Court File No.10-CV-8991-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE RECEIVERSHIP OF 2110458 ONTARIO LIMITED O/A LORETTA FLOUR, 2131413 ONTARIO LIMITED O/A LORETTA FOODS, 787755 ONTARIO LIMITED O/A NEW DURHAM TRADING, AND O/A NDT FOOD SERVICE AND O/A SKYWAY WHOLESALE AND TARBRAC HOLDINGS INC.

IN THE MATTER OF SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, as amended, and SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C. 43, as amended

---

FIRST CONFIDENTIAL REPORT TO THE COURT OF ERNST & YOUNG INC. AS RECEIVER

4 February 2011

BACKGROUND

Appointments

1. On 10 November 2010, Bank of Montreal ("**BMO**") made an application to the Court for an order, and the Court made an order (the "**Interim Receivership Order**"), appointing Ernst & Young Inc. ("**EYI**") as an interim receiver (the "**Interim Receiver**") pursuant to Section 47(1) of the *Bankruptcy & Insolvency Act* and pursuant to Section 101 of the *Courts of Justice Act* of 2110458 Ontario Limited ("**211**"), 2131413 Ontario Limited ("**213**"), 787755 Ontario Limited ("**787**") and Tarbrac Holdings Inc. ("**Tarbrac**"). A copy of the issued Interim Receivership Order is attached as Appendix "**A**" to this Report.

2. On 26 November 2010, Bank of Montreal ("**BMO**") made an application to the Court for an order, and the Court made an order (the "**Receivership Order**"), appointing EYI as receiver and receiver and manager (the "**Receiver**") pursuant to Section 243(1) of the *Bankruptcy & Insolvency Act* and pursuant to Section 101 of the *Courts of Justice Act* of the assets, undertakings and properties of 211 o/a Loretta Flour , 213 o/a Loretta Foods, 787 o/a New Durham Trading, and o/a NDT Food Service and o/a Skyway Wholesale and Tarbrac (collectively, the "**Debtors**"). A copy of the issued Receivership Order is attached as Appendix "**B**" to this Report.

3. Both the Interim Receivership Order and the Receivership Order, among other things, authorize and empower the Interim Receiver/Receiver to conduct any examinations deemed necessary and to undertake any investigations deemed necessary with respect to the location and/or disposition of assets reasonably believed to be, or to have been, property of the Debtors.

4. Paragraph 4(n) of the Receivership Order authorizes and empowers the Receiver to report to, meet with and discuss with such affected Persons as the Receiver deems appropriate on all matters relating to the Property and the receivership, and to share information, subject to such terms as to confidentiality as the Receiver deems advisable.

Business of the Debtors

5. 211 operates primarily from leased premises located in Whitby, Ontario. 211 operates under the registered trade name "**Loretta Flour**" and is also known as the "Loretta Flour Division" of the Loretta Group's operations. 211 produces various types of hard wheat flour from wheat sourced from Ontario and Western Canada.

6. 213 operates from leased premises in Mississauga, Ontario under the registered trade name "**Loretta Foods**" and is also known as the "Loretta Spice Division" of the Loretta Group's operation. 213 is responsible for sourcing and redistributing spices and food mixes globally, as well as blending and repackaging spices for use in various packs and sizes to satisfy home use and institutional customers.

7. 787 operates from leased premises in Mississauga, Ontario, and is also known as the "Food Service and Catering Division" of the Loretta Group's operations. Operating under the registered trade name "**NDT Food Service**", 787 is responsible for the daily production of food items for sale by or in mobile caterers, vending machines, contract caterers and convenience stores. In the recent past, 787 has also engaged in trading bulk sugar, flour, spices and other items, operating under the registered trade names "**New Durham Trading**" and/or "**Skyway Wholesale**."

Secured Creditors

8. The primary secured creditors of the Debtors are BMO and Signature Bank, a New York-based financial institution ("**Signature**").

9. The Receiver understands that BMO is owed approximately US$17.6 million and C$50,000 excluding costs and excluding interest accruing from November 4, 2010 (the "**BMO Debt**"). The Receiver understands that BMO has security upon all of the personal property of the Debtors (including a pledge of the shares of 787) as security for those obligations, and these obligations are cross guaranteed by each of the four Debtors. The BMO Debt arises under two agreements. The first is a term sheet pursuant to which BMO provided four credit facilities to 787, 213 and 211. The second is a discounting facility agreement between 787 and BMO pursuant to which BMO factored certain of 787's accounts receivable. The Receiver has been provided with an opinion by its counsel, Borden Ladner Gervais LLP ("BLG"), that subject to usual qualifications, the security provided by the Debtors to BMO is registered in accordance with the Ontario *Personal Property Security Act* ("OPPSA") against all forms of collateral except consumer goods and is valid and enforceable. The security granted by each of the Debtors to BMO includes charges upon all of the "personal property" Debtors, which includes all of the Debtors books, records, documents and property upon which electronic information is stored.

10. The Receiver understands that 787, 211 and 213 are indebted to Signature in the amount of approximately US$12.3 million (the "**Signature Debt**") and that those Debtors have granted security to Signature for that obligation. The Receiver also understands that the

principal of the Loretta Group and Tarbrac have guaranteed those obligations to Signature. The Receiver has been provided by BLG with an opinion that, subject to usual qualifications, the security granted by each of the Debtors to Signature is registered in accordance with the OPPSA against all forms of collateral except consumer goods and is valid and enforceable. The security granted by each of the Debtors to Signature includes charges upon all of the "personal property" of the Debtors, which includes all of the Debtors' books, records, documents and property upon which electronic information is stored.

11. The Receiver understands that there are approximately nine equipment lessors, some of whom may have priority over both BMO and Signature. The Receiver's counsel has not provided the Receiver with opinions in respect of that security.

Sales Process

12. The Receiver is currently implementing a sales process for the Food Service and Catering Division of the Debtors that was authorized by the Receivership Order. The sales process is proceeding in the ordinary course.

13. The Receiver has recently began to implement a marketing and sales process for the Loretta Flour Division and the Loretta Spice Division of the Debtors that was approved by Order of Marrocco J. of the Ontario Superior Court of Justice dated 17 January 2011.

Requests for Information

14. By letter dated 20 January 2011, the Receiver's counsel received a request from BMO's counsel for documentation in the Receiver's possession. Specifically, BMO requested copies of the Debtors' financial records and non-privileged correspondence, electronic and otherwise. A copy of the letter from BMO's counsel is attached as Appendix "**C**" to this Report.

15. By letter dated 11 January 2011, the Receiver's counsel received a request from Signature's counsel for documentation, electronic materials and information in the Receiver's possession and control. Specifically, Signature requested details regarding the

Debtors' financial records, the tracing of funds and unusual transactions, and information relating to investigations of the Debtor companies and their principals. A copy of the letter from Signature's counsel is attached as Appendix "**D**" to this Report.

16. As noted, the security granted by the Debtors to each of BMO and Signature extends to the books, records and information to which BMO and Signature have requested access.

PURPOSE

17. This is the first confidential report of the Receiver. The purpose of this First Confidential Report is to:

   (a) report to the Court concerning the requests received from BMO and Signature;

   (b) report to the Court on unusual circumstances relating to the Debtors; and,

   (c) support the making of an Order by the Court authorizing and directing the Receiver to comply with the requests made by BMO and Signature on terms as to confidentiality that will safeguard the rights and interests of BMO, Signature and the Receiver.

TERMS OF REFERENCE

18. In developing this Report, the Receiver has relied upon the books and records of the Debtors, including images of the electronic information contained on the Debtors' computers and servers, and other information from various sources. The Receiver has not audited, reviewed or otherwise verified such information. Nor, for the reasons set out in this Report has the Receiver reviewed all of the information and documents in its possession or under its control.

PRELIMINARY INVESTIGATIVE PROCEDURES

19. The Interim Receivership Order contained powers of examination, and the Receivership Order contained powers of examination and investigation broader than those set out in the model orders.

20. As part of its preliminary review, the Receiver reviewed the Debtors' books and records, and imaged electronic information contained on the Debtors' computers and servers. Much of the information detailed below was obtained by the Receiver in its preliminary investigations. Some information was obtained from BMO, especially that information related to the factored accounts receivable.

ASSET EXISTENCE, OWNERSHIP AND/OR REALIZATION ISSUES

21. As a result of its preliminary investigations and inquiries, the Receiver has noted the following unusual circumstances surrounding assets represented to be property of the Debtors:

(a) As reported in the First Report of the Interim Receiver to the Court, the Interim Receiver was unable to obtain access to the accounting system of the Debtors until November 18, 2010;

(b) At or about the time of the appointment of the Interim Receiver, a principal of the Debtors advised the Interim Receiver that the inventory and accounts receivable balances (book value) recorded on the Debtors' most recent unaudited internal financial statements was overstated by approximately $43 million (as against a stated book value of approximately $58 million);

(c) Certain inventory that was apparently represented to BMO to be property of the Debtors, and that was recorded on the Debtors' most recent unaudited internal financial statements at a book value of more than $10 million, either never existed, was never property of the Debtors, or is unaccounted for;

(d) There is some evidence of unusual and large transfers of money (millions of dollars) to third parties, including the wiring of money to US bank accounts, for which the Receiver has no explanation;

(e) The Debtors conducted business with a group of companies in the US. While the relationship between the Debtors and the US entities is unclear, the Receiver has documents and information that appear to indicate that:

(i) sales by the Debtors to the US entities were below the Debtors' cost;

(ii) some of the Debtors' inventory that is unaccounted for may have been located, or reported to have been located, on premises owned or leased by the US entities;

(iii) some of the large unexplained transfers appear to have been to persons or places related to or near the US entities or their principals;

(iv) there are records of communications between the principals of the Debtors and senior officers of the US entities that may indicate an arrangement that was designed to, and had the effect of, transferring significant amounts from the Debtors to others for no benefit to the Debtors;

(f) The Receiver has communicated or attempted communications with account debtors or apparent account debtors in respect of outstanding factored accounts receivable (in the aggregate amount of approximately U.S. $16.5 million). As of the date of this Report, the Receiver has received the following responses: Either

(i) the account debtors have denied any knowledge of or dealings with the Debtors and alleged that documentation related to the account debts was fabricated;

(ii) the account debtors do not exist; or

(iii) no response has been received.

CURRENT STATUS

22. Based on the above, and on the responses received to date in the Receiver's sale initiatives, the realizations by the Receiver from the Debtors' will be substantially less than the BMO debt. The receivership is being funded by BMO through receiver's certificates. While certain of the businesses continue to operate in order to provide the prospect of going concern sales, they are cash flow negative, even before professional fees.

23. The principals of the Debtors have been unable to explain to the satisfaction of the Receiver how the assets of the Debtors dissipated to the extent described above, or the disposition of approximately $30 million advanced to the Debtors by their secured creditors.

24. The Receiver believes that the Debtors and those through whom and with whom they were dealing are not likely aware that the Receiver has imaged the computers and has this information.

25. In the course of discussions about assets and realizations and the whereabouts of assets and the collectability of accounts receivable, the Receiver has disclosed to BMO and to Signature some information concerning the unusual circumstances of this case. In general terms, except for (i) information related to factored accounts receivable that has been provided to BMO (though more has been provided by BMO to the Receiver) and (ii) details of selected e-mails made available to BMO for illustrative purposes to assist BMO in deciding whether to fund further investigative work by the Receiver, the Receiver has not provided documentation or access to BMO or Signature.

26. Paragraph 4(n) of the Receivership Order permits the Receiver to share information with such affected persons as the receiver deems appropriate subject to such terms as to confidentiality as the receiver deems advisable.

27. Both Signature and BMO, through their counsel, have made written requests for access to and copies of books, records and information in the possession of the Receiver.

28. Public disclosure of these requests or the information requested may fundamentally restrict the ability of BMO and Signature to employ remedies.

29. The Receiver believes that the fundamental interests of BMO and Signature are in determining against whom they may have causes of action and in tracing funds and property. Therefore, it would be appropriate for the Receiver to provide the information requested on a confidential basis.

30. The provision of information to BMO and Signature is permitted by the Receivership Order. BMO and Signature both have proprietary security interests in the records to which they seek access.

31. In these circumstances, the Receiver respectfully recommends that it be authorized and directed to provide copies of documents in its possession as receiver and access to documents in its possession or under its control to BMO and Signature at their own cost and expense (including the fees and expenses incurred by the Receiver as proof of that process), and that the Receiver, acting reasonably, be authorized to request that BMO and/or Signature provide a retainer for the payment of the Receiver's fees and expenses in connection therewith.

32. The Receiver respectfully recommends that such copies and access be provided on terms as to confidentiality that will protect and not prejudice BMO or Signature as a consequence of the making of the Receiver's motion and the filing of this Report.

RELIEF SOUGHT BY THE RECEIVER

33. The Receiver respectfully requests that this Court grant an Order:

(a) authorizing the Receiver to allow BMO, Signature and their respective legal and financial advisors to have access to and make copies of, the records of the Debtors in the possession of the Receiver (the "Information"), at their own expense;

(b) providing that BMO and Signature shall not disclose the Information to any person except during the course of litigation;

(c) providing that if BMO or Signature obtain an order through the use of any Information, they shall advise the Receiver on a confidential basis;

(d) providing that if BMO or Signature commence public proceedings related to the Debtors they shall advise the Receiver and provide the Receiver with a copy of any originating process;

(e) sealing and treating as confidential the First Confidential Report of the Receiver and all motion materials relating thereto and any Order or endorsement made by the Court in connection therewith; and,

(f) providing that nothing in the Order affects the right of the Receiver to seek advice and directions from the Court.

All of which is respectfully submitted this 4 February 2011.

ERNST & YOUNG INC.
Acting in its capacity as Receiver and Receiver and Manager of
2110458 Ontario Limited o/a Loretta Flour,
2131413 Ontario Limited o/a Loretta Foods,
787755 Ontario Limited o/a New Durham Trading,
and o/a NDT Food Service and o/a Skyway Wholesale
and Tarbrac Holdings Inc.
and not in its personal or corporate capacity.

Mike P. Dean, CA•CIRP
Senior Vice-President

::ODMA\PCDOCS\TOR01\4550823\4

IN THE MATTER OF THE RECEIVERSHIP OF 2110458 ONTARIO LIMITED o/a LORETTA FLOUR, 2131413 ONTARIO LIMITED o/a LORETTA FOODS, 787755 ONTARIO LIMITED o/a NEW DURHAM TRADING, and o/a NDT FOOD SERVICE and o/a SKYWAY WHOLESALE and TARBRAC HOLDINGS INC.

Court File No. CV-10-8991-00CL

IN THE MATTER OF SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, as amended, and SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C. 43, as amended

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDINGS COMMENCED AT TORONTO

FIRST CONFIDENTIAL REPORT TO THE COURT OF ERNST & YOUNG INC., AS RECEIVER

BORDEN LADNER GERVAIS LLP
Barristers and Solicitors
Scotia Plaza
40 King Street West
Toronto, Ontario
M5H 3Y4

Tel.: 416-367-6000
Fax: 416-367-6749

Michael MacNaughton - LSUC No. 25889U
Mary Arzoumanidis - LSUC No. 53915V
Harriet Greenwood - LSUC No. 58915H

Lawyers for Ernst & Young Inc., in its capacity as Receiver of 2110458 Ontario Limited o/a Loretta Flour, 2131413 Ontario Limited o/a Loretta Foods, 787755 Ontario Limited o/a New Durham Trading, and o/a NDT Food Service and o/a Skyway Wholesale and Tarbrac Holdings Inc.
::ODMA\PCDOCS\TOR01\4550823\4