

TAB 2

**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

**THIRTEENTH 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.**

DECEMBER 1, 2010

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1.0 Introduction¹

1.1 This thirteenth report of the Receiver (the “Thirteenth Report”) is filed in support of a motion for an Order:

- (a) approving the amounts determined by the Receiver in its capacity as trustee under the CLA for certain Construction Lien Claims (defined below) filed by construction lien claimants (“Lien Claimants”) under the Construction Lien Claims Process Order dated July 24, 2009 (the “Construction Lien Claims Process Order”) pursuant to notices of determination issued by the Construction Lien Trustee pursuant to the Construction Lien Claims Process Order (the “Notices of Determination”);
- (b) confirming and declaring that the Construction Lien Claims determined pursuant to the Notices of Determination and approved by the Court (the “Determined Lien Claims”) have priority over, among other things, all judgments, executions, assignments, attachments, garnishments, receiving orders, conveyances, mortgages/charges or other agreements affecting RRDI’s interest in its premises in accordance with the provisions of the CLA, including charges in favour of WestLB, Travelers, and Fortress (if any) other than the Receiver’s Charge and the Receiver’s Borrowings Charge;

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

- (c) setting a trial date for Construction Lien Claims for the purposes of complying with section 37 of the CLA; and
- (d) approving the activities of the Receiver as described in the Thirteenth Report.

2.0 *Background to Construction Lien Claims Process*

- 2.1 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”).
- 2.2 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.
- 2.3 On the initial Application for the appointment of the Receiver commenced by WestLB as the primary secured lender to RRDI, it was disclosed that outstanding amounts were owed to numerous construction trades. The affidavit of Robert Dyck filed in support of the Application detailed, as could be determined at the time from the records of Rock Ridge Contractors Inc. (“RRCI”), unpaid amounts as of May 7, 2009 of approximately

\$4.3 million relating to construction trades. No holdback had been retained by RRDI as required by the CLA.

- 2.4 It was therefore apparent that lien claims would be asserted by the unpaid construction trades and that priority would be asserted in respect of those construction liens over WestLB and the other lenders to RRDI². Pursuant to the Appointment Order issued on June 2, 2010, Lien Claimants, notwithstanding the stay of proceedings, were permitted to register construction liens under the CLA, and to perfect their lien claims by registering certificates of action and delivering statements of claim.
- 2.5 Lien claims were registered by a total of 28 trades against title to the real property owned by RRDI pursuant to the CLA, one of which was later discharged (the lien claims of the remaining 27 Lien Claimants collectively, the “Construction Lien Claims”). One of these claims for lien was vacated, prior to the receivership, on payment of funds into Court by RRDI. The total amount of the Construction Lien Claims was approximately \$5.5 million.

² As outlined later in this Report, under the CLA, a proven claim for lien can rank in priority to other registered interests in the property, in certain circumstances; the extent of the priority is limited to any deficiency in the holdback that the responsible party was required to retain under the CLA:

Building mortgage

78 (2) Where a mortgagee takes a mortgage with the intention to secure the financing of an improvement, the liens arising from the improvement have priority over that mortgage, and any mortgage taken out to repay that mortgage, to the extent of any deficiency in the holdbacks required to be retained by the owner under Part IV, irrespective of when that mortgage, or the mortgage taken out to repay it, is registered. R.S.O. 1990, c. C.30, s. 78 (2).

Special priority against subsequent mortgages

78 (5) Where a mortgage affecting the owner’s interest in the premises is registered after the time when the first lien arose in respect of an improvement, the liens arising from the improvement have priority over the mortgage to the extent of any deficiency in the holdbacks required to be retained by the owner under Part IV. R.S.O. 1990, c. C.30, s. 78 (5).

- 2.6 It was apparent to the Receiver that it would be necessary to establish a process to resolve these Construction Lien Claims.
- 2.7 As a result, the Second Report of the Receiver dated July 3, 2009 advised the Court that a Construction Lien Claims Process Order would be sought that would provide for a process to determine and resolve Construction Lien Claims. On July 24, 2009, after consulting with and obtaining the input of counsel for the Lien Claimants, the Construction Lien Claims Process Order was granted. The order established a process by which the Construction Lien Claims would initially be determined by the Receiver, subject to dispute and review by a claims officer or a reference to a Construction Lien Master or Case Management Master. A copy of the Construction Lien Claims Process Order is attached hereto as **Appendix "B"**.
- 2.8 As set out in detail in the Receiver's Seventh Report dated October 7, 2009, a copy of which without attachments is attached hereto as **Appendix "C"**, upon the commencement by the Receiver of its administration of the Construction Lien Claims Process, certain additional factual and legal issues arose.
- 2.9 In particular, one of the preliminary issues for resolution in order to be able to make determinations regarding the Construction Lien Claims was whether each Lien Claimant was a contractor for purposes of the CLA, or a subcontractor under RRCI, which had performed services for RRDI in respect of the construction of the Hotel. This issue would potentially have an impact upon the amount of holdback that RRDI was required to retain on behalf of the Lien Claimants, and therefore the amount for which Lien

Claimants would be entitled to assert priority in respect of their Construction Lien Claims under the CLA.

- 2.10 The Receiver therefore sought and obtained an order referring to a Master the issue of whether each Lien Claimant or RRCI was a contractor for the purpose of the CLA (the “RRCI/RRDI Reference”). A copy of that order dated October 14, 2009 is attached hereto as **Appendix “D”** (the “Reference Order”).
- 2.11 The RRCI/RRDI Reference was assigned to Master Short.
- 2.12 As the Receiver noted in its Eleventh Report and its Twelfth Report, the Receiver and those parties interested in the Construction Lien Claims Process participated in steps relating to the RRCI/RRDI Reference, including the exchange of documentation, development of an agreed statement of facts, and various case conferences with Master Short.
- 2.13 In the course of pursuing the steps required in the RRCI/RRDI Reference, it became apparent to the Receiver that an additional preliminary issue for determination was whether certain Certificates of Substantial Performance (“Certificates”) which had been issued and, in some cases, published in relation to the Lien Claimants’ work were valid and had any impact on the timeliness of the Lien Claimants’ liens. In order to resolve this issue, the Receiver sought and obtained an Order dated April 21, 2010 (the “April 21 Order”) amending the scope of the RRCI/RRDI Reference to add this issue to the matters to be determined by Master Short. Attached hereto as **Appendix “E”** is a copy of the April 21 Order.

- 2.14 In the interim, the Receiver reported in its Eleventh Report that with the suspension of the Institutional Sales Process, it anticipated a potential lengthy delay before any recoveries could be realized by the Lien Claimants on their Construction Lien Claims, even if their claims were established and finally resolved through the Construction Lien Claims Process.
- 2.15 In light of the revised estimated timing for recoveries, and the extensive costs that were anticipated to be incurred in respect of the RRCI/RRDI Reference and the litigation of any disputed Construction Lien Claims, an opportunity arose for the interested parties in the Construction Lien Claims Process to explore the possibility of settlement.
- 2.16 As discussed in greater detail below, the Receiver, in its capacity as trustee under the CLA, with the assistance of its independent legal counsel Fraser Milner Casgrain LLP, had undertaken a preliminary, but very detailed, analysis of the value and issues surrounding the Construction Lien Claims. It was therefore in a position to provide this analysis to WestLB and Lien Claimants who requested it.
- 2.17 The Receiver, its independent legal counsel, and legal counsel for WestLB commenced exploring the possibility of settlement with legal counsel for various Lien Claimants. Lien Claimants were receptive to the idea, and WestLB instructed its legal counsel to enter into discussions with legal counsel for the Lien Claimants with the assistance and facilitation of the Receiver.
- 2.18 These discussions have been ongoing since May, 2010. The RRCI/RRDI Reference, which had been scheduled for hearing in August, 2010, was postponed on consent of the

Lien Claimants, and with the concurrence of Master Short, in order to permit settlement discussions to continue.

- 2.19 The Receiver is advised by WestLB, and has confirmed with the relevant Lien Claimants, that, as of the date of this Report, settlements have been achieved with all but 2 Lien Claimants. As noted in the Receiver's Twelfth Report, WestLB has confirmed that it has approval to fund these settlements with the Lien Claimants.
- 2.20 The Receiver advised the Court in the Twelfth Report that one of the conditions of settlement required by WestLB would be the assignment of all rights related to the settled Construction Lien Claims to WestLB, and that those Construction Lien Claims be resolved by the Receiver in accordance with the Construction Lien Claims Process by way of issuance of Notices of Determination. WestLB also required as a term that this motion be brought for approval of the amounts of the Determined Lien Claims as determined by the Receiver, and confirmation of the priority of the Determined Lien Claims that would be assigned to WestLB in accordance with the settlements.
- 2.21 The Receiver has issued its Notices of Determination with respect to the Determined Lien Claims, as described in greater detail below. This motion is therefore brought for approval of the Determined Lien Claims and a declaration as to priority of the Determined Lien Claims.

3.0 *Terms of Reference*

- 3.1 In preparing this Thirteenth 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 Thirteenth 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 Thirteenth Report, or relied upon by the Receiver in preparing the Thirteenth Report. All references to dollar figures contained in the Thirteenth Report are in Canadian currency unless otherwise specified.

4.0 Review by the Receiver of the Construction Lien Claims

- 4.1 Upon receipt of each Construction Lien Claim, and the documentation required to be delivered by Lien Claimants to the Receiver by paragraph 7 of the Construction Lien Claims Process Order, the Receiver undertook, with the assistance of its independent legal counsel, an extensive review of the legal and factual issues relating to both the amount and priority of each Construction Lien Claim asserted by the Lien Claimants.
- 4.2 As noted above, the Receiver's independent legal counsel identified 28 different Lien Claimants. A summary of the Construction Lien Claims of each of the Lien Claimants (some of whom have multiple Construction Lien Claims) is attached as **Appendix "F"**. Of these 28, one Lien Claimant, Artech Communications, discharged its lien. Another of the 28, Rock Solid Granite Tops, had registered a lien prior to the receivership, but the lien had been vacated upon payment of funds into Court.
- 4.3 The process conducted by the Receiver and its independent legal counsel for reviewing each Construction Lien Claim included an evaluation of the following:
- (a) the contractual relationship between RRCI/RRDI and each of the Lien Claimants;
 - (b) the value of each Construction Lien Claim;
 - (c) the timeliness of each Construction Lien Claim, including in respect of the publication of certain Certificates; and
 - (d) the applicability of the CLA to the work which was the subject matter of the Construction Lien Claim (i.e. the "lienability" of the work).

- 4.4 The following is a summary of the work performed by the Receiver and its legal counsel in reviewing the Construction Lien Claims.

The Relationship between RRCI/RRDI and the Lien Claimants

- 4.5 The completion of the Project was the result of numerous individual construction projects in respect of the Hotel. These individual projects included (a) the Longview building and amenities; (b) the Paignton House building; (c) the Cabana and related amenities; (d) the water treatment plant; (e) the sewage treatment plant; (f) civil site servicing; and (g) other miscellaneous work (collectively the “Sub-Projects”).
- 4.6 RRDI and/or RRCI generally entered into business relationships with the Lien Claimants through the issuance of formal construction contracts, letters of intent, or purchase orders (collectively the “Contract Documents”). The majority of Lien Claimants had different Contract Documents for each Sub-Project in which they were involved.
- 4.7 In reviewing each Construction Lien Claim, the Receiver reviewed the Contract Documents and records in the possession of RRDI and RRCI, as well as documents supplied by the Lien Claimants, to determine whether the Construction Lien Claim should be broken down into one or more of the various Sub-Projects, or if the Construction Lien Claim related only to the Project as a whole.
- 4.8 For the 27 remaining Lien Claimants, the Receiver identified 59 different contractual relationships (the “Contractual Relationships”). This analysis allowed the Receiver to review the value, the timeliness, and the lienability of each Contractual Relationship within each Construction Lien Claim.

Value of the Construction Lien Claim

4.9 The Receiver undertook a comprehensive analysis of the amount of the Construction Lien Claim filed by each Lien Claimant. The process was conducted using several different methods:

- (a) Reviewing the statement of accounts filed by each of the Lien Claimants and comparing such statement with the RRCI/RRDI records. Any difference was investigated and reconciled. Typical differences included invoices not posted by RRCI/RRDI, disputed invoices, and payments not posted by the Lien Claimant.
- (b) Determining the total value of the particular Contractual Relationship, and therefore the Construction Lien Claim, including initial contract value, change orders and extras. The Receiver then conducted a review of the total payments made to the Lien Claimant on account of the contract and compared the remaining balance with the amount of the Construction Lien Claim. The total value of the Contractual Relationship would be applicable in calculating the holdback priority in a situation where the Lien Claimant was determined to be a contractor pursuant to the CLA.
- (c) Reviewing the amount of the Construction Lien Claim for any deficiencies in the work performed, or for any evidence of excess billing. Excess billing was found to arise primarily as a result of Lien Claimants invoicing for work that had not yet been completed. For example, a Lien Claimant might assert that a particular component of a contract was 100%

completed, yet the Receiver's assessment, upon a review of the job, indicated that such work had only been 75% completed. In the Receiver's assessment of the value of the Construction Lien Claim, any excess billed amounts were to be deducted from the total Construction Lien Claim. This analysis was administered by Receiver, with the assistance of RRCI/RRDI construction staff, as well as the Receiver's construction consultant, The Altus Group.

- 4.10 Based on this analysis, the Receiver was able to come to a view as to the dollar value of the underlying Construction Lien Claim.

Timeliness

- 4.11 The Receiver is advised by its independent legal counsel that the timeliness of a construction lien is governed by s. 31 of the CLA. This provision establishes the expiry date of a lien, by providing the means for determining the commencement date of the 45 day period within which a Lien Claimant is required to register a lien.
- 4.12 Section 31 of the CLA determines the commencement date for the registration of a lien by first distinguishing between the liens of contractors and the liens of other persons, such as subcontractors. Since the issue of whether each Lien Claimant was a contractor or a subcontractor was the subject of the RRCI/RRDI Reference, it was necessary for the Receiver to consider the timeliness of registration of the Construction Lien Claims on the basis of both potential outcomes of the RRCI/RRDI Reference: (a) that each Lien Claimant was a contractor with RRDI, or (b) that each Lien Claimant was a subcontractor engaged by another party who contracted directly with RRDI.

- 4.13 As noted above, the Receiver had also determined in its review of the documentation that certain Certificates had been issued and published in respect of certain Contractual Relationships relating to some of the Lien Claimants. Not all of the issued Certificates were published. A listing of the Certificates, both published and unpublished, is attached hereto as **Appendix “G”**.
- 4.14 Section 31 of the CLA also determines timing by distinguishing between services and materials which are supplied to an improvement where the contract has been certified or declared to be substantially performed and where there is no certification or declaration of the substantial performance of the contract (i.e. no Certificate). Certain Lien Claimants challenged the validity of the Certificates issued in respect of their work. Since the validity of each published Certificate was also an issue to be determined in the RRCI/RRDI Reference, the Receiver considered the timeliness of registration of each claim for lien under two further scenarios: (a) one in which the Certificates would be found to be valid, and (b) another in which the Certificates would be found to be invalid.
- 4.15 Assuming that the RRCI/RRDI Reference determined that a Lien Claimant was a contractor for the purposes of the CLA, the deadline for registering a claim for lien would be forty-five days after the date on which a valid Certificate in respect of the contract was published. Where no valid Certificate had been published, or where a published Certificate had been found to be invalid, the deadline for registration would be forty-five days after the earlier of the date the contract was completed or abandoned.
- 4.16 Assuming that (a) the RRCI/RRDI Reference, if heard, were to decide that RRCI was the contractor for the Project, and therefore Lien Claimants were subcontractors, and (b) if no

Certificate had been published in respect of any contract between RRDI and RRCI and no certification of completion of a subcontract was made in respect of any work on the Project, the deadline for registering a claim for lien by a subcontractor would be forty-five days after the date on which the subcontractor last supplied services or materials to the Project. However, if a Certificate had been published, the period within which to register a lien would expire for sub-contractors after 45 days from the date of publication of the Certificate.

- 4.17 In order to determine the expiry date under section 31 of the CLA and therefore assess the timeliness of the Construction Lien Claims, the Receiver considered the notes and records of the various site supervisors for the Project, RRCI/RRDI records in the Receiver's possession, the dates of the last invoices included in the Construction Lien Claims, and the documents produced by each Lien Claimant pursuant to the Construction Lien Claims Process Order and orders made in the RRCI/RRDI Reference. The Receiver also considered that the Construction Lien Claims Process Order stipulated a contract termination date of May 22, 2009, for any contracts and subcontracts which were not completed at that time.

Applicability of CLA to Work Performed

- 4.18 The Receiver reviewed each Construction Lien Claim to determine what services and materials were supplied to the improvement, in order to consider whether such services and materials fell within the definition of "improvement" in the CLA (i.e. whether the work is "lienable"). In gathering information about these services and materials, the Receiver considered the documents

and records contained in RRDI's files, information obtained through interviews of site personnel, the claims for lien, Statements of Claim, and the Lien Claimants' productions.

- 4.19 The Receiver then considered whether the work which formed the subject of each Construction Lien Claim was properly the subject matter of a construction lien under the CLA. Statutory provisions and jurisprudence were considered in assessing the applicability of the CLA to the work in respect of each Construction Lien Claim.

Range of Outcomes

- 4.20 In undertaking this review and analysis, the Receiver was able to identify a range of outcomes for the validity and value of each Construction Lien Claim based on all of the above-noted factors, including (a) whether or not a Lien Claimant was held to be a contractor, and (b) whether or not a valid Certificate had been published in respect of that Lien Claimant's work.
- 4.21 As a result of this analysis, the Receiver was able to determine a range of outcomes for each Lien Claimant. In so doing, the Receiver considered the outcomes for the Lien Claimants' priority claims, based on a calculation of the holdback that RRDI ought to have retained in the two relevant scenarios for the calculation of the holdback: (a) where Lien Claimants were contractors; and (b) where Lien Claimants were subcontractors. The Receiver determined that the priority claim, in aggregate, of all Lien Claimants could be as low as approximately \$1.2 million, if Lien Claimants were found to be contractors, and the Certificates published in respect of their work were found to be valid, or as high as the total amount of all registered Construction Lien Claims, or approximately \$5.5 million, if Lien Claimants were found to be subcontractors.

5.0 Settlements with Lien Claimants and the Determination of the Construction Lien Claims

- 5.1 As described above, as a result of the suspension of the Institutional Sales Process, it became apparent that even once the issues referred to Master Short on the RRCI/RRDI Reference were decided, and the Construction Lien Claims were determined thereafter in accordance with the Construction Lien Claims Process Order, there would be a substantial period of time before there would be any realization on the sale of the assets of RRDI that may give rise to proceeds available for distribution to the Lien Claimants.
- 5.2 As a result, as reported in the Receiver's Twelfth Report, the Receiver perceived an opportunity for the parties to explore settlement of the Construction Lien Claims, rather than expending substantial time and money on litigating the issues in the RRCI/RRDI Reference and thereafter potentially litigating the determinations made by the Receiver pursuant to the Construction Lien Claims Process Order.
- 5.3 As WestLB is the primary secured creditor and mortgagee of RRDI, and as it was clear that there was a substantial priority claim in favour of Lien Claimants in respect of the holdback deficiency pursuant to the CLA, WestLB agreed that settlement discussions would be appropriate.
- 5.4 As the Receiver and its independent legal counsel had already undertaken a substantial review of the background facts and issues relating to each specific Construction Lien Claim, as discussed above, the Receiver provided information and assistance to certain Lien Claimants and to WestLB regarding the variables affecting each individual Construction Lien Claim, and the Receiver was able to provide an analysis of the range of

outcomes available to the Lien Claimants. This provided the parameters for the parties to engage in settlement discussions.

- 5.5 As a result of negotiations that have been ongoing since in or about June, 2010, WestLB has been able to achieve settlements with 25 of the 27 Lien Claimants.
- 5.6 WestLB has agreed, in making these settlements, to pay each of the Lien Claimants a lump-sum payment in consideration for the assignment to WestLB by each of the settled Lien Claimants of their Construction Lien Claims.
- 5.7 WestLB has advised the Receiver that, among the other terms and conditions of settlement with the Lien Claimants (which are privileged), prior to paying the settlement amounts and taking such assignments, it required the Receiver to issue Notices of Determination pursuant to the Construction Lien Claims Process, and an Order of this Court declaring and confirming the priority of the Determined Lien Claims that will be assigned to WestLB.
- 5.8 The Receiver has also been advised by WestLB that, in the context of the settlements that have been negotiated, the Lien Claimants and WestLB have agreed to the Determined Lien Claims. The Receiver has received, or expects to receive, executed consents from each of the Lien Claimants confirming their agreement. The Receiver has reviewed these amounts, and considers the amounts to be reasonable. The Receiver has therefore issued Notices of Determination in respect of the Determined Lien Claims in the amounts as outlined in the schedule attached hereto as **Appendix "H"**.

5.9 In reviewing the amounts agreed to by WestLB and the Lien Claimants for purposes of the Notices of Determination and coming to its conclusion regarding reasonableness of those amounts, the Receiver has considered all of the factors relevant to the Construction Lien Claims, including those described above, which the Receiver considered in its initial review. These factors include:

(a) the range of various possible outcomes of the RRCI/RRDI Reference, and the impact that those outcomes may have on the value of the Determined Lien Claims;

(b) the amount that would have priority in respect of the holdback deficiency;

(c) the specific factual and legal issues related to each Determined Lien Claim outlined in detail in Section 4.0 above and the impact these have on the amount that may be recovered by Lien Claimants;

(d) the risks of litigation; and

(e) the cost to the estate and the impact on other stakeholders of a protracted process pursuant to the Construction Lien Claims Process Order.

5.10 Taking into consideration all of the circumstances, the Receiver therefore recommends that the Court approve the amounts set out in the Notices of Determination as final and binding for all purposes. If for some reason, the settlements are not completed with respect to the Determined Lien Claims, the Receiver will seek further direction from the Court.

5.11 The Construction Lien Claims Process Order permits the issuance of Notices of Dispute by Lien Claimants in response to Notices of Determination issued by the Receiver, and provides for a reference to a claims officer or a Construction Lien Master or Case Management Master in respect of any disputed Notices of Determination. As the Determined Lien Claims are being resolved on a consensual basis and approval by the Court is being sought on this motion, it is not considered necessary for these steps to be undertaken, and the Receiver therefore proposes that the provisions of paragraphs 11 and 12 of the Construction Lien Claims Process Order, as it relates to the Determined Lien Claims, be dispensed with. Paragraph 18 of the Construction Lien Claims Process Order provides the Court with this discretion.

5.12 The Receiver therefore requests the approval by the Court of the Notices of Determination as provided in the draft order filed.

6.0 *Priority of Construction Lien Claims*

- 6.1 As described above, the Construction Lien Claims Process Order was implemented by the Receiver in order to determine the value of the Construction Lien Claims, and to establish the extent to which the Construction Lien Claims would have priority over other encumbrances on title to the real property of RRDI.
- 6.2 The Construction Lien Claims asserted by the Lien Claimants are based on unpaid amounts for work performed for RRDI prior to the receivership. As noted, the total amount claimed by the Lien Claimants under their Construction Lien Claims is approximately \$5.5 million.
- 6.3 The Receiver is advised by its independent legal counsel that in certain circumstances the CLA provides that construction lien claims have priority over other encumbrances registered on title to the property of an owner. In particular, construction lien claims are deemed by the CLA to have priority over “building mortgages”, as those are defined in the CLA, to the extent of any deficiency in the holdback amount required to be retained by the owner pursuant to the CLA. Construction lien claims also have priority over any mortgage registered subsequent to when the first lien arose (that is, when services or material were first supplied to the improvement), to the extent of any deficiency in the holdback amount required to be retained.
- 6.4 In the case of RRDI, the Lien Claimants have asserted priority over the other encumbrances on title to the Hotel, including the mortgages given to WestLB, Fortress, and Travelers, for the entire amount of their Construction Lien Claims, on the grounds

that their claims fall within the amount of deficiency in the holdback that was required to be retained on their behalf, but was not retained by RRDI.

- 6.5 As noted above, no amounts were retained by RRDI in respect of the required holdback. The amount of holdback that RRDI was required to retain for the benefit of each Lien Claimant varies depending on whether the Lien Claimant was a contractor with RRDI or a subcontractor, under RRCI, or otherwise.
- 6.6 If RRCI was a contractor as defined by the CLA, and each trade was a subcontractor engaged by RRCI, the Receiver is advised by its independent counsel that the amount of the holdback required to be retained by RRDI was 10% of the entire construction contract with the general contractor. If each trade was a direct contractor with RRDI, then the amount of the holdback required to be retained under the CLA was 10% of the value of the services and material actually supplied by each trade to the improvement, less any previously released holdback.
- 6.7 The Receiver has undertaken a review of this issue for purposes of determining the amounts that RRDI was required to hold back, and the amounts therefore payable in priority to any building mortgage or subsequent mortgage.
- 6.8 If the RRCI/RRDI Reference had determined that each Lien Claimant was a subtrade under a prime contract between RRDI and RRCI, then the amount of the holdback required to be retained would be \$10.3 million, based on a total value of the work performed for construction of the Hotel of approximately \$103 million. RRDI had released, prior to the receivership, approximately \$3.3 million in holdback funds. This left approximately \$7 million that RRDI ought to have retained as holdback in this

scenario, which is in excess of the total amount claimed by the Lien Claimants. There is therefore the possibility of the entire amount of \$5.5 million claimed by the Lien Claimants to have priority over subsequent encumbrances, in the event that RRCI was found to be a contractor on the RRCI/RRDI Reference.

6.9 As of the commencement of the receivership proceedings, there were three mortgages registered on title to the real property of RRDI:

- (a) The first priority mortgage registered on title is in favour of WestLB, in the amount of \$125,000,000. It is registered as both Instrument Number MT29969 registered on March 6, 2007, and as Instrument Number MT63504, registered on March 9, 2009 (collectively, the “WestLB Charge”). The WestLB Charge remains registered on title.
- (b) In addition, there is a second mortgage registered on title in favour of Travelers, in the amount of \$22,500,000, registered subsequent in time to the WestLB mortgage as Instrument Number MT9970 on March 6, 2007 (the “Travelers Charge”). The Travelers Charge remains registered on title.
- (c) There was also a third mortgage registered in favour of Fortress Credit Corp. in the amount of \$40,000,000, registered subsequent to Travelers and WestLB as Instrument Number MT33625, on June 6, 2007 (the “Fortress Charge”). The Fortress Charge was also the subject of a subordination agreement between Fortress and WestLB which subordinated the Fortress Charge to the WestLB Charge.

- 6.10 On October 12, 2010, WestLB's legal counsel was advised by legal counsel for Fortress that the latter had assigned its debt and security relating to RRDI to a numbered company related to Ken Fowler. A review of the parcel register for the real property of RRDI has revealed that the Fortress Charge has been discharged.
- 6.11 Attached hereto as **Appendix "I"** is an up-to-date copy of the parcel register for the real property of RRDI disclosing the discharge of the Fortress Charge. The parcel register does not reveal any additional mortgages or charges on the property, other than described above.
- 6.12 In addition to the charges outlined above, there are various Court-ordered receivership-related charges that attach to the assets of RRDI, including its real property. These consist of:
- (a) the Receiver's Charge and the Receiver's Borrowings Charge established by the Appointment Order, which have been given priority over all obligations of RRDI, including Construction Lien Claims, by the Appointment Order; and
 - (b) the Unit Owner's Charges and a Primary Marriott Charge and a Secondary Marriott Charge in favour of Marriott Hotels, all of which are provided for by the Amended August 18 Order. The Unit Owner's Charges, the Primary Marriott Charge and the Secondary Marriott Charge are expressly made subordinate to those Construction Lien Claims that are determined to have priority over mortgages/charges registered on title to the real property of RRDI. Attached hereto as **Appendix "J"** is a copy of the Amended August 18 Order.

- 6.13 WestLB has conceded, for purposes of resolving the Construction Lien Claims, that the WestLB Charge is a “building mortgage” for purposes of the CLA, and is therefore considered subordinate to the Construction Lien Claims, to the extent of any deficiency in the holdback required to be retained pursuant to the CLA.
- 6.14 In its review, the Receiver has determined that the first work on the premises of RRDI by a construction trade, which first gave rise to a lien for purposes of the CLA, was in 2005. As such, the Fortress Charge, before it was discharged, and the Travelers Charge, both of which were registered in 2007, are “subsequent mortgages” for purposes of the CLA, and are therefore subordinate to the Construction Lien Claims, to the extent of any deficiency in the holdback required to be retained pursuant to the CLA.
- 6.15 Prior to it having discharged its charge, Fortress had conceded that it had a subsequent mortgage for purposes of the CLA, and was therefore subordinate to the Construction Lien Claims to the extent of the holdback deficiency.
- 6.16 An executions search discloses no writs of execution against the property of RRDI.
- 6.17 The amounts of the Determined Lien Claims, in aggregate of \$2,833,050, as determined pursuant to the Notices of Determination, are well within the range of outcomes if the matter of amount and priority were to be litigated, and are in a total amount that is approximately 45% less than the potential maximum priority claim of approximately \$5.1 million for the Determined Lien Claims.
- 6.18 Given the foregoing, the Receiver has concluded, with the advice of its independent legal counsel, that the Determined Lien Claims have priority over the WestLB Charge, the

Travelers Charge, the former Fortress Charge, which has now been discharged, the Unit Owner's Charges, the Primary Marriott Charge and the Secondary Marriott Charge. As such, the Receiver respectfully requests that this Court grant a declaration as to the priority of the Determined Lien Claims, as provided for in the draft order filed herewith.

7.0 *RRCI/RRDI Reference Update*

- 7.1 Pursuant to the process established by Master Short for the determination of the issues on the RRCI/RRDI Reference, most of the Lien Claimants have produced the documents they intend to rely upon in the RRCI/RRDI Reference. The RRCI/RRDI Reference timetable contemplated witness examinations and responding materials from WestLB leading to the hearing of the RRCI/RRDI Reference. The RRCI/RRDI Reference was held in abeyance while WestLB explored settlement opportunities with the Lien Claimants, as discussed above. At a case conference held on November 5, 2010, Master Short set a preliminary timetable for the next steps in the RRCI/RRDI Reference for any Lien Claimant who has not settled and still intends to pursue its Construction Lien Claim. A copy of Master Short's Endorsement (the "Endorsement") is attached to this Report as **Appendix "K"**.

8.0 *Setting Actions down for Trial*

- 8.1 Section 37 of the CLA provides that a perfected lien expires immediately after the second anniversary of the commencement of the action that perfected the lien, unless, before that anniversary, an order is made for the trial of an action in which the lien may be enforced.
- 8.2 In order to comply with the requirements of section 37, the Lien Claimants have requested, and Master Short has directed in his Endorsement, that the Receiver address this matter with this Honourable Court. Accordingly, the Receiver requests that an Order be made for purposes of this provision, fixing a day, time and place for the trials of the actions to enforce the Construction Lien Claims of the Lien Claimants. All pleadings contemplated by the Construction Lien Claims Process Order have been delivered, satisfying the requirements of s. 60(1)(a) of the CLA.
- 8.3 The process contemplated by the Construction Lien Claims Process Order requires any Lien Claimant who wishes to appeal the Receiver's Notice of Determination to deliver a Dispute Notice within 30 days of the Receiver posting the Notice of Determination on its website. Any appeal of a Notice of Determination is to be heard by reference to a qualified claims officer, Construction Lien Master or Case Management Master.
- 8.4 In light of the process set out by the Construction Lien Claims Process Order, and given the statutory requirement under section 37 of the CLA to fix a date, time and place for trial, the Receiver proposes that the trial of any Construction Lien Claims that have not been determined herein take place by way of appeal of Notices of Determination which may be issued under the Construction Lien Claims Process Order. The Receiver proposes that the date for such trial be set as July 29, 2011. This will permit WestLB and

the remaining Lien Claimants who have not yet settled to continue to pursue the possibility of settlement, or for the Construction Lien Claims Process to proceed.

- 8.5 Furthermore, in order to comply with the operation of section 37 of the CLA with respect to the Determined Lien Claims, the Receiver proposes that a notional trial date be set as of the date of this motion. However, no trial will actually take place, as the proposed order will finally resolve all Determined Lien Claims.

Status of Lien Claims Not Yet Settled

- 8.6 At the time of this Report, there remained 2 Construction Lien Claims yet to be settled. The Construction Lien Claim of Ross Windows has not been resolved because, as has been described in detail in the Receiver's Twelfth Report, the Receiver has issued a Statement of Claim in respect of deficiencies relating to the work that is the subject matter of its Construction Lien Claim. The Construction Lien Claim of Rock Solid Granite Tops is the subject matter of funds that have been paid into Court, and is not a settlement that will be funded by WestLB. It remains under discussion among the Receiver, WestLB, and Rock Solid Granite Tops.

9.0 Conclusions and Recommendations

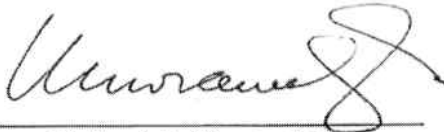
9.1 For the reasons outlined herein, the Receiver respectfully recommends that this Honourable Court grant the Order as requested herein:

- (a) approving the Notices of Determination and the amounts set out therein issued by the Receiver;
- (b) determining the priority of the Determined Lien Claims as set out in this Report;
- (c) setting a date for trial to enforce the Construction Lien Claims, for purposes of complying with section 37 of the CLA; and
- (d) approving the activities of the Receiver as described in this Report.

* * *

All of which is respectfully submitted, this 1st day of December, 2010.

**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
Managing Director