

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

IN THE MATTER OF SECTION 47(1) OF *THE BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, C.B-3, AS AMENDED, SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, C. C. 43, AND SECTION 68 OF THE *CONSTRUCTION LIEN ACT*, R.S.O. 1990 C. C. 30, AS AMENDED

BETWEEN:

WESTLB AG, TORONTO BRANCH

Applicant

and

THE ROSSEAU RESORT DEVELOPMENTS INC.

Respondent

**SIXTEENTH REPORT OF
ALVAREZ & MARSAL CANADA ULC,
AS RECEIVER AND MANAGER AND CONSTRUCTION LIEN ACT TRUSTEE AND
ALVAREZ & MARSAL CANADA INC., AS INTERIM RECEIVER
OF THE ASSETS OF THE ROSSEAU RESORT DEVELOPMENTS INC.**

MARCH 4, 2011

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1.0 *Introduction and Summary of Proceedings to Date*¹

- 1.1 On May 22, 2009, the Ontario Superior Court of Justice (the “Court”) issued an order appointing Alvarez & Marsal Canada ULC (“A&M”) and McIntosh & Morawetz Inc. (now Alvarez & Marsal Canada Inc.) as trustee and interim receiver, respectively (collectively the “Interim Receiver”), pursuant to Section 68 of the *Construction Lien Act* (Ontario) (“CLA”) and Section 47(1) of the *Bankruptcy and Insolvency Act* (Canada) (“BIA”) of all the property, assets and undertakings (the “Assets”) of The Rosseau Resort Developments Inc. (“RRDI” or the “Company”). On June 2, 2009, the Court issued an Amended and Restated Appointment Order (the “Appointment Order”) continuing the appointment of the Interim Receiver and appointing A&M as receiver and manager (the “Receiver and Manager”) pursuant to Section 101 of the *Courts of Justice Act* (Ontario) (“CJA”) and pursuant to the CLA of the Assets of RRDI (the Interim Receiver and the Receiver and Manager collectively defined as the “Receiver”).
- 1.2 All background materials in respect of these proceedings, including, among other things, the Receiver’s past reports to Court and orders of the Court, can be found on the Receiver’s website at www.alvarezandmarsal.com/rosseau.

¹ Capitalized terms in this Sixteenth Report shall have the meanings ascribed to them in either the body of this report or in the Glossary of Defined Terms attached as Appendix “A”.

2.0 *Terms of Reference*

- 2.1 In preparing this Sixteenth Report, the Receiver has relied on unaudited financial information prepared by the Company and the Company's consultants and advisors, the Company's books and records and discussions with certain remaining employees of the Company. The Receiver has not performed an audit or other verification of such information. An examination of the Company's financial forecasts as outlined in the Canadian Institute of Chartered Accountants Handbook has not been performed. Future oriented financial information relied on in this Sixteenth Report is based on assumptions regarding future events; actual results achieved may vary from this information and these variations may be material. The Receiver expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this Sixteenth Report, or relied upon by the Receiver in preparing the Sixteenth Report. All references to dollar figures contained in the Sixteenth Report are in Canadian currency unless otherwise specified.

3.0 *The Motion*

- 3.1 This Report is filed by the Receiver of RRDI in support of a motion for advice and directions regarding the payment of condominium fees by RRDI to Muskoka Standard Condominium Corporation No. 62 (the "Resort Corporation"²) by way of set-off.
- 3.2 The two Independent Directors of the Resort Corporation³ have asserted that RRDI is in arrears of its condominium fees in respect of the amounts payable for the operational year 2009-2010 and owe additional condominium fees once the budget for 2010-2011 is settled and condominium fees are assessed.
- 3.3 The Receiver has disputed this claim. RRDI's obligation to pay condominium fees, if any, to the Resort Corporation was satisfied by setting-off that obligation against amounts owed by the Resort Corporation to RRDI, resulting from RRDI's funding of all of the Hotel's operating expenses prior to and since the appointment of the Receiver. The total amount funded by RRDI to Marriott to date amounts to \$4.175 million. Pursuant to a number of contracts governing the relationship between RRDI and the Resort Corporation, described in detail below, the Resort Corporation is obliged to reimburse RRDI for its share of those expenses funded by RRDI, together with other amounts paid by RRDI directly on behalf of the Resort Corporation, in the total amount of \$1,491,129. By setting off this obligation against the condominium

² Sometimes also referred to in prior reports as the "Residential Condominium Corporation" or the "Condominium Corporation"

³ The Resort Corporation Board of Directors consists of five members, three of whom are appointees of RRDI, and two of whom (the "Independent Directors") are individual Unit Owners who have been appointed pursuant to section 42(11) of the Condominium Act.

fees owed by RRDI, the mutual obligations of RRDI and the Resort Corporation have been satisfied, with the result being that there is a net amount owing by the Resort Corporation to RRDI for the first operational year of the Resort Corporation ended March 9, 2010. Accordingly no amounts remain owing for condominium fees for 2009-2010. Similarly, any amounts assessed for 2010-2011 will be paid when invoiced by way of set-off.

- 3.4 This claim would have been resolved if the Unit Owner Proposal to acquire the Hotel had proceeded. In light of the support of WestLB for the Potential Transaction, discussed below, rather than the Unit Owner Proposal, the Receiver is left with no choice but to bring this issue before the Court for resolution. On February 22, 2011, the Receiver's legal counsel wrote a detailed letter to the Independent Directors outlining the Receiver's position in this regard which had previously been conveyed in discussions. Attached as Appendix "B" is a copy of the letter to the Independent Directors dated February 22, 2011.
- 3.5 By letter dated February 24, 2011, the Independent Directors advised that they continue to oppose the Receiver's position and claim that condominium fees are outstanding and should be set aside from the proceeds of the Potential Transaction (described below). Attached as Appendix "C" is a copy of the response of the Independent Directors.
- 3.6 In their letter, the Independent Directors have asserted a number of allegations against the Receiver, which the Receiver disputes but which need not be addressed at this time. The most significant allegation is an assertion by the Independent Directors that they will seek an order of the Court "prohibiting the Receiver from selling or other

otherwise disposing of any of the units he owns in the Condominium Corporation until this matter is resolved or ask the Court to require the payment into Court of the sum of at least \$2,387,000 prior to any such sale until the dispute is resolved.”

- 3.7 As discussed more fully in the Receiver’s Fifteenth Report, WestLB and the Receiver are currently involved in negotiations with respect to a Potential Transaction for the sale of the Assets of RRDI. The indication by the Independent Directors that they intend to take steps in the receivership proceedings to hinder the sale of the Assets and the distribution of proceeds of sale must be resolved in order that the Receiver may pursue the Potential Transaction or, if not concluded, any other transaction with certainty.
- 3.8 The Receiver has therefore brought this motion for advice and directions, seeking a declaration from the Court that:
- a) RRDI has appropriately set-off the mutual obligations of RRDI and the Resort Corporation, and as a result, any condominium fees payable by RRDI to the Resort Corporation to date have been paid in full, and that future condominium fees payable by RRDI to the Resort Corporation as they may be assessed may be similarly accounted for and,
 - b) in any event,
 - (i) the claims alleged by the Independent Directors do not provide grounds to prohibit the Receiver from completing the Potential Transaction, or any other sale of the Assets; and

- (ii) no sums shall be required to be retained by the Receiver or paid into Court out of the proceeds of sale of the Assets once any sale transaction is completed.

3.9 This is a discreet issue relevant to the Potential Transaction or, if not concluded, any other sale transaction for the Assets.

4.0 The Hotel

The Resort Corporation

- 4.1 The Hotel is a condominium resort hotel known as The Rosseau, a J.W. Marriott Hotel and Spa, located on Lake Rosseau, in Muskoka, Ontario. RRDI is the developer of the Hotel.
- 4.2 The Hotel is a mixed-use condominium development developed by RRDI. There are 221 condominium units in the Hotel (the "Units"). Eighty-nine Units are currently owned by individual Unit Owners. The remaining 132 Units are owned by RRDI. During a significant portion of the first operational year of the Resort Corporation ending March 8, 2010, RRDI owned 148 Units. RRDI also owns a unit designated as a hotel management unit, which houses the front desk and back office of the Hotel (the "Hotel Management Unit").
- 4.3 The Units form part of the Resort Corporation pursuant to a declaration registered on title to the property of RRDI on March 9, 2009 (the "Declaration"). Attached as Appendix "D" is a copy of the Declaration.
- 4.4 The Resort Corporation is comprised of the Units and its common elements. Pursuant to the *Condominium Act*, common elements of the Resort Corporation are defined as "all the property except the units" (the "Common Elements"). The Units are used as accommodation suites for Hotel guests when they are not in use by Unit Owners, whose usage is limited by, among other things, a rental pool management agreement between RRDI and each respective Unit Owner and a restrictive covenant registered on title. The Common Elements comprise certain public areas of the Hotel.

The Commercial Space

- 4.5 There is a commercial component of the Hotel that does not form part of the Resort Corporation, comprised of meeting rooms and ballrooms, restaurants, and a spa and pool area owned by RRDI (collectively, the "Commercial Space"). RRDI had initially planned for a commercial condominium to be registered to own and manage the Commercial Space, which has not yet been established.
- 4.6 The Commercial Space owned by RRDI and the Units and the Common Elements owned by the Unit Owners all comprise one integrated Hotel facility.

5.0 The Common Expenses of the Resort Corporation

- 5.1 Common expenses are defined by the *Condominium Act* as “the expenses related to the performance of the objects and duties of a corporation and all expenses specified as common expenses in this Act or in a declaration”. The common expenses of the Resort Corporation are itemized at Schedule E to the Declaration (the “Common Expenses”). All Unit Owners are required to pay condominium fees on account of their obligation to contribute to the Common Expenses.
- 5.2 The first operating year of the Resort Corporation commenced on March 9, 2009 and ended March 8, 2010. The Resort Corporation’s first year operating budget (the “First Year Budget”) estimated Common Expenses of \$1,952,140. The First Year Budget provided the basis on which each Unit Owner, including RRDI, was assessed by the Resort Corporation for condominium fees. Attached as Appendix “E” is a copy of the First Year Budget. Prior to the receivership, no invoices were issued to Unit Owners for their condominium fees.
- 5.3 Most Unit Owners have paid condominium fees to the Resort Corporation for the year 2009-2010, and some have paid fees for 2010-2011. Those Unit Owners that have paid condominium fees for 2010-2011 paid such fees based on an estimated obligation for 2010-2011 and are, in general, those Unit Owners who purchased Units subsequent to the commencement of the receivership, during the One Day Sale. Very little of the condominium fees collected by the Resort Corporation have been applied/spent by the Resort Corporation. To date all expenses of the Hotel, including those costs for which the Resort Corporation is ultimately responsible, have been paid

by RRDI. There is a balance of approximately \$495,000 currently being held by the Resort Corporation. The amounts that have been spent by the Resort Corporation relate to certain administrative expenses directly attributable to the Resort Corporation and not expenses associated with the operation of the Hotel.

6.0 The Obligations of the Resort Corporation to RRDI to Reimburse its share of Expenses

6.1 As noted, the Hotel is an integrated whole, owned in part by Unit Owners, and in part by RRDI as owner of the Commercial Space. The nature of the Hotel and its structure means that the costs of operating and maintaining the respective properties of the Unit Owners and RRDI necessarily overlap. To address this, the parties have entered into certain agreements governing the sharing of facilities and the costs associated therewith. The following are the relevant agreements:

Hotel Easement and Restrictive Covenant Agreement

- a) Under a Hotel Easement and Restrictive Covenant Agreement ("Hotel Easement Agreement"), the Resort Corporation is identified as the entity responsible for the control, management and administration of its Common Elements. The Resort Corporation covenants to maintain its Common Elements in accordance with Hotel Standards, as those are defined in the agreement⁴. The Resort Corporation acknowledges that if it does not maintain its Common Elements in accordance with Hotel Standards, any of RRDI, the rental pool manager (which is currently RRDI) or the Hotel Operator (which is currently Marriott Hotels of Canada Ltd. ("Marriott")) may carry out, at the sole cost of the Resort Corporation, any maintenance of, repairs to or replacement of its Common Elements required to meet the Hotel Standards, and the Resort Corporation will reimburse such person on demand for such costs incurred.
- b) Attached as Appendix "F" is a copy of the Hotel Easement Agreement.

Reciprocal Agreement

- a) A Reciprocal Agreement executed by the Resort Corporation and RRDI dated March 9, 2009 (the "Reciprocal Agreement") governs the allocation of certain

⁴ "Hotel Standards" are defined as the standards and policies for the management and operation of a hotel (including the Resort Units) having the design, development, construction, furnishing, equipping, operating, service and maintenance standards at least equal to a "JW Marriott" or equivalent hotel; as required from time to time under the Hotel Management Agreement.

costs of ownership between the Resort Corporation, on the one hand, and RRDI as owner of the Commercial Space on the other. The parties to the agreement acknowledge the integrated use, operation, maintenance, repair and replacement of the Hotel. The Reciprocal Agreement provides that each of the Parties to the agreement "will pay for the costs of operating, maintaining, repairing, replacing and insuring the Shared Facilities located within its Structure, Common Elements or lands, as the case may be". Schedule C to the Reciprocal Agreement lists the Shared Facility Costs⁵, and allocates various percentages to each of the Resort Corporation and the Commercial Space for these costs. Each Party agrees to pay to the other Party the appropriate amount so that the costs borne by each Party for the Shared Facilities equals the portion attributable to it under Schedule C.

- b) The Reciprocal Agreement makes RRDI, as initial property manager, responsible for managing the operations, maintenance, repair, replacement of the services, utilities, facilities and systems that are shared by the residential and commercial owners. However, RRDI is permitted under the Agreement to delegate this responsibility to Marriott as Hotel Operator. The parties acknowledge that the Hotel Operator has no liability to the parties under the Reciprocal Agreement.
- c) Attached as Appendix "G" is a copy of the Reciprocal Agreement.

Shared Facilities Agreement

- a) The sharing of costs set out in the Reciprocal Agreement is also reflected in a Shared Facilities Agreement dated March 9, 2009 among the Resort Corporation, RRDI, and 1515511 Ontario Inc. (the "Shared Facilities Agreement"). Similar to the Reciprocal Agreement, the Resort Corporation agrees to be responsible to pay for the costs of operating, maintaining, repairing, replacing and insuring the Shared Facilities located within its Structure, Common Elements, or lands. Each party agrees to pay its share of Shared Facilities Costs in accordance with Schedule C to the Shared Facilities Agreement.⁶ Each Party agrees to pay to the other Party the appropriate amount so that the costs borne by each Party for the Shared Facilities equals the portion attributable to it under Schedule C.

⁵ The costs allocated in Schedule C to this agreement as between the Resort Corporation and the Commercial Space include: window cleaning, fire safety maintenance, HVAC maintenance, parking maintenance, exterior building maintenance, elevator maintenance, garbage removal, common areas maintenance, office supplies, legal & audit, insurance, meeting costs, property management fees, performance audit, reserve funds study, potable water and sewage treatment, electricity, propane, cabana pool equipment and storage rooms maintenance, cabana washrooms cleaning and maintenance, access cards, and public liability insurance.

⁶ The costs allocated in Schedule C to this agreement as between the Resort Corporation and the Commercial Space are grounds maintenance, snow removal, seasonal decoration, and security services.

- b) Attached as Appendix "H" is a copy of the Shared Facilities Agreement.

Water/Sewage Treatment Services Agreement

- a) RRDI and the Resort Corporation have executed a Water/Sewage Treatment Services Agreement dated February 9, 2009 (the "Water/Sewage Agreement") pursuant to which RRDI agrees to supply water and wastewater treatment services to the Units and common elements of the Resort Corporation, and agrees to operate maintain and repair such systems. The Resort Corporation agrees to pay the amounts for such services as allocated by the Reciprocal Agreement.
- b) Attached hereto as Appendix "I" is a copy of the Water/Sewage Agreement.

Declaration

- a) The Declaration recognizes the shared costs as an obligation of the Resort Corporation. Schedule E of the Declaration includes, as a Common Expense of the Resort Corporation, "the Corporation's share of the cost under the Condominium Use Agreements, or any of them." The Condominium Use Agreements are defined to include the Hotel Easement Agreement, the Reciprocal Agreement, and the Shared Facilities Agreement.

Hotel Management Agreement

- a) The Hotel Management Agreement is an agreement between RRDI and Marriott, whereby Marriott is retained by RRDI to operate the Hotel. Under the Hotel Management Agreement, RRDI delegates the responsibility for maintaining the Hotel to Marriott. Marriott takes on the responsibility, among other things, for planning, executing and supervising repairs, and maintenance for the Hotel, as well as payment of costs and expenses reasonably necessary for the proper and efficient operation of the Hotel. Marriott also takes responsibility for maintaining the Hotel in good repair and condition, and making routine maintenance, repairs, and alterations.
- b) Before distribution of proceeds of operations to RRDI, Marriott is entitled to deduct certain "Deductions" from Gross Revenues of the Hotel, as those are defined in the Hotel Management Agreement. Those Deductions include costs of repairing and maintaining the Hotel, and the costs of supplying utilities. RRDI is required to fund Operating Losses (as defined in the agreement) arising from such Deductions.

6.2 The set-off by RRDI against condominium fees is created by the following obligations:

- a) Under the Reciprocal Agreement, RRDI is acknowledged as initial property manager responsible for managing the Shared Facilities. The right of RRDI to delegate this role to a hotel operator is recognized in that agreement by the Resort Corporation.
- b) As a result of the delegation of responsibilities by RRDI to Marriott under the Hotel Management Agreement, Marriott, as operator of the Hotel, initially incurs and pays the expenses of operating the entire Hotel, including the Units, the Common Elements, and the Commercial Space. The expenses paid by Marriott include all categories of expenses itemized in Schedule C to the Reciprocal Agreement and Schedule C to the Shared Facilities Agreement.
- c) Marriott assumes no personal liability for these costs. Its obligation is solely to account for such costs to RRDI. Marriott is entitled to deduct such costs before distributing Operating Profit to RRDI. There has been no Operating Profit to date. Rather, RRDI has funded \$4.175 million to Marriott for Operating Losses during the receivership to date, and additional amounts will be funded by RRDI.
- d) The Resort Corporation has agreed to share these costs with RRDI:
 - (i) The Hotel Easement Agreement confirms the responsibility of the Resort Corporation to maintain its Common Elements, and the obligation to reimburse RRDI for the costs of doing so should it not fulfill that obligation;
 - (ii) The Reciprocal Agreement and the Shared Facilities Agreement allocate a share of responsibility for Shared Facility Costs to the Resort Corporation; and
 - (iii) The Declaration makes such Shared Facility Costs a Common Expense of the Resort Corporation.

6.3 The foregoing documents establish and confirm the liability of the Resort Corporation to RRDI for its share of costs.

6.4 Attached hereto as Appendix "K" is a diagram showing the flow of mutual obligations as between RRDI and the Resort Corporation.

7.0 *Costs Incurred on behalf of the Resort Corporation*

- 7.1 Marriott maintains records of the costs and charges incurred in the course of its operations, which have been provided to RRDI in order to permit it to determine the amount that the Resort Corporation is obliged to reimburse RRDI.
- 7.2 For the operating year of the Resort Corporation ended March 8, 2010, the total amount incurred for those costs identified as Shared Facility Costs was \$2,017,307.15. Attached as Appendix "J" is a copy of a summary of costs, as provided by Marriott and reviewed by the Receiver, and their allocation.
- 7.3 Applying the percentage allocations for these costs under the Reciprocal Agreement and the Shared Facilities Agreement, the amount of the Resort Corporation's share of the \$2,017,307.15 obligation is \$1,285,126.77, the balance being the responsibility of RRDI as owner of the Commercial Space.
- 7.4 In addition to the amounts of Shared Facility Costs that the Resort Corporation owes pursuant to the Reciprocal Agreement and the Shared Facilities Agreement, RRDI has paid directly, on behalf of the Resort Corporation, certain expenses incurred by the Resort Corporation, in the amount of \$121,138.70. Attached hereto as Appendix "L" is a schedule of such direct expenses paid by RRDI on behalf of the Resort Corporation.
- 7.5 The Resort Corporation also budgeted for the payment of a management fee, which has been charged by RRDI to the Resort Corporation in the amount of \$84,864 for the period March 9, 2009 to March 8, 2010, for administering the affairs of the Resort Corporation.

8.0 Satisfaction of Condominium Fees Obligation of RRDI by Mutual Set-Off

- 8.1 As of March 9, 2010, RRDI owed the sum of \$1,342,971.28 to the Resort Corporation for condominium fees, based on the number of Units it owned from time to time between March 9, 2009 and March 8, 2010, including the Hotel Management Unit. As of that same date, the Resort Corporation owed the sum of \$1,285,126.77 to RRDI for Shared Facility Costs, \$121,138.70 for other costs paid by RRDI on behalf of the Resort Corporation, and \$84,864 for management fees, for a total of \$1,491,129.47.
- 8.2 RRDI has set-off these two debts, leaving a net balance owing to RRDI by the Resort Corporation of \$148,158.19 as of March 9, 2010. As a result, RRDI was not in arrears of condominium fees, but was in fact in a net receivable position with the Resort Corporation.
- 8.3 Attached as Appendix "M" is a copy of draft financial statements of the Resort Corporation for the year ended March 8, 2010 in the form as provided to the directors of the Resort Corporation, which reflects a net payable owing to RRDI. Subsequent to the preparation of these draft financial statements, the Resort Corporation has made minor adjustments as a result of its review of its records and the applicable allocations. The adjustments are in the Resort Corporation's favour, and are reflected in the numbers described above. The Independent Directors have not approved the financial statements, nor have they approved the appointment of an auditor of the financial statements.

- 8.4 RRDI, by its Receiver and with Receiver Borrowings provided by WestLB, continues to pay all of the costs that are to be allocated between RRDI and the Resort Corporation. Set-off is therefore available in respect of any condominium fees that may be payable by RRDI once the budget for the Resort Corporation is set for 2010-2011 and subsequent years.

9.0 Conclusion and Recommendations

9.1 The Independent Directors assert that RRDI is in arrears of its condominium fees. The Receiver disagrees with this assertion. The Independent Directors have advised the Receiver that they intend to take steps to prevent the Receiver from selling the Assets and/or to ask the Court to require the Receiver to withhold over \$2 million from distribution of sale proceeds in respect of an obligation that has clearly already been satisfied, and for which there are no grounds to assert a claim.

9.2 The Receiver therefore seeks a declaration:

- a) that the condominium fees payable by RRDI to the Resort Corporation have been satisfied by setting those fees off against the mutual obligation of the Resort Corporation to reimburse RRDI for its share of Shared Facility Costs, and that any future obligations for condominium fees may similarly be netted out against such Shared Facility Costs and,
- b) in any event:
 - (i) that the claims alleged by the Independent Directors do not provide grounds to prohibit the Receiver from completing the Proposed Transaction, or any other sale of the Assets; and
 - (ii) that no sums shall be required to be retained by the Receiver or paid into Court out of the proceeds of sale of the Hotel.

* * *

All of which is respectfully submitted, this 4th day of March, 2011.

**ALVAREZ & MARSAL CANADA ULC &
ALVAREZ & MARSAL CANADA INC. IN THEIR CAPACITIES AS
CONSTRUCTION LIEN ACT TRUSTEE AND RECEIVER AND MANAGER,
AND INTERIM RECEIVER, RESPECTIVELY, OF THE ASSETS OF
THE ROSSEAU RESORT DEVELOPMENTS INC.**

Per:


Richard A. Morawetz