Receivership Order") appointing the Receiver as the receiver and manager of the current and future assets, undertakings and properties of KFC (the "Property").

B. The Receivership Order empowers and authorizes the Receiver to market any or all of the Property and negotiate such terms and conditions of sale as the Receiver in its discretion may deem appropriate.

C. The Purchaser wishes to purchase the Assets (as defined below) subject to, and in accordance with, the terms and conditions of this Agreement.

NOW THEREFORE, in consideration of the mutual covenants and provisions herein contained, and for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, it is agreed between the parties as follows:

ARTICLE 1 – DEFINITIONS

1.1 Definitions. In this Agreement, the following terms shall have the following meanings:

- (a) "Agreement" means this Asset Purchase Agreement;
- (b) "Assets" means all of the property and assets set out in Schedule "A";
- (c) "Business Day" means a day other than a Saturday, Sunday or statutory holiday in Alberta;
- (d) "Canadian Dollars" or "Cdn. \$" or "\$" shall mean lawful money of Canada;
- (e) "Claim" shall mean any secured, lien, possessory lien, unsecured, administrative, trust or other type of claim, against KFC and/or any and all of the Assets, of every nature and kind and howsoever arising, including, without limitation, debts, dues, rights, actions, causes of action, third party claims, rights by way of indemnity, surety or set-off and

- 2 -

securities, whether legal, beneficial, equitable, absolute or contingent, liquidated or unliquidated, vested or not vested, due or accruing due, present or future, known or unknown, but not including the Permitted Encumbrances;

- (f) "Closing" means the closing of the transactions set forth in this Agreement at the Closing Time;
- (g) "Closing Time" shall mean 10:00 a.m. (Calgary time) on or before 21 days after the satisfaction or waiver of the conditions set out in paragraph 2.5 of this Agreement, or such later date as the parties may agree to in writing;
- (h) "Court" means the Court of Queen's Bench of Alberta in the Judicial District of Calgary presiding over the Receivership Proceedings;
- (i) "Deposit" has the meaning attributed thereto in paragraph 2.4 of this Agreement;
- (j) "GST" has the meaning attributed thereto in paragraph 2.3 of this Agreement;
- (k) "ITA" means the *Income Tax Act* (Canada), as amended;
- (l) "Order" means an order granted by the Court;
- (m) "Permitted Encumbrances" means the permitted encumbrances set out in Schedule "B" to this Agreement;
- (n) "Purchase Price" means the sum of \$3,000,000;
- (o) "Transaction" means the transaction of purchase and sale of the Assets and other arrangements, if any, contemplated by this Agreement; and
- (p) "Vesting Order" means an Order, in form and substance acceptable to the Purchaser and the Receiver acting reasonably, approving the sale of, and vesting title to, the Assets, upon Closing, to the Purchaser free and clear of all Claims.

1.2 **Headings.** The headings appearing in this Agreement are inserted for convenience of reference only and will not affect the interpretation of this Agreement.

1.3 **Plurality and Gender.** Words used herein importing the singular number only shall include the plural and vice versa and words importing gender shall include all genders and words importing individuals shall include corporations, partnerships, trusts, syndicates, joint ventures, governments and governmental agents and authorities and vice versa.

1.4 **Schedules.** The following Schedules are incorporated into and form part of this Agreement:

Schedule "A" Assets

Schedule "B" Permitted Encumbrances

ARTICLE 2 – PURCHASE AND SALE

2.1 **Sale of the Assets.** Upon the satisfaction of the terms and conditions stated herein, on Closing, the Purchaser hereby purchases from the Receiver, and the Receiver hereby sells, assigns,

conveys and delivers to the Purchaser, the Assets, on an as is where is basis, at and for the Purchase Price.

- 2.2 **Payment of Purchase Price.** Upon the satisfaction of the terms and conditions stated herein, the Purchaser shall pay to the Receiver, on or before the Closing Time, the Purchase Price plus applicable GST. Unless otherwise agreed, all amounts payable shall be paid to the Receiver by cheque certified by, or draft of, a Canadian chartered bank to be released upon Closing.
- 2.3 **GST.** The Purchase Price shall not include the amount of Goods and Services Tax exigible on the within transaction pursuant to the provisions of the *Excise Tax Act* (Canada) (the "GST"), which GST shall be tendered by the Purchaser to the Receiver in addition to the Purchase Price. At or before the Closing Time, the Purchaser shall deliver, or cause to be delivered, to the Receiver i) the registration number of the Purchaser for purposes of the GST together with the covenant and indemnity of the Purchaser to make appropriate filings with respect to this transaction as it relates to GST as required by the ITA, or ii) payment or evidence of payment of applicable federal or provincial taxes including GST, or, alternatively, iii) appropriate exemption certificates in form and substance satisfactory to the Receiver.
- 2.4 **Deposit.** Within two business days of execution of this Agreement, the Purchaser shall provide the Receiver a deposit in the amount of \$300,000 (the "Deposit"). The Deposit shall be made by a cheque certified by, or draft of, a Canadian chartered bank. The Deposit shall be deemed to be a cash deposit to be applied to the Purchase Price. The Deposit shall be returned to the Purchaser if this Agreement is terminated pursuant to paragraph 2.6. The Deposit will be forfeited if this Agreement is terminated for any other reason.
- 2.5 **Conditions Precedent.** This Agreement is conditional on the satisfaction or waiver of the following conditions, which are inserted for the benefit of all of the parties to this agreement and may be waived, in whole or in part, in writing by all of the parties hereto:
- (a) the Court shall have granted the Vesting Order, which shall, among other things, approve the Purchaser's acquisition of the Assets free and clear of all Claims, interests and encumbrances, howsoever arising, except for the Permitted Encumbrances;
 - (b) the Vesting Order shall not be subject to any stay or other impediment in connection with the execution and closing of the Transaction; and
 - (c) at the Closing Time, subject only to the Permitted Encumbrances, the Assets shall be absolutely unencumbered and free of any and all Claims pursuant to the Vesting Order.
- 2.6 **Termination.** If the conditions contained in section 2.5 are not satisfied or waived on or before May 11th, 2015 or such later date as may be agreed to in writing by all of the parties, this Agreement shall terminate and cease to have any further force or effect.

ARTICLE 3 – "AS IS, WHERE IS"

- 3.1 **As Is, Where Is.** The Purchaser hereby acknowledges and agrees that the Assets are being purchased on an "as is, where is" basis, and that it has conducted to its satisfaction its own independent investigation, analysis and evaluation of the Assets as it deems necessary or appropriate and that in making its decision to enter into this Agreement and to consummate the transactions contemplated hereby it has and will rely solely on such independent investigation. Without limiting the foregoing, any and all conditions, warranties or representations expressed or implied pursuant to any legislation in any jurisdiction do not apply hereto and have been

- 4 -

waived by the Purchaser. The Purchaser acknowledges that there is no representation, warranty, term, condition, understanding or agreement, express or implied, oral or written, legal, equitable, conventional, collateral or otherwise, given in this Agreement or in any document furnished in connection with this Agreement, as to title, outstanding liens, encumbrances, description, merchantability, value, suitability or marketability of the Assets or in respect of any other matter or thing whatsoever, except as otherwise expressly stated herein. The Purchaser shall be deemed to have relied entirely on its own inspection and investigation in proceeding with the transactions contemplated hereunder.

ARTICLE 4 – MISCELLANEOUS

4.1 **Further Assurances.** The parties will execute such further and other documents and do such further and other things as may be necessary to carry out and give effect to the intent of this Agreement.

4.2 **Notice.** All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally to the parties or sent by courier or facsimile to the following address (or such other address for a party as shall be specified by like notice):

(a) to Purchaser, as follows:

#137, 10555 48th Street SE
Calgary, Alberta T2C 2B7

Attention:
Fax:

with a copy to:

Tingle Merrett
Suite 1250, 639 - 5th Avenue S.W.
Calgary Alberta T2P 0M9

Attention:

(b) to the Receiver, as follows:

Ernst & Young Inc.
Receiver of Kyoto Fuels Corporation
1000, 440 2nd Avenue SW
Calgary, AB T2P 5E9

Attention: Robert J. Taylor / Nick JB Purich

with a copy to:

- 5 -

Dentons Canada LLP
15th Floor, Bankers Court
850-2nd Street SW
Calgary, AB T2P 0R8
Fax: 403.268.3100

Attention: Derek Pontin

Any such notice or other communication shall be effective upon delivery.

- 4.3 Legal Advice.** The parties have consulted with and been advised by their own solicitors before entering into this Agreement, have read same and know the contents thereof.
- 4.4 Entire Agreement.** This Agreement constitutes the entire agreement between the parties and there are no representations or warranties, express or implied, statutory or otherwise and no collateral agreements other than as expressly set forth or referred to in this Agreement.
- 4.5 Severability.** In case any provision in this Agreement shall be prohibited, invalid, illegal or unenforceable in any jurisdiction, such provision shall be ineffective only to the extent of such prohibition, invalidity, illegality or unenforceability in such jurisdiction without affecting or impairing the validity, legality or enforceability of the remaining provisions hereof, and any such prohibition, invalidity, illegality or unenforceability shall not affect or impair such provision in any other jurisdiction.
- 4.6 Amendment.** No amendment of this Agreement will be binding unless made in writing by all the parties.
- 4.7 Time of the Essence.** Time shall be of the essence of this Agreement.
- 4.8 Costs.** Each party shall be responsible for its own costs in preparation of this Agreement and completion of the Transaction.
- 4.9 Waiver.** Failure by either party hereto to insist in any one or more instances upon the strict performance of any one of the covenants and obligations contained herein shall not be construed as a waiver or relinquishment of such covenant or obligation. No waiver by any party hereto (whether in whole or in part) of any such covenant or obligation shall be deemed to have been made unless expressed in writing and signed by the waiving party.
- 4.10 Applicable Law and Court Jurisdiction.** This Agreement shall be governed by, and construed in accordance with, the laws of the Province of Alberta and the laws of Canada applicable therein, and the parties hereby attorn to the jurisdiction of the Court in relation to any matter relating to this Agreement.
- 4.11 Successors and Assigns.** This Agreement will enure to the benefit of and be binding upon the parties and their respective successors and permitted assigns.
- 4.12 Counterparts.** This Agreement may be signed in counterparts and each such counterpart will constitute an original document and such counterparts, taken together, will constitute one and the same instrument. A counterpart may be delivered by fax or any other form of electronic transmission.

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- 6 -

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- 7 -

IN WITNESS WHEREOF the parties hereto have executed this Agreement as of the date first above written.

1866768 ALBERTA LTD

Per:

A handwritten signature in cursive script, appearing to read "Alicia Karl", is written over a horizontal line.

ERNST & YOUNG INC., in its capacity as receiver and manager of the current and future assets, undertakings and properties of KYOTO FUELS CORPORATION

Per:

A solid horizontal line intended for a signature.