Action No.:

Affidavit of Karla McCarthy
Sworn this 27 day of ~~April, 2009~~ September 2010

**IN THE COURT OF QUEEN'S BENCH OF ALBERTA**
**JUDICIAL DISTRICT OF CALGARY**

BETWEEN:

Plaintiff

- and -

**PAINTEARTH ENERGY SERVICES INC., PAINTEARTH ENERGY SERVICES LTD. and PES SUBSURFACE CANADA INC.**

Defendants

**AFFIDAVIT**

I, Karla McCarthy, of the City of Vancouver, in the Province of British Columbia, Banker, MAKE OATH AND SAY AS FOLLOWS:

**Background**

1. I am the Assistant Vice President in the Special Credit Department at HSBC Bank Canada ("HSBC" or the "Bank") and am presently responsible for the administration of the accounts of Paintearth Energy Services Inc. ("Paintearth Inc.") at HSBC. As such, I have personal knowledge of the matters and facts hereinafter deposed to, except where stated to be based on information and belief and, where so stated, I verily believe the same to be true.

2. Paintearth Inc., Paintearth Energy Services Ltd. ("Paintearth Ltd.") and PES Subsurface Canada Inc. ("PES") are in the business of providing subsurface and coating products for use in the oil and gas industry primarily out of premises located in Alberta, Canada and Texas in the United States of America.

3. Paintearth Ltd. and PES are wholly owned subsidiaries of Paintearth Inc.

**Loans and Security**

4. HSBC provided an operating loan, a Mastercard loan, a foreign exchange loan and a demand loan to Paintearth Inc. pursuant to a credit facility letter dated September 21, 2006 and amendments thereto (the "Credit Facility"). The principal amount of the operating loan advanced by HSBC to Paintearth Inc. was $5,500,000. The principal amount of the Mastercard loan advanced by HSBC to Paintearth Inc. was $100,000. The principal amount of the foreign exchange loan was $540,000. The principal amount of the demand loan advanced was $194,000. (The operating loan, the Mastercard loan, the foreign exchange loan and the demand loan are collectively referred to as the "Loans".) Pursuant to the terms of the Credit Facility, the Loans were to be repaid to the Bank on demand.

5. As security for the Loans, Paintearth Inc. executed in favour of the Bank, a General Security Agreement, a General Assignment of Book Debts and an assignment of life insurance policy all dated October 19, 2006. In addition, Paintearth Inc. granted security to HSBC pursuant to section 427 of the *Bank Act* and pursuant to an Agreement as to Loans and Advances and Security dated October 28, 2006 (collectively the "Paintearth Inc. Security").

6. Paintearth Ltd. guaranteed the Loans pursuant to a guarantee dated October 19, 2006 limited to the principal amount of $14,730,000 (the "Paintearth Ld. Guarantee"). PES guaranteed the Loans pursuant to an unlimited guarantee dated April 30, 2010 (the "PES Guarantee"). The Bank holds valid first charge security upon all the property, assets and undertaking of Paintearth Ltd. and PES as security for the Paintearth Ltd. Guarantee and the PES Guarantee, including but not limited to General Security Agreements dated October 19, 2006 and April 30, 2010 respectively.

**Defaults**

7. It was a term of the Credit Facility Letter that, in addition to ensuring that the Loans did not exceed the loan amounts as set out therein, Paintearth Inc. ensure that the

amounts advanced and outstanding under the operating loan not exceed the margin requirements as calculated by the bank and set out in the Credit Facility Letter (the "Margin Requirement Obligation").

8. In addition, Paintearth Inc. was required, pursuant to the terms of the Credit Facility Letter, to deliver to the Bank within certain timeframes, financial information including, but not limited to, aged lists of accounts receivable and accounts payable, declarations of inventory in accordance with the *Bank Act* security, audited consolidated financial statements and *pro forma* financial statements, cash flow statements and budget for the following fiscal year ("Financial Disclosure Requirements").

9. The financial positions of Paintearth Inc., Paintearth Ltd. and PES have deteriorated dramatically to the point where HSBC is satisfied the parties cannot meet their liabilities generally as they become due. Further, HSBC has serious concerns that the value of the security granted in support of the Loans has declined significantly and to the point where HSBC is at substantial risk in terms of recovering the amounts outstanding.

10. In addition, Paintearth Inc. has defaulted under the terms of the Loans. Such defaults include but are not limited to, the failure to comply with the Financial Disclosure Requirements, inability to meet liabilities generally as they become due and suffering complete management paralysis as a result of the resignation of directors and the absence of authority in management.

**Ernst and Young "Look See"**

11. In view of the defaults pursuant to the Loans and the Security, by letter dated September 21, 2010, the bank engaged Ernst & Young Inc. ("E & Y") to conduct a "look see" with respect to the financial position of Paintearth Inc.

12. Following such appointment, I have been advised by Neil Narfason, Senior Vice President of E & Y, and do verily believe, that he attended the premises of Paintearth Inc. and determined that

(a) There was a complete absence of authorized management with respect to Paintearth Inc. as a result of the resignation of all directors and the refusal of the shareholders to authorize the lone officer of Paintearth Inc. to sign documents, including checks and other key operation documents, fundamental to the ongoing operation;

(b) Inventory valued at approximately $440,000 had been removed by suppliers of Paintearth Inc. within the previous week;

(c) There are 27 employees of Paintearth Inc. who are in a state of uncertainty and chaos with respect to the ongoing business operation;

(d) There are outstanding receivables that require collection and the company is unable to obtain required supplies or inventory.

13. I was further advised by Shaun Wold, who I understand to be the lone officer of Paintearth Inc., and do verily believe, that he has no authority to act on behalf of said Defendant. As a result there is complete paralysis of management at Paintearth Inc.

**Demands**

14. By letters dated September 22, 2010, HSBC issued demands for the immediate repayment of all outstanding loans and related obligations upon all of Paintearth Inc., Paintearth Ltd. and PES (sometimes collectively referred to herein as the "Debtor Companies"). Attached as Exhibits A collectively to this my Affidavit are copies of the demands.

15. As of September 21, 2010, the sum of $4,963,962.78 is outstanding by each of the Debtor Companies to HSBC pursuant to the Loans, the Paintearth Ltd. Guarantee and the PES Guarantee with interest continuing to accrue.

16. Further, by Notices of Intention to Enforce Security pursuant to section 244 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, ("Notices of Intention") dated September 22, 2010, HSBC formally notified the Debtor Companies that it intended to

proceed to realize on its security. Attached as Exhibits B collectively to this my Affidavit are copies of the Notices of Intention.

**Appointment of Receiver**

17. Based on the information provided by E & Y and the principals of the Debtor Companies, it is clear to me that immediate steps must be taken in order to prevent further dissipation of the assets of Paintearth Inc., Paintearth Ltd and PES. Further, it is clear that there is a serious risk that the Bank will suffer significant losses if a capable party is not appointed to take control of and manage the Debtor Companies' property, undertaking and assets.

18. E & Y has consented to act as receiver of the Debtor Companies.

19. I make this Affidavit in support of an Order appointing E & Y as receiver over the property, assets and undertaking of the Debtor Companies.

| | | |
|---|---|---|
| SWORN BEFORE ME at the City of Vancouver, in the Province of British Columbia, this 27th day of September, 2010 | ) | |
| A Notary Public in and for the Province Of British Columbia | ) | KARLA MCCARTHY |

RONALD J. ARGUE
BARRISTER & SOLICITOR
HSBC BANK CANADA
900, 888 DUNSMUIR STREET
VANCOUVER, B.C. V6C 3K4

Action No.:

**IN THE COURT OF QUEEN'S BENCH OF ALBERTA JUDICIAL DISTRICT OF CALGARY**

**IN THE COURT OF QUEEN'S BENCH OF ALBERTA JUDICIAL DISTRICT OF CALGARY**

BETWEEN:

Plaintiff

- and -

**PAINTEARTH ENERGY SERVICES INC., PAINTEARTH ENERGY SERVICES LTD. and PES SUBSURFACE CANADA INC.**

Defendants

**AFFIDAVIT OF KARLA MCCARTHY**

BORDEN LADNER GERVAIS LLP
Barristers and Solicitors
1900, 520 – 3rd Avenue S.W.
Calgary, AB T2P 0R3

**Attention:** John Ircandia

**Telephone:** (403) 232-9406
**Fax:** (403) 266-1395

File No. 400500-000805

# EXHIBITS A

This is Exhibit "A" referred to in the Affidavit of Karla McCartny
Sworn before me this 27th
Day of September A.D. 2010

~~A Commissioner for Oaths in and for the Province of Alberta~~ Notary Public in and for the Province of British Columbia

Borden Ladner Gervais LLP
Lawyers • Patent & Trade-mark Agents
Centennial Place, East Tower
1900, 520 Third Avenue S.W.
Calgary, Alberta, Canada T2P 0R3
tel: (403) 232-9500 fax: (403) 266-1395
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BORDEN LADNER GERVAIS

**John L. Ircandia**
direct tel.: (403) 232-9406
e-mail: JIrcandia@blgcanada.com
file no: 400500-000805

September 22, 2010

Paintearth Energy Services Inc.
2435 – 22nd Street NE
Calgary, AB T2E 8K8

Attention: Shawn Wold

Dear Sir:

**Re: Loans from HSBC Bank Canada to Paintearth Energy Services Inc.**

This firm represents HSBC Bank Canada (the "Bank") with respect to a commercial demand loan granted by the Bank to Paintearth Energy Services Inc. ("Paintearth Inc.") pursuant to a Credit Facility Letter dated September 21, 2006 and subsequently amended on April 15, 2010 and June 22, 2010 (the "Demand Facility").

The amounts outstanding under the Demand Facility, as at September 21, 2010 are as follows:

| | |
|---|---|
| Operating Loan | $4,843,065.89; |
| Interest | $20,383.33 (CDN); |
| Interest | $513.56 (USD); and |
| Mastercard Facility | $100,000.00 |

The amounts outstanding under the Demand Facility are secured, in part, by a general security agreement dated October 19, 2006, a general assignment of book debts dated October 19, 2006 and security under section 427 of the *Bank Act*.

Pursuant to the terms of the Demand Facility, all amounts outstanding thereunder are repayable to the Bank upon demand. Further, it is apparent that Paintearth Inc. is in default of numerous covenants under the Demand Facility, including the resignation of all directors. In view of the foregoing, please accept this as formal demand upon Paintearth Inc. for immediate repayment of all sums outstanding as referred to above together with interest and all other sums payable pursuant to the terms of the Demand Facility.

CALGARY • MONTRÉAL • OTTAWA • TORONTO • VANCOUVER • WATERLOO REGION

In the event that payment of the amounts due and owing are not made in accordance with this demand, we are instructed to enforce the Bank's right to collect all amounts outstanding, including commencing legal proceedings and enforcing all security. Enclosed herewith is a Notice of Intention to Enforce a Security issued pursuant to section 244 of the *Bankruptcy and Insolvency Act.*

Yours truly,

**BORDEN LADNER GERVAIS LLP**

JOHN L. IRCANDIA

encl.

Borden Ladner Gervais LLP
Lawyers • Patent & Trade-mark Agents
Centennial Place, East Tower
1900, 520 Third Avenue S.W.
Calgary, Alberta, Canada T2P 0R3
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BORDEN
LADNER
GERVAIS

**John L. Ircandia**
direct tel.: (403) 232-9406
e-mail: JIrcandia@blgcanada.com
file no: 400500-000805

September 22, 2010

Paintearth Energy Services Ltd.
2435 – 22nd Street NE
Calgary, AB T2E 8K8

Attention: Shawn Wold

Dear Sir:

Re: **Guarantee granted to HSBC Bank Canada by Paintearth Energy Services Ltd. ("Paintearth Ltd.")**

This firm represents HSBC Bank Canada (the "Bank") with respect to a commercial demand loan granted by the Bank to Paintearth Energy Services Inc. ("Paintearth Inc.") pursuant to a Credit Facility Letter dated September 21, 2006 and subsequently amended on April 15, 2010 and June 22, 2010 (the "Demand Facility"). The Paintearth Inc. loan was unconditionally guaranteed by Paintearth Ltd. pursuant to a guarantee dated October 19, 2006 ("Guarantee") which in turn was secured by a general security agreement of the same date.

The amounts outstanding under the Demand Facility, as at September 21, 2010 are as follows:

| | |
|---|---|
| Operating Loan | $4,843,065.89; |
| Interest | $20,383.33 (CDN); |
| Interest | $513.56 (USD); and |
| Mastercard Facility | $100,000.00 |

Pursuant to the terms of the Demand Facility, all amounts outstanding thereunder were repayable to the Bank upon demand. Further, Paintearth Inc. was in default and remains in default of numerous covenants under the Demand Facility, including the resignation of all directors. In view of the foregoing, the Bank by letter dated September 22, 2010 issued formal demand upon Paintearth Inc. for immediate repayment of all outstanding sums as referred to above. Please accept this as formal demand upon Paintearth Ltd. for immediate repayment of all sums outstanding as referred to above together with interest and all other sums payable pursuant to the terms of the Guarantee..

In the event that payment of the amounts due and owing are not made in accordance with this demand, we are instructed to enforce the Bank's right to collect all amounts outstanding, including commencing legal proceedings and enforcing all security. Enclosed herewith is a Notice of Intention to Enforce a Security issued pursuant to section 244 of the *Bankruptcy and Insolvency Act*.

Yours truly,

**BORDEN LADNER GERVAIS LLP**

JOHN L. IRCANDIA

encl.

Borden Ladner Gervais LLP
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GERVAIS

**John L. Ircandia**
direct tel.: (403) 232-9406
e-mail: JIrcandia@blgcanada.com
file no: 400500-000805

September 22, 2010

PES Subsurface Canada Inc.
2435 – 22nd Street NE
Calgary, AB T2E 8K8

Attention: Shawn Wold

Dear Sir:

**Re: Guarantee granted to HSBC Bank Canada by PES Subsurface Canada Inc. ("PES")**

This firm represents HSBC Bank Canada (the "Bank") with respect to a commercial demand loan granted by the Bank to Paintearth Energy Services Inc. ("Paintearth Inc.") pursuant to a Credit Facility Letter dated September 21, 2006 and subsequently amended on April 15, 2010 and June 22, 2010 (the "Demand Facility"). The Paintearth Inc. loan was unconditionally guaranteed by Paintearth Ltd. pursuant to a guarantee dated April 30, 2010 ("Guarantee") which in turn was secured by a general security agreement of the same date.

The amounts outstanding under the Demand Facility, as at September 21, 2010 are as follows:

| | |
|---|---|
| Operating Loan | $4,843,065.89; |
| Interest | $20,383.33 (CDN); |
| Interest | $513.56 (USD); and |
| Mastercard Facility | $100,000.00 |

Pursuant to the terms of the Demand Facility, all amounts outstanding thereunder were repayable to the Bank upon demand. Further, Paintearth Inc. was in default and remains in default of numerous covenants under the Demand Facility, including the resignation of all directors. In view of the foregoing, the Bank by letter dated September 22, 2010 issued formal demand upon Paintearth Inc. for immediate repayment of all outstanding sums as referred to above. Please accept this as formal demand upon PES for immediate repayment of all sums outstanding as referred to above together with interest and all other sums payable pursuant to the terms of the Guarantee..

In the event that payment of the amounts due and owing are not made in accordance with this demand, we are instructed to enforce the Bank's right to collect all amounts outstanding, including commencing legal proceedings and enforcing all security. Enclosed herewith is a Notice of Intention to Enforce a Security issued pursuant to section 244 of the *Bankruptcy and Insolvency Act*.

Yours truly,

**BORDEN LADNER GERVAIS LLP**

JOHN L. IRCANDIA

encl.

# EXHIBITS B

This is Exhibit "B" referred to
in the Affidavit of
Karla McCarthy
Sworn before me this 27th
Day of September A.D. 20 10

~~A Commissioner for Oaths in and for the Province of Alberta~~ Notary Public
in and for the Province of British Columbia

RONALD J. ARGUE
BARRISTER & SOLICITOR
HSBC BANK CANADA
900, 888 DUNSMUIR STREET
VANCOUVER, B.C. V6C 3K4

***BANKRUPTCY AND INSOLVENCY ACT***

Form 86

**NOTICE OF INTENTION TO ENFORCE A SECURITY**

**Subsection 244(1)**

TO: Paintearth Energy Services Inc.
2455- 22nd Street, NE
Calgary, AB T2E 8K8

TAKE NOTICE THAT:

1. HSBC Bank Canada ("HSBC"), a secured creditor, intends to enforce its security on or against the property of Paintearth Energy Services Inc. ("Paintearth") described below:

(a) all presently owned and after acquired personal property of whatsoever nature and kind and wheresoever situate and all proceeds thereof and therefrom, renewals thereof, accessions thereto and substitutions therefore;

(b) all debts, claims, demands, moneys and choses in action (including but not limited to all book debts) no due or accruing due or hereafter to become due or accruing or growing due or which may become vested in Paintearth;

(c) steel and all products of agriculture the forest quarry and mine and seal lakes and rivers purchased, shipped or dealt with;

(d) insurance policy number LI-F547, 134-7 issued by Sun Life Assurance Company of Canada and all their rights thereunder and all monies which may at any time become payable thereunder.

2. The security that is to be enforced is in the form of the following:

(a) a general security agreement dated October 19, 2006;

(b) a general assignment of book debts dated October 19, 2006;

(c) security under section 427 of the *Bank Act*; and

(d) an assignment of life insurance policy dated October 19, 2006 given by Paintearth and Rick Luchak to HSBC.

3. The total amount of indebtedness secured by the security is the principal sum of $4,843,065.89, as at September 21, 2010, plus accrued interest, legal fees and other recoverable costs.

4. HSBC will not have the right to enforce the security until after the expiry of the 10 day period following the sending of this notice, unless Paintearth consents to an earlier enforcement.

DATED at Calgary, Alberta this 23 day of September, 2010.

**HSBC BANK CANADA**

Per: ______________________
By its solicitors, Borden Ladner Gervais LLP

## ACKNOWLEDGMENT AND WAIVER

**Paintearth Energy Services Inc.** hereby acknowledges and agrees that it has received a copy of a Notice of Intention to Enforce Security dated September ___, 2010, pursuant to s. 244(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "*BIA*") in respect of the security granted by **Paintearth Energy Services Inc.** in favour of HSBC Bank Canada.

**Paintearth Energy Services Inc.**, with full knowledge and understanding of the effect of s. 244 of the *BIA*, hereby consents to the enforcement by HSBC Bank Canada of all security held by HSBC Bank Canada for the indebtedness referred to in the Notice of Intention, either prior to the expiry of the 10 day period referred to in the Notice of Intention, or at any time thereafter.

DATED at Calgary, Alberta this ___ day of September, 2010.

**Paintearth Energy Services Inc.**

Per: ______________________________

*BANKRUPTCY AND INSOLVENCY ACT*
Form 86

**NOTICE OF INTENTION TO ENFORCE A SECURITY**
**Subsection 244(1)**

TO: Paintearth Energy Services Ltd.
2435- 22nd Street, NE
Calgary, AB T2E 8K8

TAKE NOTICE THAT:

1. HSBC Bank Canada ("HSBC"), a secured creditor, intends to enforce its security on or against the property of Paintearth Energy Services Ltd. ("Paintearth Ltd.") described below:

   a) all presently owned and after acquired personal property of whatsoever nature and kind and wheresoever situate and all proceed thereof and therefrom, renewals thereof, accessions thereto and substitutions therefore.

2. The Security that is to be enforced is in the form of a General Security Agreement dated October 19, 2006.

3. The total amount of indebtedness secured by the security is the principal sum of $4,843,065.89 as at September 21, 2010, plus accrued interest, legal fees and other recoverable costs.

3. HSBC will not have the right to enforce the security until after the expiry of the 10 day period following the sending of this notice, unless Paintearth Ltd. consents to an earlier enforcement.

DATED at Calgary, Alberta this 22 day of September, 2010.

**HSBC BANK CANADA**

Per: ______________________
By its solicitors, Borden Ladner Gervais LLP

**ACKNOWLEDGMENT AND WAIVER**

**Paintearth Energy Services Ltd.** hereby acknowledges and agrees that it has received a copy of a Notice of Intention to Enforce Security dated September ___, 2010, pursuant to s. 244(1) of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, as amended (the "*BIA*") in respect of the security granted by **Paintearth Energy Services Ltdf.** in favour of HSBC Bank Canada.

**Paintearth Energy Services Ltd.**, with full knowledge and understanding of the effect of s. 244 of the *BIA,* hereby consents to the enforcement by HSBC Bank Canada of all security held by HSBC Bank Canada for the indebtedness referred to in the Notice of Intention, either prior to the expiry of the 10 day period referred to in the Notice of Intention, or at any time thereafter.

DATED at Calgary, Alberta this ___ day of September, 2010.

**Paintearth Energy Services Ltd.**

Per: ______________________________

*BANKRUPTCY AND INSOLVENCY ACT*
Form 86

**NOTICE OF INTENTION TO ENFORCE A SECURITY**
**Subsection 244(1)**

TO: PES Subsurface Canada Inc.
2435- 22nd Street, NE
Calgary, AB T2E 8K8

TAKE NOTICE THAT:

1. HSBC Bank Canada ("HSBC"), a secured creditor, intends to enforce its security on the property of PES Subsurface Canada Inc. ("PES.") described as all presently owned and after acquired personal property of whatsoever nature and kind and whersoever situate and all proceeds thereof and therefrom, renewals thereof, accessions thereto and substitutions therefore.

2. The security that is to be enforced is in the form of a General Security Agreement dated April 30, 2010.

2. The total amount of indebtedness secured by the security is the principal sum of $4,843,065.89 as at September 21, 2010, plus accrued interest, legal fees and other recoverable costs.

3. HSBC will not have the right to enforce the security until after the expiry of the 10 day period following the sending of this notice, unless PES consents to an earlier enforcement.

DATED at Calgary, Alberta this 22 day of September, 2010.

**HSBC BANK CANADA**

Per: ______________________
By its solicitors, Borden Ladner Gervais LLP

CAL01: 809522: v1

**ACKNOWLEDGMENT AND WAIVER**

**PES Subsurface Canada Inc.** (**"PES"**) hereby acknowledges and agrees that it has received a copy of a Notice of Intention to Enforce Security dated September ___, 2010, pursuant to s. 244(1) of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, as amended (the "*BIA*") in respect of the security granted by **PES** in favour of HSBC Bank Canada.

**PES** with full knowledge and understanding of the effect of s. 244 of the *BIA,* hereby consents to the enforcement by HSBC Bank Canada of all security held by HSBC Bank Canada for the indebtedness referred to in the Notice of Intention, either prior to the expiry of the 10 day period referred to in the Notice of Intention, or at any time thereafter.

DATED at Calgary, Alberta this ___ day of September, 2010.

**PES Subsurface Canada Inc..**

Per: ______________________________