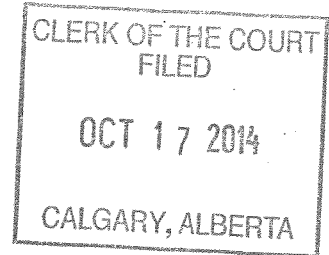


'COURT FILE NUMBER 1401-05914
COURT COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE CALGARY
APPLICANT CP ENERGY MARKETING LP
RESPONDENT KYOTO FUELS CORPORATION
DOCUMENT FIRST REPORT OF THE RECEIVER



OCTOBER 16, 2014

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS
DOCUMENT

RECEIVER

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EXHIBIT TO THE FIRST REPORT

INTERIM STATEMENT OF RECEIPTS AND DISBURSEMENTS

EXHIBIT 1

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. Subsequently, 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, to borrow up to \$600,000 by way of Receiver's Certificates and to make such arrangements or agreements as deemed necessary by the Receiver.
5. The purpose of this First Report of the Receiver is to provide this Honourable Court with:
 - a) An update on the actions of the Receiver since the date of receivership;
 - b) An update on the sale process of Kyoto's assets; and
 - c) Respectfully recommend that this Honourable Court grant an order authorizing the Receiver to borrow an additional \$250,000 by way of Receiver's Certificates, thereby increasing the Receiver's borrowing limit to \$850,000, and confirming the same is secured by the Receiver's Borrowings Charge (as defined in the Receivership Order).

TERMS OF REFERENCE

6. In developing this First 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 First Report are in Canadian dollars.

BACKGROUND

8. Kyoto was intended to be 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").
9. The Plant never operated at commercial production capacity. The Plant operated briefly in the fall of 2013 to test the production process. An insignificant amount of biodiesel was produced; however, the Plant never operated subsequent to producing that test production.
10. The Receiver understands the Plant would have required significant additional investment in order for it to operate commercially including additional test production, specification testing of such production, and completion of the Plant's testing lab. Due to the Company's lack of financial resources, the Plant was never completed and has never operated commercially.
11. At the date of the Receivership Order, Kyoto's primary secured creditors were as follows:
 - a) T&E in first position against Kyoto in respect of the interim financing of \$400,000 it provided to fund the CCAA Proceedings. The priority of the T&E financing is confirmed in the Receivership Order;
 - b) CP Energy Marketing LP ("CP") and Agriculture Financial Services Corporation ("AFSC") ranking in second position, pari passu, for approximately \$11.2 million (together, the "Senior Secured Lenders"); and
 - c) T&E secured in third position against Kyoto in respect of financing it provided prior to the CCAA Proceedings totalling approximately \$3.9 million.
12. The Receiver is in the process of obtaining a legal opinion confirming the validity and priority of the security of Kyoto's primary secured creditors, as described above.
13. Background information and other information regarding these receivership proceedings have been posted by the Receiver on its website at: www.ey.com/ca/kyotofuels.

MOTHBALL PROCESS

14. Operating the Plant as a going concern was not feasible. The Company did not have the working capital to commission the plant for commercial operations, to support ongoing losses in the current biodiesel market due to depressed market prices for biodiesel fuel, or service the existing debt load. Additionally, Kyoto had neither an agreement for the supply of feedstock nor any purchaser for its biodiesel production.

15. Accordingly, to ensure the safety and preservation of the Plant, with the concurrence of the Senior Secured Lenders, the Receiver drained all fluids from tanks and pipes, flushed pipes and tanks and took other steps to reduce potential environmental risk and make the plant safe and secure in the short term (the "Mothball Process"). This process included the sale of certain chemicals on site (principally the untested biodiesel produced by Kyoto in its testing phase in September 2013) and removal and disposal of certain chemicals that could not be sold (methoxide, caustic soda, and sulphuric acid).
16. In advance of completing the Mothball Process, the Receiver contacted Alberta Energy to communicate its plans for the Mothball Process and a sales process. The Receiver was informed that no specific permits were required to undertake the Mothball Process as described above and that Alberta Energy had no issue with the sales process.
17. The Mothball Process was carried out by the Receiver with the assistance of Integrated Industrial Solutions (2011) Inc. ("IIS"). IIS had contracts in place with Kyoto to provide operational and administrative functions to Kyoto prior to the Initial Order. The Receiver negotiated with IIS to provide staffing to conclude the Mothball Process.
18. IIS initially indicated that its cost to complete the Mothball Process would be approximately \$850,000, excluding professional costs. This estimate included IIS costs of approximately \$710,000. After protracted negotiations with IIS and a review of the process required, a statement of work was agreed between IIS and the Receiver. The revised estimated costs of the Mothball Process, excluding professional fees, were approximately \$529,000.
19. As previously noted, a component of the Mothball Process included the Receiver selling the on-site glycerin and biodiesel for approximately \$154,000 which partially offset the cost of the Mothball Process.
20. The Mothball Process concluded on July 17, 2014 when all IIS staff vacated the premises. Twenty four hour security has been in place at the Plant since that date until recently.

SALES PROCESS

21. The Receiver undertook a sales process to realize on the assets of Kyoto for the benefit of its stakeholders concurrently with the Mothball Process described above.
22. The sales process included:
 - d) Preparation of a list of parties who may be interested in submitting an offer for some or all of the assets based on the Receiver's industry knowledge and experience, market research and input from Kyoto and the Senior Secured Lenders (the "Prospective Bidders"). The initial Prospective Bidders list comprised 1,179 individual entities;
 - e) A summary description of the assets was prepared (the "Teaser") establishing the opportunity and setting the bid deadline as 5pm (Mountain Time) on August 5, 2014 (the "Bid Deadline");
 - f) The Teaser was sent to each party on the list of Prospective Bidders by either email or ordinary mail on or about June 6, 2014;

- g) Advertisements for the sale of the assets were placed in the following publications:
- Biofuels Digest - July 1, 2014;
 - Biofuels International - week commencing June 23, 2014;
 - Renewable Energy Magazine - electronically July 1, 2014, hardcopy July 10, 2014; and
 - Biodiesel Magazine.com - July 1, 2014; and
- h) The Receiver prepared an electronic data room with approximately 180 documents detailing the assets and the acquisition opportunity, as well as financial and technical background information.
23. Twenty-nine parties contacted the Receiver to discuss the acquisition opportunity and were provided a copy of a confidentiality agreement ("CA"). Twenty parties returned the CA and were provided access to the data room.
24. One party contacted the Receiver to organize a Plant visit which was completed in advance of the Bid Deadline.
25. At the Bid Deadline the Receiver received two offers and one commission-based liquidation proposal ("Initial Liquidation Proposal"). The Receiver did not actively pursue the Initial Liquidation Proposal as the interest of the Senior Secured Lenders was to obtain an *en bloc* sale of the Plant.
26. Neither of the two offers received were compliant with the sales process as:
- a) Neither provided the requisite 10% deposit as outlined in the Teaser; and
 - b) Neither party provided proof of funding in respect of its bid.
27. Following the Bid Deadline, and after discussions with the Senior Secured Lenders, the Receiver requested that each offeror provide proof of funding in respect of their bid and a deposit of \$500,000 (which was less than 10% of either bid) within 5 business days (the "Revised Bid Requirements"). Neither party complied with the Revised Bid Requirements.

BID DEADLINE EXTENSION AND REQUEST FOR LIQUIDATION PROPOSALS

28. The Receiver solicited feedback from parties who had participated in the sales process but had not submitted a bid by the Bid Deadline. Certain of these parties indicated that they required additional time to consider the acquisition opportunity.
29. After neither of the offerors met the Revised Bid Requirements, the Receiver, with the support of the Senior Secured Lenders, determined that to maximize the opportunities to elicit an *en bloc* sale, the Bid Deadline should be extended to September 19, 2014 (the "Revised Bid Deadline").

30. On August 25, 2014, the Receiver notified all parties who had originally had access to the data room, as well as new parties either identified by the Senior Secured Lenders or by the Receiver of the Revised Bid Deadline.
31. Concurrent with notification of the Revised Bid Deadline, the Receiver made a request for proposals from qualified liquidators for a piecemeal liquidation of the Plant (the "Liquidation RFP") with a proposal deadline of September 19, 2014 (the "Proposal Deadline").
32. The Liquidation RFP was sent to 16 parties identified by the Receiver through its experience with other asset dispositions. The parties contacted consisted of liquidators located throughout North America.

SALES PROCESS AND LIQUIDATION RFP RESULTS

33. Following the issuance of the notice of the Revised Bid Deadline, the Receiver sent out an additional four CAs, three of which were executed and returned in satisfactory form. The Receiver provided data room access to these three additional parties.
34. One potential purchaser and two potential liquidators arranged and completed site inspections of the Plant.
35. At the Revised Bid Deadline and Proposal Deadline, the Receiver was in receipt of no *en bloc* bids and one liquidation proposal (the "LSI Proposal") from Liquidity Services Inc. ("LSI"), a US based company.
36. The Receiver has not, at this time, accepted the LSI Proposal as:
 - a) The "one lot" sale process is similar to the sales process undertaken by the Receiver;
 - b) The suggested timeframe for the liquidation is approximately six months which would incur significant carrying costs as further discussed below; and
 - c) LSI does not provide any guarantees on completing the process or on proceeds to be realized.
37. Following the Revised Bid Deadline, on September 30, 2014, the Receiver received an *en bloc* offer for the assets of Kyoto. This offer (the "Late Offer") was not accompanied by a 10% deposit or proof of funding as required in the sales process.
38. The Receiver has requested of the party who made the Late Offer to provide the requisite proof of funding and deposit but neither has been received to date. Accordingly the Receiver does not believe the Late Offer to be capable of completion.

PROPOSED FINAL BID PROCESS

39. After discussions with the Senior Secured Lenders, a final sales process (the "Proposed Final Bid Process") has been agreed upon that will include a final 30 day marketing process as detailed below. The Receiver is working with the Senior Secured Lenders to set a minimum sale price (the "Minimum Bid Amount") at which they will support a sale to any party for an amount equal to or in excess of the Minimum Bid Amount. Accordingly, the Receiver will circulate the details of the Final Bid Process, as outlined below, to all parties who had previously been active in the dataroom, plus certain other parties that had expressed an interest including, but not limited to, former directors and shareholders of Kyoto.
40. The Proposed Final Bid Process will commence following the approval of this Honourable Court and upon the Receiver and the Senior Secured Lenders agreeing on a Minimum Bid Amount.
41. For a bid to be eligible in the Proposed Final Bid Process the bid must be greater than or equal to the Minimum Bid Amount, accompanied by proof of funding, a 10% refundable deposit and confirmation that the purchase would be without conditions and on an "as is, where is" basis, and otherwise acceptable to the Receiver, in its sole discretion, having regard to all relevant factors including conditionality (an "Eligible Bid").
42. At the end of the Proposed Final Bid Process, the winning bid will be the highest Eligible Bid. If there are more than one Eligible Bid, and the highest Eligible Bid does not exceed the next highest Eligible Bid by more than \$100,000, then within 5 business days of the Final Bid Process deadline, the Receiver will distribute to the makers of all Eligible Bids an invitation to an auction to be held at the offices of the Receiver at 1000, 440-2nd Avenue SW, Calgary AB, within 5 business days or such other place and time as the Receiver may notify all bidders who have submitted an Eligible Bid and expressed their intention to participate in the auction (the "Final Auction").
43. The Receiver will provide the terms of the most favourable Eligible Bid (the "Lead Bid") to all parties invited to the final auction. The Receiver in its sole discretion will set the terms for bidding at the Final Auction and:
 - a) each bid made in the course of the Final Auction must exceed the aggregate purchase price payable by the Lead Bid, or any subsequent higher bid, by an increment of at least \$50,000 or such amount agreed to by the Receiver and the Senior Secured Lenders;
 - b) the Receiver shall have the discretion to accept or reject any and all Final Auction bids and to determine what constitutes the best Final Auction bid, if any, having regard to all relevant factors including price and conditionality;
 - c) the "Winning Bidder" shall be: (a) if there are no acceptable bids at the Final Auction, the person with the Lead Bid; or (b) the bidder with the highest acceptable Final Auction bid; and
 - d) upon determining the Winning Bidder, the Receiver shall apply for a Court Order vesting the Property in the Winning Bidder.
44. The Receiver shall have the right to amend or extend any deadline in the Final Bid Process.

RECEIVERSHIP STRATEGY

45. The Receiver has maintained constant communication with the Senior Secured Lenders in respect of this Receivership. From the outset, the focus has been to achieve an *en bloc* sale of the Property as this course of action was expected to achieve the highest potential recovery for Kyoto's creditors.
46. Given the lack of result from the extended sales process, the Receiver is presently in discussions with the Senior Secured Lenders and assessing alternatives that were not previously pursued. The Receiver is also taking steps to further reduce carrying costs.
47. The Plant is currently set up for significant power consumption which carries a monthly cost of between \$10,000 and \$15,000. The Receiver could not take steps to reduce the committed power supply if an *en bloc* sale was to be completed, but has now commenced discussions with the utility provider as to its options to reduce the committed power supply.
48. The Senior Secured Lenders have requested that the Receiver obtain a quote for the costs of fully dismantling the Plant and selling it piecemeal. The process and costs of dismantling the Plant were not previously explored as the cost would have been unwarranted while actively pursuing an *en bloc* sale, which was the outcome desired by the Senior Secured Lenders.
49. As part of understanding the process and costs of dismantling the Plant, the Receiver has been in contact with the Alberta Government again to understand what, if any, requirements the Government has in respect of a dismantling process. The Receiver has also engaged a consultant to provide it with a quote to dismantle all of the on-site equipment.
50. The Receiver is not aware of any environmental issues with the Property; however, given the nature of the Property, the Receiver has contacted a qualified environmental engineering firm that has provided quotes to perform a phase one and, if necessary, a phase two environmental assessment.
51. The Receiver has engaged a qualified appraiser to determine the value of the land and the building if the equipment were to be removed.

RECEIPTS AND DISBURSEMENTS

52. Attached as Exhibit "1" is an interim statement of receipts and disbursements for the period May 29, 2014 to October 16, 2014.
53. The Receivership Order authorized the Receiver to borrow up to \$600,000 by way of Receiver's Certificates. This amount has been fully drawn.
54. The Receiver has billed and been paid \$96,844 (inclusive of GST) to date. The Receiver has billed but not been paid fees of \$74,852 and has current unbilled time of approximately \$50,000.
55. The Receiver's legal counsel has not been paid any fees to date. It currently has outstanding fees of \$58,031 and approximately \$10,000 of current unbilled time.
56. The Receiver initially estimated that the proposed Mothball Process and sale process would take 60 days and that the funding available by way of Receiver's Certificates would be sufficient for this time period. To date the receivership has lasted 140 days and accordingly the Receiver has a shortfall of available funds as shown below.

Kyoto Fuels Corporation - In Receivership		
Receivership Financial Position		
\$ CAD, Unaudited		
Cash on hand		163,432
Accrued Operating Costs		
Security	15,000	
Consulting	2,000	
Utilities	14,000	
Subtotal		31,000
Professional Fees		
Receiver's billed, unpaid amounts	74,852	
Receiver's unbilled amount	50,000	
Receiver's counsel's billed, unpaid amounts	58,031	
Receiver's counsel's unbilled amount	10,000	
Subtotal		192,883
Net Receivership Financial Position		(60,451)

ONGOING COSTS

57. The Receiver estimates that ongoing monthly costs will be approximately \$62,000 including security, insurance, utilities and estimated professional fees. The following is a summary of estimated monthly operating costs:

Kyoto Fuels Corporation - In Receivership		
Estimated Monthly Operating Costs		
\$ CAD, unaudited		
	Note	Amount
Insurance	a	5,000
Security	b	2,000
Utilities	c	14,000
GE (Generator)	d	1,800
National Lease (Radios)	d	570
Miscellaneous (water, septic, consulting)		4,000
Subtotal monthly operating costs (fall season)		27,370
Additional winter operating cost	e	10,000
Subtotal monthly operating costs (winter season)		37,370
Receiver's fees	f	15,000
Receiver's counsel's fees	f	10,000
Monthly estimated professional fees		25,000
Estimated monthly operating costs		62,370

58. The estimated ongoing operating costs are as follows:
- Insurance has been reduced based on a reduced value of the Property as agreed by the Senior Secured Lenders;
 - Security checks of the plant and building are budgeted to be conducted weekly to comply with the insurance policy requirements. Until October 10, 2014, the Receiver had 24 hour security in place due to the higher activity at the plant during the sales process but subsequently, with the concurrence of the Senior Secured Lenders, has reduced such level of security as it is no longer required due to the reduced activity;
 - Utility costs of the plant remain significant to maintain the large transformer and high demand capacity which is necessary for operation of the Plant. The Receiver has contacted the power provider and is working with its legal counsel to determine its options in respect of reducing utility costs;

- d) The generator and radios are leased and would be required to continue operating the plant as a going concern. They appear to have a value in excess of the amount outstanding on their leases and the Receiver recommends retaining these assets;
 - e) Current operating costs do not reflect the costs of maintaining the plant during winter months which include the cost of heating the plant, and additional plant checks by the former plant manager to ensure systems are running correctly. The Receiver estimates these costs could be as high as \$10,000 per month; and
 - f) Professional fees are estimated to be up to \$25,000 per month on the basis that the Receiver is actively continuing to market the assets, engaging other professionals such as appraisers and decommissioning experts, and developing options for the consideration of the Senior Secured Lenders.
59. The Receiver continues to maintain regular communication with the Senior Secured Lenders in respect of available options.
60. Additional funding is required to enable the Receiver to maintain the assets and undertake the requested actions.
61. The Receiver is therefore requesting that it be authorized to draw an additional \$250,000 by way of Receiver's Certificates (the "Receiver's Borrowings Charge Increase"). AFSC has indicated it is prepared to advance said funds on similar terms as the previous Receiver's Certificates.
62. If the Receiver's Borrowings Charge Increase is not approved, if the Senior Secured Lenders do not provide the requested funding under the Receiver's Borrowings Charge Increase, or if the cost of dismantling the Plant is expected to exceed the potential recoveries, the Receiver expects it will seek its discharge from this Honourable Court.

RECOMMENDATION

63. The Receiver respectfully requests that this Honourable Court approve the:

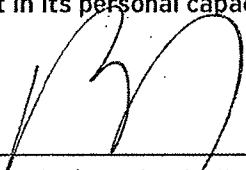
- a) Receiver's actions and conduct to date;
- b) The Proposed Final Bid Process; and
- c) Receiver's Borrowings Charge Increase.

All of which is respectfully submitted this 16th day of October, 2014.

* * *

ERNST & YOUNG INC.

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



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

Kyoto Fuels Corporation - In Receivership
Interim Statement of Receipts and Disbursements
May 29, 2014 to October 16, 2014
\$ CAD, unaudited

Receipts

Cash on hand at the date of Receivership	13,579	
Advances by AFSC pursuant to Receiver's Certificates	600,000	
Sales of biodiesel and chemicals	153,581	
Other receipts	37,116	
Total receipts		804,276

Disbursements

Decommissioning - IIS	236,939	
Consulting	39,257	
Operating	194,148	
Disposal	73,655	
Receiver's fees and costs	96,844	
Total disbursements		640,843

Cash on hand		<u>\$ 163,432</u>
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