Court File No. FM-22-16

IN THE COURT OF QUEEN'S BENCH OF NEW BRUNSWICK
IN BANKRUPTCY AND INSOLVENCY
JUDICIAL DISTRICT OF FREDERICTON

IN THE MATTER OF THE RECEIVERSHIP OF:
GRAY'S AQUA MANAGEMENT LTD., GRAY AQUA FARMS LTD., GRAY AQUA GROUP LTD., BUTTER COVE AQUA FARMS LTD., GOBLIN BAY AQUA FARMS LTD., JERVIS ISLAND AQUA FARMS LTD., PASS-MY-CAN AQUA FARMS LTD., GRAY AQUA PROCESSING LTD., M. GRAY HOLDINGS LTD., 608672 N.B. LTD., 608691 N.B. LTD., 608715 NB LIMITED AND 608716 NB LIMITED

PURSUANT TO Section 33 of The *Judicature Act,* R.S.N.B. 1973, Ch. J-2, Rule 41, Rules of Court, New Brunswick and Section 243 of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3

BETWEEN:

CALLIDUS CAPITAL CORPORATION

APPLICANT

COURT OF QUEEN'S BENCH
FREDERICTON, NB
RECEIVED AND FILED
FEB 08 2017
COUR DU BANC DE LA REINE
FREDERICTON, N-B
REÇU ET DÉPOSÉ

- and –

GRAY'S AQUA MANAGEMENT LTD., GRAY AQUA FARMS LTD., GRAY AQUA GROUP LTD., BUTTER COVE AQUA FARMS LTD., GOBLIN BAY AQUA FARMS LTD., JERVIS ISLAND AQUA FARMS LTD., PASS-MY-CAN AQUA FARMS LTD., GRAY AQUA PROCESSING LTD., M. GRAY HOLDINGS LTD., 608672 N.B. LTD., 608691 N.B. LTD., 608715 NB LIMITED AND 608716 NB LIMITED

RESPONDENTS OR THE COMPANIES

SECOND REPORT OF THE RECEIVER
6 February 2017

INTRODUCTION AND PURPOSE

1. In connection with the application of Callidus Capital Corporation (**"Callidus"**) pursuant to section 33 of the Judicature Act (New Brunswick), Rule 41 of the Rules of Court of New Brunswick, and section 243 of the Bankruptcy and Insolvency Act (Canada) that were heard by The Honourable Judy L. Clendening of the Court of Queen's Bench of New Brunswick on 25 April 2016 (the **"Receivership Date"**), Ernst & Young Inc. (**"EYI"**) was appointed receiver (the **"Receiver"**) of all of the assets, undertakings and properties of the Respondents acquired for, or used in relation to the businesses carried on by the Respondents, including all proceeds thereof (the **"Property"**).

2. The 25 April 2016 Order (the **"Receivership Order"**), attached hereto and marked as **Appendix "A"**, authorized the Receiver to, among other things:

   (a) to take possession and control of the Property and any proceeds or receipts arising from the Property but, while the Receiver is in possession of any of the Property, the Receiver must preserve and protect it;

   (b) to change locks and security codes, relocate all or some of the Property to safeguard it, engage independent security personnel, take physical inventories and place insurance coverage;

   (c) to manage, operate, and carry on the businesses of the Respondents, including the power to enter into any agreements, incur and pay any obligations in the ordinary course of business, cease to carry on all or any part of the business, or cease to perform any contracts of the Respondents;

   (d) to engage consultants, appraisers, agents, experts, auditors, accountants, managers, counsel and such other persons from time to time and on whatever basis, including on a temporary basis, to assist with the exercise of the Receiver's powers and duties, including without limitation those conferred by this Order;

(e) to purchase or lease such machinery, equipment, inventories, supplies, premises or other assets to continue the businesses of the Respondents, or any part or parts thereof;

(f) to receive and collect all monies and accounts now owed or hereafter owing to the Respondents and to exercise all remedies of the Respondents in collecting such monies, including, without limitation, to enforce any security held by the Respondents;

(g) to settle, extend or compromise any indebtedness owing to the Respondents;

(h) to execute, assign, issue and endorse documents of whatever nature in respect of any of the Property, whether in the Receiver's name or in the name and on behalf of the Respondents, for any purpose pursuant to this Order;

(i) to undertake environmental or workers' health and safety assessments of the Property and operations of the Respondents;

(j) initiate, prosecute and continue the prosecution of any and all proceedings and to defend all proceedings now pending or hereafter instituted with respect to the Property or the Receiver, and to settle or compromise any such proceedings. The authority hereby conveyed shall extend to such appeals or applications for judicial review in respect of any order or judgement pronounced in any such proceeding;

(k) to make payment of any and all costs, expenses and other amounts that the Receiver determines, in its sole discretion, are necessary or advisable to preserve, protect or maintain the Property, including, without limitation taxes, municipal taxes, insurance premiums, repair and maintenance costs, costs or charges related to security, management fees, and any costs and disbursements incurred by any manager appointed by the Receiver;

(l) to market any or all of the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and negotiate such terms and conditions of sale as the Receiver in its discretion may deem appropriate;

(m) to sell, convey, transfer, lease or assign the Property or any part or parts thereof out of the ordinary course of business,

(i) without the approval of this Court in respect of any transaction not exceeding $100,000, provided that the aggregate consideration for all such transactions does not exceed $1,000,000; and

(ii) with the approval of this Court in respect of any transaction in which the purchase price or aggregate purchase price exceeds the applicable amount set out in the preceding clause;

and in each such case notice under section 59 of the *Personal Property Security Act* (New Brunswick) shall not be required.

(n) to apply for any vesting order or other orders necessary to convey the Property or any part or parts thereof to a purchaser or purchasers thereof, free and clear of any liens or encumbrances affecting such Property;

(o) to report to, meet with and discuss with such affected Persons (as defined below) 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;

(p) to register a copy of this Order and any other Orders in respect of the Property against title to any of the Property;

(q) to apply for any permits, licences, approvals or permissions as may be required by any governmental authority and any renewals thereof for and on behalf of and, if thought desirable by the Receiver, in the name of the Respondents;

(r) to enter into agreements with any trustee in bankruptcy appointed in respect of the Respondents including, without limiting the generality of the foregoing, the ability to enter into occupation agreements for any property owned or leased by the Respondents;

(s) to exercise any shareholder, partnership, joint venture or other rights which the Respondents may have; and

(t) to take any steps reasonably incidental to the exercise of these powers or the performance of any statutory obligations.

3. The purpose of this Second Report is to report to this Honourable Court on matters relating to the activities of the Receiver since its appointment on 25 April 2016, including but not limited to providing an overview of the operational challenges faced by the Receiver specific to the live inventory, marketing efforts undertaken by the Receiver leading to the proposed sale of assets identified below, commentary on the Simpson Island inventory sale and various other administrative matters addressed by the Receiver during the administration to date. The Receiver has organized its comments within this Second Report as follows:

- Terms of Reference
- General Activities of the Receiver;
- Expedited Sale Process;
- Aquaculture Operations – New Brunswick
  - Depopulation Exercise
  - Hatchery Lease and Smolt Sales;
  - Simpson Island Sale Agreement;
- Aquaculture Operations – Newfoundland and Labrador
  - Gray Aqua Processing Land Claim Dispute
  - Harvest
- Settlement with the Canadian Food Inspection Agency;

- Sale of BDC Security to Callidus;
- Sale of Property;
  - Sale by Tender Process;
  - Unsolicited Amended Tender Submission; and
- Interim Statement of Receipts and Disbursements.

TERMS OF REFERENCE

4. In preparing this Second Report, the Receiver has been provided with, and has relied upon unaudited historical financial statements, other unaudited financial information and projections prepared by the Respondents, the books and records of the Respondents, discussions with the management and employees of the Respondents, and other information from various sources. The Receiver has assumed that the information it has been provided is accurate and complete. The Receiver did not audit, review or otherwise attempt to verify the accuracy or completeness of the information. Accordingly, the Receiver expresses no opinion or other form of assurance with respect to the information presented in this Second Report or relied upon by the Receiver in preparing this Second Report. Further, the nature of the Receiver's work completed in these proceedings will not necessarily disclose errors, misstatements, irregularities or illegal acts, if such exist, on the part of the Respondents, or its officers or employees or in the information.

5. All references to monetary amounts in this Second Report are in Canadian dollars unless otherwise noted.

6. Capitalized terms not defined in this Second Report are as defined in the Receivership Order.

7. Copies of court materials in these proceedings may be obtained from the Receiver's website established in connection with the Respondents (www.ey.com/ca/grayaqua).

GENERAL ACTIVITIES OF THE RECEIVER

8. Immediately following its appointment, the Receiver took specific steps to gain control of the Respondents' operations and secure the Property situated at various locations throughout the Provinces of New Brunswick ("**NB**") and Newfoundland and Labrador ("**NL**").

9. The Receiver implemented the following conservatory and protective measures in relation to the estate (the "**Estate**") assets:

a) the Receiver changed the locks at the main building and warehouse in Northampton, NB. A control log was instituted to control the issuance of keys. Locks were not changed at all locations as the contents maintained at many of the remote sites were limited in value or 24 hour on site staffing was in place;

b) insurance coverage over the Property was assessed and policy continuation terms were negotiated with existing insurance providers;

c) pre-receivership bank accounts held by the Respondents at the TD Bank and Bank of Nova Scotia were frozen and all residual funds were forwarded to the Receiver;

d) purchase orders were instituted to control authorized purchases. All post receivership purchases were approved by the Receiver. Approved purchase commitments were recorded, tracked and reviewed on a regular basis by the Receiver;

e) the Receiver opened a single trust account with the Royal Bank of Canada where all receivership deposits and disbursements were processed;

f) the Receiver conducted a series of employee meetings to advise employees of the issuance of the Receivership Order and address questions pertaining to the receivership administration including but not limited to terms of continuing employment. No employee was automatically terminated as a result of the Receivership Order being issued;

g) the Receiver negotiated payment terms with the Respondents suppliers in order to maintain the supply of goods and services to the business post receivership;

h) accounts receivable listings and prepaid expenses were updated and reviewed by management. The Receiver issued notices to all parties with outstanding accounts receivable balances due to the Respondents providing notice of the Receivership and directing said parties to forward all payments on account directly to the Receiver;

i) the Receiver secured an electronic copy of the Respondents accounting server upon being appointed. The electronic back up is stored offsite at the Receivers Halifax office;

j) accounting records were established in the name of Ernst & Young Inc., Receiver of the Gray Aqua Group of Companies. Transactions of the Respondents prior to the Receiver's appointment were segregated from the Receiver's transactions.

10. Pursuant to Subsection 245(1) of the Bankruptcy and Insolvency Act, the Receiver was required to notify all creditors of the Respondents of our appointment. Statutory notices were sent to all known creditors on 5 May 2016.

11. The Receiver coordinated a series of meetings with the Respondents' senior management team in addition to the Respondents' NB and NL site managers to discuss operational issues confronting the Respondents as the 2016 grow out season was soon to take effect.

12. Attending the initial planning meetings between the Receiver's staff and management of the Respondents were Bob Sweeney and Bryan Bosien of Sweeney International Marine Corp. (**"SIMC"**), whom the Receiver engaged to provide independent industry advice.

13. Though EYI had previous familiarity with the Respondents' operations from its historical mandates as BIA Proposal Trustee and monitoring agent as regards the affairs of the Respondents, the Receiver's staff learned quickly upon arrival at the Respondents' base of operations in Northampton NB that the situation facing the Respondents was considerably more dire than had been first anticipated.

14. The Receiver identified that the Respondents inventory of vessels available to service the NB sites were limited in number and were in a general state of disrepair. Critical supply vessels for feed delivery, net changing, sea lice treatments, on site feed storage and harvesting either were not available in NB, not operational or did not exist within the Respondents fleet of vessels.

15. Management did not have an operating plan to facilitate the enhanced feed delivery schedule required to support the NB marine operations. Furthermore, the Respondents did not control or have agreements with 3rd party service providers to harvest, process or market the NB inventories once they achieved market size. Almost immediately upon the Receiver meeting with management, it became clear that the Respondents were grossly ill prepared for the upcoming grow-out season and thus found themselves in a precarious position.

16. Mr. Sweeney's assessment of the situation during the first days of the receivership was that the Respondents' level of operational planning was between 8 and 12 weeks behind where it should have been for that point of the season. The lack of working infrastructure and operational uncertainties caused the Receiver to have serious concerns whether it would be able to oversee the successful grow out, harvest and sale of the NB market fish or generate a positive recovery from receivership funding required to grow and sustain the live fish inventories. An interim report outlining issues facing the Receiver was prepared by SIMC. A copy of which is attached hereto and marked as **Appendix "B"**.

17. The operational challenges facing the Receiver were reported to Callidus, in its capacity as senior secured creditor and receivership financier by letter dated 5 May 2016 addressed to Mr. Jim Hall, Vice President of Callidus. In this letter, the Receiver outlined the serious operational risks facing the administration and outlined various realization scenarios that should be considered.

EXPEDITED SALES PROCESS

18. The operational challenges associated with preserving, protecting and growing the live salmon inventory combined with the infrastructure limitations made the Property under

the Receiver's mandate unique by nature. While traditional realization methods such as a tender sale process, involving protracted advertising campaigns, coupled with lengthy bidding and review processes have historically been the benchmarks of receivership proceedings involving static assets, such was not feasible in relation to this receivership in the early days of the administration.

19. There are a limited number of aquaculture organizations based in Atlantic Canada with adequate resources capable of absorbing the Respondents' operations into their own and successfully addressing the operational challenges facing the Respondents and the Receiver. Given the seasonality of the business, the short time lines available to address environmental concerns (eg. sea lice treatments) and in consideration of the financial risks associated with further investments in the fish inventories absent access to necessary infrastructure (proper sized vessels, barges, management resources, harvest and processing equipment, processing facilities and marketing channels to bring the product to market) the Receiver recommended that efforts be taken to facilitate an expedited sale process, with the intention to maximize the net recovery for the Estate and minimize further financial exposure to Callidus.

20. Live salmon inventories are only valuable to an operator with capacity to raise, harvest, process and market them. Consequently, after consulting with the senior secured creditors of the Estate, the Receiver approached the two leading aquaculture operators within the region and solicited their interest to pursue negotiations for a potential acquisition of the Property.

21. Only one of the parties approached by the Receiver (the "**Expedited Party**") expressed interest in pursuing such discussions. The other party, although interested in the Property, was focussed on its existing operations and addressing the various challenges that aquaculture operators face during that time of year.

22. The Receiver pursued a series of good faith negotiations with the Expedited Party throughout the month of May 2016. The negotiations involved representatives from the Expedited Party, the Receiver and Callidus and considered various transactional options including the sale of Callidus' security or a sale of assets by the Receiver subject to the

approval of this Honourable Court. Regular updates on the expedited sale negotiation process were provided to counsel for the Business Development Bank of Canada (“**BDC**”) who was at that time the second largest secured creditor of the Estate.

23. At the same time that the expedited negotiations were being conducted, the Receiver in consultation with SIMC, the Respondents’ private veterinarian, representatives from the NB and NL Departments of Aquaculture and Fisheries (“**DAAF**”) and with the assistance of the Respondents management team worked to preserve, protect and secure the Property including the fish inventories and develop operational solutions necessary to address the infrastructure challenges at hand on a best efforts basis. The financial holding costs required to sustain the Respondents operations were extensive. The Receivers borrowings from 25 April 2016 through 3 June 2016 totalled $2.6 million.

24. An expedited agreement acceptable to all parties was ultimately not achieved and negotiations with the Expedited Party were discontinued effective 1 June 2016. As a result, the Receiver was left to manage the aquaculture operations and pursue an alternative realization strategy for the Property.

AQUACULTURE OPERATIONS - NEW BRUNSWICK

Depopulation Exercise

25. The Respondents operated three marine sites in the province of NB referred to as Hog Island, Hospital Island and Simpson Island. As at the Receivership Date, the Companies perpetual inventories cumulatively reported there to be approximately 827,000 pre-market salmon located at three NB sites. As a result of the failed expedited sales process identified above, these inventories had to be maintained and cared for by the Receiver pending their eventual sale, harvest or removal from the marine sites.

26. The Receiver identified a number of operational challenges including but not limited to vessel dependability, feed delivery logistics, sea lice treatment schedules, harvest, processing and marketing plans in addition to other environmental matters all of which impacted upon the aquaculture operation. Significant effort to develop solutions for the above issues using existing infrastructure or negotiating service contracts with

independent service providers were expended by the Receiver throughout the receivership administration.

27. One of the most significant concerns potentially affecting the grow-out operation was the threat of sea lice. As reported in the Receivers First Report to this Honourable Court, environmental conditions at the Respondent's NB marine sites during the summer of 2016 resulted in high sea lice levels. Management continuously monitored sea lice counts and took measures to mitigate sea lice levels using both in feed medication and external product applications. Strategies to address sea lice were reviewed with DAAF officials, the Respondents private veterinarian and other industry advisors. However, in early July 2016 site management advised the Receiver that despite all efforts to that date, sea lice counts were rapidly increasing.

28. On 27 July 2016, the Receiver notified its insurer (the "**Insurer**") that sea lice counts at Hospital Island were escalating despite the Company's best efforts to control the infestation. The Receiver advised that evidence of sea lice damage to the fish was occurring and significant mortalities were expected to follow. The Respondents insurance policy includes coverage for sea lice losses, however, the policy does not cover intentional slaughter whether by an Order of official body or otherwise.

29. The Receiver advised the Insurer that the Respondents were not equipped with adequate infrastructure to address mass mortalities if they were to arise. Furthermore, the Receiver advised the Insurer that given existing water temperatures, (then reported at 15 degrees Celsius with expectations to rise) should mass mortalities arise, there would be little time to remove the biomass from the water before the mortalities decomposed leading to an unmanageable situation and a long term clean up exercise with environmental consequences to surrounding areas.

30. The Receiver advised the Insurer that, in its opinion, the best way forward was to depopulate the site using 3rd party contracted pumper boats while the inventory was still alive in order to control what would otherwise escalate to be an environmental disaster at the site. The Receiver sought instructions from the Insurer on how to proceed. The Insurer responded by seeking additional information on the status of the sea lice

mitigation efforts and mortality count details. Furthermore, the Insurer requested that it be notified in the event that a large scale removal of site inventories be enacted.

31. In a letter dated 31 July 2016, the Chief Veterinarian for DAAF set out its conclusion that inventories at all three NB sites should be depopulated to avoid a catastrophic event. A copy of the DAAF letter is attached hereto as **Appendix "C"**.

32. The Receiver found itself in a difficult situation as a result of the escalating sea lice numbers and the exclusion provision within the Respondents insurance policy. The Receiver considered two possible options:

    (a) Depopulate the NB sites and avoid environmental ramifications recognizing that such actions might trigger a claim exclusion within the insurance policy; or

    (b) Wait for the inevitable to happen and file a claim against the Respondents insurance policy. The claim however, would come at a significant financial and public relation cost as mass mortalities, if not removed in a controlled manner, would result in a catastrophic environmental situation arising. The smell and flow of decomposed biomass would affect the residents, businesses and tourists in the sea side community of St. Andrew's, NB. The Receiver was unable to effectively mitigate the environmental issues arising from such losses if they were allowed to occur.

33. The Receiver, after consultation with Callidus and its legal counsel, concluded that it had no choice but to depopulate the Hog Island and Hospital Island sites. As an Officer of the Court, the Receiver could not stand by and allow an environmental disaster to unfold without taking preventative action. The Insurers were advised of the Receivers decision via e-mail dated 29 July 2016. Attached as **Appendix "D"** is the notification e-mail to the Insurers representatives confirming the Receivers intentions, outlining the Receivers reasoning as to why the unique circumstances facing the parties should not invalidate the policy and included the Receivers formal ask of the Insurers to confirm its position with respect to the pending claim.

34. On 4 August 2016, the senior loss adjuster for the Insurer advised that he had been requested to complete a full investigation of the present state of the stock. The adjuster provided a Reservation of Rights letter to the Receiver, a copy of which is attached as **Appendix "E"**.

35. The Receiver arranged to contract 3rd party equipment and facilities at a cost to the Estate of approximately $290,000 to partially depopulate the Hog Island and Hospital Island sites between 1 August 2016 and 10 September 2016. Daily depopulation rates were limited by various factors including pumper vessel capacity and offloading facility limitations. Consequently, in addition to depopulating live inventory from the sites, the Receiver had to engage supplemental 3rd party diving services to retrieve elevated mortality levels lost in advance of the depopulation activities being completed at a further cost to the Estate of approximately $280,000. Inventory records maintained by the Receiver indicated that 284,300 (53%) live salmon were removed from the Hog Island and Hospital Island sites via controlled depopulation activities and 252,996 (47%) dead salmon were retrieved and removed by divers over the same period. As a result of the Receivers efforts to depopulate the sites (removing live inventory via pumper boats and removing natural mortalities using additional diving services) the Receiver was able to effectively control the environmental issues at site and avoid a catastrophic loss. SIMC officials advise that absent the Receivers depopulation actions there would have been an uncontrollable loss at the NB sites with serious environmental implications.

36. The Receiver has cooperated fully with all information requests made by the Insurers. As at the date of this Report, the Insurers have not yet provided a formal position in response to the Receiver's sea lice claim.

Hatchery Lease and Smolt Sales

37. The assets of Gray Aqua Farms Ltd. (**"GAF"**) include the Respondents interests in lands, buildings, equipment and fish inventories (brood stock, smolt and fry) situated on leased lands located in Northampton NB (the **"Hatchery"**). As at the Receivership Date, the Respondents perpetual inventory records reported there to be approximately 750,000 smolt in the Hatchery subject to various grow out contracts with Kelly Cove Salmon Ltd.

("**KCS**") (the "**KCS Smolt**"), approximately 360,000 smolt not associated with 3rd party grow out contracts (the "**GAF Smolt**") and 1,700,000 fry (the "**Fry**"). Approximately 900,000 of the Fry were subject to a KCS grow out agreement (the "**KCS Fry**") whereas approximately 800,000 of the Fry were controlled by GAF (the "**GAF Fry**").

38. The marketability of the brood stock, KCS Smolt, the GAF Smolt and the Fry (collectively the "**Hatchery Inventory**") was compromised by various factors identified by the Receiver:

a) The KCS Smolt and the KCS Fry were subject to two separate grow out agreements pre-dating the Receivership;

b) An outbreak of bacterial kidney disease ("**BKD**") was reported within the Hatchery just prior to the receivership. As a result of the BKD outbreak, the Hatchery Inventory could not be introduced into Nova Scotia or NL waters thereby limiting the number of potential buyers for the Hatchery Inventory;

c) Smolt introductions into marine waters typically occur in the Spring or Fall of the year and aquaculture operators generally have long term plans in place to satisfy their smolt requirements as smolt sites have to be properly prepared (cages, nets etc…) in advance of receiving inventory. Local aquaculture operators contacted by the Receiver, with the exception of KCS, expressed no interest in the Hatchery Inventory; and

d) The Respondents had no operating plans to receive 2016 smolt as at the Receivership Date and Callidus was not prepared to financially support a new year class of fish inventory requiring 18 to 24 months of growth before reaching market size.

39. As noted above, the Receiver solicited expressions of interest in the Hatchery Inventory from a number of aquaculture operators. KCS was the only party to express an interest. The Receiver, after consulting with Callidus, negotiated various amendments to the pre-receivership smolt grow out agreements with KCS to address complications associated with the BKD outbreak and to include the GAF Smolt as part of the inventories being

sold. Proceeds arising from the smolt sales are reported with the Receivers Interim Statement of Receipts and Disbursements (the "SRD"), a copy of which is attached as **Appendix "F"**.

40. Smolt sales to KCS completed by the Receiver pursuant to the amended pre-receivership grow out agreements generated $1.1 million for the Estate. Smolt sold to KCS were transferred out of the Hatchery between 8 July 2016 and 5 August 2016 leaving only the Fry and brood stock inventory on hand.

41. The Receiver harvested the BKD affected brood stock. The marketability of the brood stock for any other purpose was determined to be negligible as a result of their exposure to the BKD virus.

42. On or about 19 July 2016, representatives from KCS approached the Receiver and solicited the Receivers interest to enter into a short term lease of the Hatchery. The Receiver considered the opportunity with Callidus and ultimately determined it was in the Estates best interest to enter into a hatchery lease (the "**KCS Hatchery Lease**") providing various benefits to the administration including but not limited to:

    a) Maintaining ongoing employment for a number of affected GAF employees; and

    b) Absent such an agreement being reached, the Receiver would have incurred additional costs to dispose of the Fry, clean and winterize the Hatchery or in the alternative, the Receiver would have been forced to invest approximately $0.6 million to preserve, protect and grow the Fry through 31 December 2016 pending the results of the tender sale process discussed in greater detail below. Further investments within the Fry may not have been recoverable.

43. Consequently, the Receiver negotiated and executed an agreement with KCS to lease the Hatchery for a 12 month period. The KCS Hatchery Lease also provided for the sale of the Fry to KCS. A copy of the KCS Hatchery Lease is attached as **Appendix "G"**.

Simpson Island Sale Agreement

44. As previously reported within the Receivers First Report dated 31 August 2016, the Receiver concluded that continuing to rear the Simpson Island fish inventory was not an economically viable or prudent activity for the Receiver to pursue. As contemplated within the 1 September 2016 Order from this Honourable Court, the Receiver entered into negotiations and ultimately was successful negotiating a series of agreements between the Receiver, KCS, 047759 N.B. Ltd., and 628228 N.B. Incorporated resulting in the Fish Inventory Depopulation Sale (as defined within the 1 September 2016 Order) concluding. A copy of the Simpson Island Asset Purchase and Sale Agreement (the **"Simpson Island Agreement"**) is attached as **Appendix "H"**.

45. Additional recoveries pursuant to paragraph 2.2 (b) of the Simpson Island Agreement may materialize subject to final harvest numbers being confirmed with the purchaser. Additional realizations from the Simpson Island Agreement, if any, will not be determinable until late summer 2017.

AQUACULTURE OPERATIONS - NEWFOUNDLAND AND LABRADOR

Gray Aqua Processing Land Claim Dispute

46. The Receiver intervened in a land claim dispute which arose prior to the Receivership Date as between Mr. Wallace Roberts and Her Majesty the Queen in Right of Newfoundland (the **"Crown"**). Mr. Roberts sought to compel the Crown to issue a land grant of certain lands situated at or near Hermitage Newfoundland and Labrador (the **"Grant Lands"**). The Receiver intervened as part of the Gray Aqua Processing facility was built upon a portion of the Grant Lands that Mr. Roberts sought title to.

47. The matter was brought before Justice Robert P. Stack of the Supreme Court of Newfoundland and Labrador Trial Division (General). Justice Stack issued a written decision on 19 July 2016 dismissing Mr. Roberts claim. On 12 August 2016, Mr. Wallace filed a notice of appeal, however, no further information in relation to the appeal has been produced.

Harvest

48. The operational challenges and sea lice infestations which negatively affected the NB marine sites were not experienced in NL. The Respondents have been operating marine sites in the province of NL longer than NB and as a result the local management team was better prepared and equipped to oversee operations in that region. Furthermore, environmental conditions in the Respondents NL waters during 2016 were less prone to sea lice infestations arising than were experienced in NB.

49. Unlike the Respondents NB marine sites, salmon inventories in NL were successfully grown to market size and were harvested in the normal course of operations by the Receiver. In total, 2.7 million lbs of finished product was produced and sold between 24 July 2016 and 24 November 2016 generating $10.2 million gross sale proceeds for the Estate.

SETTLEMENT WITH THE CANADIAN FOOD INSPECTION AGENCY

50. As initially outlined in the affidavit of Jim Hall filed in support of the appointment of the Receiver, the Respondents NL operations were materially affected in the Spring of 2013 by an infectious salmon anemia ("**ISA**") outbreak, which resulted in the Minister of Agriculture and Agri-Foods Canada (the "**Minister**") and the Canadian Food Inspection Agency (the "**CFIA**") issuing a depopulation order in relation to all of the Company's salmon inventory located at Goblin Bay NL.

51. Pursuant to the Health of Animals Act (Canada) (the "**HAA**"), CFIA is responsible for the administration of a compensatory scheme whereby farmers engaged in the raising of food and food-source animal crops are able to recover losses of market value occasioned by events falling within the scope of the compensable loss categories recognized thereunder. The ISA loss sustained by the Respondents in the Spring of 2013 was such a compensable loss.

52. The Respondents were dissatisfied with the compensation award proposed by CFIA and subsequently filed a Notice of Appeal in the Federal Court of Canada pursuant to the HAA (the "**CFIA Appeal**"), stating that the value of the compensation paid was

unreasonably lower than the market value of the salmon at the time the depopulation order was issued.

53. The CFIA Appeal remained an outstanding action as at the Receivership Date. The Receiver assumed carriage of the CFIA Appeal, and instructed its diligent prosecution.

54. On 25 May 2016 the Receiver participated in a full day mediation process at the Federal Court in Fredericton NB. As a result of the mediation, the CFIA Appeal was resolved, with the Respondents (by way of the Receiver) agreeing to discontinue the CFIA Appeal and grant a Release in favour of the Minister and CFIA, et al, in return for the sum of $519,073 which was subsequently paid.

55. The Receiver considers the mediated settlement outcome of the CFIA Appeal to be a favourable one in the circumstances.

SALE OF BDC SECURITY TO CALLIDUS

56. The affidavit of Jim Hall dated 15 April 2016 filed in support of the Receivership application identified the existence of various secured creditors. As noted in the Hall affidavit the majority of said creditors held security over specific assets of the Estate whereas BDC held general security from the group of companies. An inter-creditor agreement dated 2 March 2015 outlined the respective priority rights as between Callidus and BDC.

57. A subsequent agreement between Callidus and BDC was finalized on 13 June 2016 by which BDC assigned to Callidus the security and agreements held by BDC in respect of the Gray Aqua Group of Companies. BDC is no longer a creditor of the Estate.

SALE OF PROPERTY

Sale by Tender Process

58. Pursuant to subparagraph 3(l) of the Receivership Order, the Receiver is empowered and authorized by this Honourable Court to market any or all of the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and

negotiating such terms and conditions of sale as the Receiver in its discretion deems appropriate.

59. In accordance with the provisions of the Receivership Order, the Receiver after having addressed the operational issues associated with the live fish inventories considered various options to determine the most fair and effective method to solicit offers for the Property that would result in the Receiver obtaining the highest and/or best price for the benefit of the stakeholders of the Respondents. Sales options considered by the Receiver included an auction sale, a tender sale, or a private sale negotiation.

60. Based upon its experiences conducting sales of similar assets in insolvency proceedings in Atlantic Canada and other regions across Canada, the Receiver determined that the best method to solicit offers for the Property was to conduct a tender process (the **"Tender Process"**). In coming to this conclusion, the Receiver considered the potential for en bloc bids for the Property which would enable a turn-key going concern business utilizing the operating platform established by the Respondents. This in turn could increase the possibility of continued or increasing employment levels in rural jurisdictions in both NB and NL.

61. To assist the Receiver with its assessments of bids arising from the Tender Process, the Receiver commissioned a series of appraisals in relation to the Property. The separate appraisals focused on particular components of the Respondents assets namely: i) Equipment; ii) Vessels; iii) Real Property in NB; iv) Real Property in NL; and, v) Aquaculture Licenses. The cumulative appraised value of the Property totalled $6.7 million on a forced liquidation basis and $17.8 million at fair market value. The most significant difference between the valuation estimate categories pertained to the estimates of value for the aquaculture sites ($0.8 million on a liquidation basis and $8.4 million at fair market value). Copies of the appraisals commissioned for the Receiver are attached at **Appendix "I"**.

62. On 26 October 2016, the Receiver finalized a tender information package (the **"Tender Information Package"**) a copy of which is attached as **Appendix "J"**. To broadly

market the Property and inform potentially interested parties about the Tender Process, the Receiver:

a) posted an electronic copy of the Tender Information Package to the Receiver's website at www.ey.com/ca/grayaqua. The Receiver is unable to confirm the number of interested parties who viewed or downloaded the Tender Information Package during the Tender Process because the Receiver's website does not provide that information;

b) placed advertisements within a series of regional and national newspapers describing the Property being sold, key timelines of the Tender Process and the Receivers contact information should interested parties wish to obtain additional details. The Receiver placed advertisements as follows:

   i. in the business section of the Telegram (a newspaper published in NL), once per week for four (4) weeks, with the advertisements being placed in the 3, 10, 17, and 24 November 2016 editions;

   ii. in the National Edition of the Globe & Mail, with an advertisement being placed in the 12 November 2016 edition;

   iii. in the business section of each of The Daily Gleaner, the Telegraph-Journal, and the Times & Transcript (newspapers published in NB), once per week for (4) weeks, with the advertisements being placed in the 3, 8, 15, and 22 November 2016 editions; and

   iv. in the Insolvency Insider (an email based newsletter focused on Canadian Insolvency News), with the advertisements being placed on 31 October 2016, and 7, 14, 21 and 28 November 2016. Copies of the advertising notices are attached as **Appendix "K"**.

(c) developed a list of targeted prospective buyers comprising industry participants, aquaculture associations, and auctioneers from across Canada, the United States, Scotland, Norway, and Chile that the Receiver believed might have an interest in the Property. The Receiver contacted these prospective buyers individually via phone or email to advise them of the Tender Process.

63. The Receiver directly contacted one-hundred twenty (120) prospective buyers. Eighty-five (85) of these parties were located in North America, ten (10) were located in Scotland, eight (8) were located in Chile, and seventeen (17) were located in Norway. The Receiver facilitated on site viewings of the Property with ten (10) prospective bidders.

64. As set out in the Tender Information Package, sealed tenders were to be received by the Receiver on or before 12:00 PM (noon) Atlantic Standard time on 30 November 2016 for the purchase, on an "as-is, where-is" basis, of all or part of the Property, subject to terms and conditions of sale commonly used in receivership proceedings. These terms and conditions included a requirement that a 15% deposit accompany the tender submission.

65. Sixteen tenders were submitted in response to the Tender Process. Tender submissions varied and included (i) offers to purchase individual assets within parcels, (ii) offers to purchase individual parcels, (iii) offers to sell the assets of the Company on behalf of the Receiver, (iv) an offer, subject to receiving financing from Third Parties (including Callidus), to operate select portions of the Property; and (v) three en bloc offers to purchase all of the Property of the Respondents.

66. The Receiver examined all tenders submitted to identify which tender or combination of tenders would maximize the net recovery to the Estate. The Receiver concluded that the en bloc tender submissions generated the highest potential recovery for the Estate. Formal notices to the thirteen non en bloc bidders advising that their bids had not been accepted and returning their deposits were sent on 2 December 2016.

67. The tender price submissions of the three en bloc bids were not materially different ranging from \$6.6 million to \$7.5 million. As such, the Receiver concluded that it would be appropriate to solicit amended tenders from each of the en bloc bidders pursuant to paragraph 29 of the Conditions of Sale included within the Tender Information Package which provides as follows:

"29. In the event that some of the tenders submitted have similar terms and/or amounts, the Receiver may in its sole discretion call upon those tenderers to submit further tenders."

68. On 2 December 2016, the Receiver sent a letter to each of the three en bloc tenderers inviting them to participate in a supplemental tender process. Pursuant to the terms of those letters, the Receiver notified each of the parties that, among other items:

a) three parties were invited to submit amended tenders for the purchase of all of the assets of the Companies;

b) the deadline to submit amended tenders was 12:00 Noon (AST) on 14 December 2016;

c) each of the parties was entitled, upon their request, to conduct additional due diligence; and

d) unless otherwise stated in the invitation to participate in the supplemental tender process, the Conditions of Sale included in the Tender Information Package would remain in force.

69. In response to the invitations, each of the three parties submitted amended tenders on 14 December 2016. A summary of the initial bids and supplemental bids from the en bloc bidders follows:

	Initial Bid	**Supplemental Bid**	***Bid Increase***
Bidder 10	$7,110,000	$7,300,000	*$190,000*
Bidder 16	$6,558,000	$7,566,000	*$1,008,000*
Marine Harvest	$7,500,000	$15,000,000	*$7,500,000*

70. After reviewing the amended tenders, the Receiver concluded that the amended bid from Marine Harvest ASA ("**Marine Harvest**") for $15.0 million offered the highest net recovery for the Estate pursuant to the Tender Process. Copies of the amended tenders were provided to Callidus for their review.

71. The Receiver compared the amended tender submissions against the appraisal reports commissioned by the Receiver. The Receiver considered the marketing process undertaken and the positive number of industry participants who considered the opportunity. The Receiver ultimately concluded that the amended Marine Harvest en bloc submission represented a reasonable recovery for the Property. The Receiver recommended to Callidus that the amended Marine Harvest tender bid be accepted. Callidus confirmed its support for the Receivers recommendation.

72. Attached as **Appendix "L"** is a tender bid summary (the "**Tender Bid Summary**") without tenderers names outlining the bids received pursuant to the initial call for tenders and the supplemental tender process.

73. On 15 December 2016, the Receiver formally notified the unsuccessful en bloc bidders that their amended tender submissions had been rejected and returned their respective deposits. On that same date, the Receiver provided formal confirmation to Marine Harvest that its amended tender bid had been accepted subject to the approval of this Honourable Court. A copy of the Marine Harvest bid acceptance letter is attached as **Appendix "M"**.

74. On 19 December 2016, Marine Harvest issued a public press release confirming that it had been nominated by the Receiver as the successful tender bidder for the Property. The text of Marine Harvests press release, including disclosure of the accepted purchase price of $15.0 million follows:

> *"Marine Harvest is pleased to announce that we have been nominated by the Receiver of all the assets owned by the Gray Aqua Group of Companies, to purchase the Company. The acquisition price on a cash and debt free basis is CAD 15 million. The Company is based on the East Coast of Canada and is currently in receivership. The acquisition is important from a strategic point of view, as it further broadens Marine Harvest's global farming footprint in a country where we are already present on the West Coast. The market for salmon in North-East America continues to develop very favourably, and the acquisition represents as such a compelling value proposition.*
>
> *The assets purchased include one hatchery in New Brunswick, two farming licenses in New Brunswick, seven farming licenses in Newfoundland, and one processing plant in Newfoundland. Currently no fish has been stocked in the above mentioned licenses. In*

> *addition, the Company has applied for 17 farming licenses in Newfoundland which are yet to be approved. Marine Harvest is looking forward to engage with the relevant authorities to secure additional farming locations as well as to establish new jobs in the local communities."*

Unsolicited Amended Tender Submission

75. On 21 December 2016, KCS (one of the two unsuccessful en bloc bidders) submitted an unsolicited amended tender submission (the "**Unsolicited Tender**") to the Receiver for its consideration, a copy of which is attached as **Appendix "N"**. KCS acknowledged that its previous two tender submissions for $6.5 million and $7.5 million (rounded) had not been accepted by the Receiver. In response, KCS increased its en bloc offer for the Property to $17.0 million. KCS expressed its belief that the Receiver has discretion to accept its revised offer pursuant to section 39 of the Conditions of Sale within the Tender Information Package. The Unsolicited Tender was accompanied by a deposit of $2,560,700.

76. The Receiver provided a copy of the Unsolicited Tender to Callidus and confirmed its intention to reject the Unsolicited Tender. The Receiver confirmed to Callidus that it had reviewed the situation with legal counsel and believed that it has no choice but to respect the integrity of the tender process conducted to date. That process was open and transparent to all parties and each bidder, including KCS, was permitted ample opportunity to submit its highest and best bid. The Tender Process was successful with a clear winning bid having emerged which the Receiver formally accepted. The Receiver advised Callidus that it was not prepared to accept the Unsolicited Tender. However, for full disclosure to all parties, the Receiver committed to advise the Court of the late offer and notify KCS or other parties wishing to intervene in the sale approval hearing to address their concerns with this Honourable Court at a later date.

77. The Receiver understands that legal counsel for Callidus and Marine Harvest have discussed the Unsolicited Tender, the Receivers position with respect to the Unsolicited Tender and have reached an agreement satisfactory to both parties that confirms Callidus's support for the Receivers sale approval motion.

78. The Receiver, as an Officer of the Court, believes it is duty bound to respect the integrity of the Tender Process which it developed and implemented as part of these receivership proceedings. Consequently, the Receiver requests, pursuant to subparagraph 3(l)(ii) of the Receivership Order, that this Honourable Court approve the sale of the Property to Marine Harvest pursuant to the Conditions of Sale outlined in the Tender Information Package at the supplemental tender price of $15.0 million.

INTERIM STATEMENT OF RECEIPTS AND DISBURSMENTS

79. Attached to this Report as **Appendix "F"** is the Interim Statement of Receipts and Disbursements for the Estate for the period 25 April 2016 to 3 February 2017 reflecting all transactions associated with the receivership administration to that date. The Receiver currently holds $9,130,969 in the receivership trust account inclusive of a $1,125,000 deposit from Marine Harvest.

80. Pursuant to the terms of the Receivership Order, the Receiver was empowered to borrow up to a maximum amount of $15.0 million. As noted in the SRD, the Receiver borrowed $7.6 million from Callidus to support the operations prior to positive cash flows from the NL harvests materializing.

81. The Receiver intends to bring a distribution motion before this Honourable Court post conclusion of the Marine Harvest sale if approved by this Honourable Court.

RELIEF SOUGHT BY THE MONITOR

82. The Receiver respectfully requests that this Court approve an Order:

a) Approving the sale of the Property to Marine Harvest pursuant to the terms and conditions of sale referenced in the Tender Information Package for consideration totalling $15.0 million;

b) Approving the issuance of a Vesting Order to permit the conveyance of the Property to Marine Harvest free and clear of all encumbrances; and

c) Approving the activities of the Receiver during the receivership proceedings, as reported herein, to the extent not previously approved.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 6th day of February 2017

ERNST & YOUNG INC.
Licensed Insolvency Trustee
acting in its capacity as the Court-appointed
Receiver of the Respondents and not in its
personal or corporate capacity

Per:

George Kinsman, CPA, CA, CIRP, LIT
Senior Vice President