Court File No. CV10-9023-00CL
Estate File Nos. 31-456611, 31-456614, 31-456616, 31-456617

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE BANKRUPTCY OF
DB MEDIA DISTRIBUTION INC., DB MEDIA DISTRIBUTION (CANADA), CH LLC (CANADA) AND CH SUB LLC (CANADA)

THIRD REPORT OF THE TRUSTEE IN BANKRUPTCY
ALVAREZ & MARSAL CANADA INC.
October 16, 2012

INTRODUCTION

1. On December 9, 2010, DB Media Distribution Inc. ("**DB Media**"), DB Media Distribution (Canada) ("**DB Media Canada**"), CH LLC (Canada) ("**CH**") and CH Sub LLC (Canada) ("**CH SUB**") (collectively, "**DB Media Distribution**" or the "**Companies**") filed assignments in bankruptcy. Alvarez & Marsal Canada Inc. ("**A&M Canada**") was appointed as trustee in bankruptcy (the "**Trustee**") of each of DB Media, DB Media Canada, CH and CH SUB pursuant to certificates of appointment issued by the Office of the Superintendent of Bankruptcy Canada on December 9, 2010.

2. On December 10, 2010, this Honourable Court granted orders authorizing the Trustee to administer the bankrupt estates of DB Media, DB Media Canada, CH and CH SUB on a consolidated basis for the purpose of carrying out its administrative duties and responsibilities as Trustee under the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, as amended (the "**BIA**") (the "**Procedural Consolidation Orders**"). The Procedural Consolidation Orders allowed the Trustee to reduce the cost of administration of the bankrupt entities by avoiding performing separate actions such as:

   i. Convening and conducting meetings of creditors and inspectors;
   ii. Making, filing, advertising and distributing all filings and notices required under the BIA; and
   iii. Appointing separate groups of inspectors.

The Procedural Consolidation Orders are attached hereto as **Exhibit "A"**.

3. In addition to the Procedural Consolidation Orders, this Honourable Court granted two other separate Orders on December 10, 2010 (collectively, the "**December 10th Orders**"):

   i. Relieving the Trustee of any obligation to send notice of the bankruptcy and of the first meeting of creditors to such creditors of the Companies whose claims in the aggregate do not exceed $100;

   ii. Relieving the Trustee of its obligation to include a full list of creditors in the notice of the bankruptcy and of the first meeting of creditors and authorizing the Trustee to instead make a one-line entry for the customers and employees and to direct creditors to a website established by the Trustee (www.alvarezandmarsal.com/DBMD) (website was subsequently moved to www.amcanadadocs.com/DBMD) which contains a complete list of creditors;

   iii. Directing the Trustee to post a complete list of creditors of the Companies, including customer names, to a dedicated webpage on the website set up by the Trustee;

   iv. Directing the Trustee to redirect the Companies' book and DVD club websites to a website hosted by the Trustee, which provides notice of the bankruptcies of the Companies and contains the statutory notice of the bankruptcies and documents for filing proofs of claim; and

   v. Directing the Trustee to conduct a spot audit of the inventory of the Companies for the purpose of complying with s. 16(3) of the BIA.

   Copies of the December 10th Orders are attached hereto as **Exhibit "B"**.

4. The first report of the Trustee dated December 9, 2010 (the "**First Report**") was filed in support of the Trustee's motion for the Procedural Consolidation Orders and the December 10th Orders. A copy of the First Report is attached hereto as **Exhibit "C"**.

5. The second report of the Trustee dated December 23, 2010 (the "**Second Report**") was prepared for and presented at the First Meeting of Creditors held on December 23, 2010. A copy of the Second Report is attached hereto as **Exhibit "D"**.

PURPOSE OF THIS THIRD REPORT

6. This third report of the Trustee in these proceedings (the "**Third Report**") has been filed to provide an update to this Honourable Court with respect to:
   i. The Trustee's activities in DB Media Distribution's bankruptcy proceedings since the date of bankruptcy;
   ii. The Trustee's receipts and disbursements from the date of bankruptcy; and to provide this Honourable Court with additional information to support the Trustee's motion for orders regarding the following:
      (a) Approving a proposed settlement agreement between the Trustee and Direct Brands, Inc. ("**DBI**") regarding potential transfers at undervalue and other matters (the "**Direct Brands Settlement**");
      (b) Approving the Trustee's final statement of receipts and disbursements and the allocation of certain receipts and disbursements between DB Media and DB Media Canada;
      (c) Approving the proof of claim process and dividend sheet;
      (d) Authorizing and directing the Trustee to distribute $1,501,876.82 to DB Media's creditors and $1,176,791.41 (inclusive of the distribution from DB Media on account of the intracompany balance owing at the date of bankruptcy) to DB Media Canada's creditors;
      (e) Declaring that all steps taken by and activities of the Trustee and all amounts distributed by the Trustee are hereby approved, and the A&M Canada shall have no further liability in respect thereof;
      (f) Approving the activities of the Trustee from the date of bankruptcy to the date of this Third Report;
      (g) Approving the fees and disbursements of the Trustee and its legal counsel, Osler, Hoskin & Harcourt LLP ("**Osler**") from the date of bankruptcy to the date of the Trustee's discharge, as set out in the affidavits of Douglas R. McIntosh sworn October 11, 2012 (the "**McIntosh Affidavit**") and Marc S. Wasserman sworn October 16, 2012 (the "**Wasserman Affidavit**") and authorizing the Trustee to pay its outstanding fees and disbursements and those of its counsel (the "**Final Fees**"); and
      (h) Providing other relief related and ancillary to the foregoing.

DISCLAIMER

7. In preparing this Third Report, the Trustee has relied upon the Companies' books and records, unaudited financial information and statements prepared by the Companies, as well as information supplied by former management of DB Media Distribution and its parent company, DBI, former employees and advisors to the Companies (collectively, the "**Information**"). The Trustee has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information provided to it, and, accordingly the Trustee expresses no opinion or other form of assurance on the Information contained in this Third Report. Specifically, the Trustee's procedures and enquiries are not intended to, did not and do not constitute an audit or review engagement in any form. A&M Canada assumes no responsibility or liability for loss or damage occasioned by any person or party as a result of the circulation, publication, re-production or use of this Third Report. Any use which any person or party, other than this Court, makes of this Third Report or any reliance upon or decision made based upon it is the sole responsibility of such person or party.

8. All references to monetary amounts in this Third Report are in Canadian dollars unless otherwise noted.

BACKGROUND

9. DB Media Canada is a general partnership registered under the laws of the Province of Ontario with general partners CH and CH SUB, being two limited liability companies formed under the laws of the State of Delaware, U.S.A.

10. DB Media is a corporation organized under the laws of the Province of Ontario and is a sister corporation of CH.

11. DB Media was a direct-to-consumer distributor of books and DB Media Canada was a direct-to-consumer distributor of DVDs in Canada through their various specialty clubs. Prior to the date of bankruptcy, DB Media Canada also sold music compact discs, cassettes and albums to club members, but discontinued this line of business in 2008.

12. DB Media Canada and DB Media and their predecessors had been in business in Canada selling entertainment products for over fifty-five years, and books for over seventy years, respectively. At the date of bankruptcy, DB Media and DB Media Canada had active member bases of

approximately 229,000 and 147,000 for the book and DVD clubs, respectively. The Companies operated from a warehouse and office premises located at 5900 Finch Avenue East, Scarborough, Ontario which was leased by DB Media Canada. DB Media Canada subleased part of the premises to two third-party entities.

13. Customers who were members of these specialty clubs were able to purchase books and DVDs by mail, telephone or on-line. Customers were also able to return books and DVDs to the Companies for credit notes. Credits were applied to the customers' accounts to be used against future purchases. At the date of bankruptcy of the Companies, over 72,000 members held unexpired credits ranging in the amounts from less than $1 to $2,500.

14. At the date of bankruptcy, DB Media employed approximately 100 full-time, non-unionized hourly warehouse and salaried office staff. The staff performed duties for both DB Media and DB Media Canada and the costs were allocated between the two entities through an intracompany account.

15. DB Media Distribution did not have any secured debt at the date of bankruptcy.

16. Summarized financial information for the Companies prior to the bankruptcy was provided in the Second Report.

TRUSTEE'S ACTIVITIES TO DATE

17. The main activities of the Trustee for the period December 9, 2010 to September 15, 2012 can be summarized in the following categories:
    i. Taking possession of the assets and initial activities;
    ii. Administration of the wind-down of the estates;
    iii. Liquidation of the assets of the estates;
    iv. Vacating the leased premises;
    v. Review of potential preferences and potential transfers at undervalue;
    vi. Administering the proof of claims process; and
    vii. Reporting and communications.

i. Taking Possession of the Assets and Initial Activities

18. The Trustee undertook the following primary activities:

- Attended at DB Media Distribution's office at 5900 Finch Avenue East in Scarborough, ON on December 9, 2010 (the "**Date of Bankruptcy**"); attended an initial meeting with the former general manager, controller and operations manager regarding the bankruptcy assignment; advised the former employees of the bankruptcy assignments and discontinuation of the Companies' operations;
- Secured the leased premises and assets; obtained back-up of electronic records;
- Mailed the notice of bankruptcy and first meeting of creditors to known creditors, Canada Revenue Agency and other governmental agencies; coordinated the publication of a notice regarding same in *The Globe & Mail* (National Edition);
- Developed and maintained a website for creditors to access information about the bankruptcy proceedings as well as the proof of claim form and instructions regarding same;
- Prepared and posted a complete list of creditors of the bankrupt estates based on the Companies' books and records, including former customers with credit balances, on the Trustee's website;
- Redirected the Companies' book and DVD club websites to the Trustee's website;
- Developed a wind-down plan with DB Media Distribution's former senior management team and identified key resources;
- Developed a cash flow forecast and determined liquidity requirements for the wind-down period;
- Developed a media strategy and responded to press enquiries;
- Arranged for bank accounts to be opened in the name of the Trustee;
- Obtained insurance coverage from its broker for the period the Trustee was occupying the leased premises;
- Retained Osler as legal counsel to the Trustee;
- Performed a spot audit of inventory pursuant to the inventory Order; and
- Performed various other activities necessary to preserve the assets of the bankrupt estates.

ii. Administration of the Wind-down of the Estates

19. The Trustee performed the following primary activities:

- Oversaw the continued operation of DB Media Distribution's customer call centre (with a reduced level of staff) as a vehicle to inform customers of the bankruptcy and to collect outstanding accounts receivable;
- Managed a wind-down team of former employees; coordinated the preparation and payment of payroll for same;
- Processed records of employment and WEPP information for over 100 employees;
- Had various discussions with and prepared correspondence to DB Media's former employees regarding the status of completion of the 2010 T4s, the WEPP program, and other employment and/or estate issues;
- Oversaw the preparation and issuance of the 2010 and 2011 T4s for DB Media's former employees, including the preparation of a schedule of source information required by DB Media's and DB Media Canada's actuaries for the calculation of the pension adjustment for the T4s;
- Had various discussions with Desjardins Financial Security ("**Desjardins**") regarding DB Media's benefits plans, post-employment benefits for the retirees and the unrestricted deposit account held at Desjardins;
- Prepared for and attended at the first meeting of creditors on December 23, 2010;
- Prepared correspondence and had discussions with pre- and post-bankruptcy creditors of DB Media Distribution regarding the filing of proofs of claims and/or payments on account, the closing of DB Media Distribution's accounts related to same, and the status of the bankruptcy proceedings;
- Prepared and maintained a schedule of receipts and disbursements for the estates; processed cheques for post-bankruptcy creditors;
- Reviewed mail received by DB Media Distribution;
- Prepared HST returns and provincial tax returns as required; followed up with Canada Revenue Agency regarding same;
- Oversaw the preparation of DB Media Distribution's financial statements as at the Date of Bankruptcy;
- Reviewed pre-bankruptcy tax returns; prepared tax returns for the stub period to December 31, 2010 as required for the four entities, including an incorporated entity and partnership;

- Oversaw the preparation of pre-bankruptcy NR4 and T5 forms; and
- Prepared government filings for WSIB, EHT and QST as required.

iii. Liquidation of the Assets of the Estates

20. The Trustee performed the following primary activities:

- Oversaw the collection of outstanding accounts receivable from customers, including processing of payments from customers by cheque, bank transfer and credit card; held numerous discussions with individual customers regarding their outstanding accounts; engaged a collection agency to assist with collections;
- Recovered funds held in foreign exchange accounts with MF Global Canada Co. and a deposit account with Desjardins;
- Arranged for the transfer of funds in the Companies' bank accounts at the Date of Bankruptcy to the Trustee's bank accounts; had numerous discussions with the Companies' bank regarding the administration of the post-bankruptcy collection of customer payments made by direct deposit into the Companies' pre-bankruptcy bank accounts and issues related to potential customer charge backs; negotiated arrangements for the transfer of same to the Trustee's bank accounts;
- Arranged for the collection and transfer of credit card payments made by customers after the bankruptcy to the Companies' the third party processing agency, Chase Paymentech, to the Trustee's bank accounts;
- Negotiated with the landlord of the leased premises for the transfer of DB Media Distribution's on-site fixed assets in lieu of January's lease payment;
- Determined (with counsel) the extent of book and DVD inventory that were not subject to license agreements, and that, accordingly, could be realized on by the Trustee; met with potential purchasers for the sale of non-licensed inventory; negotiated a number of separate purchase and sale agreements;
- Negotiated a settlement with the Ontario Ministry of Finance regarding a provincial sales tax recovery claim;
- Negotiated the sale of information technology related assets to a third party;
- Negotiated the sale and disposal of miscellaneous assets for scrap value; and
- Realized on remaining assets, including additional receipts from miscellaneous asset sales, proceeds from the pre-bankruptcy rental of DB Media Distribution's customer lists, and various deposits.

iv. Vacating the Leased Premises

21. The Trustee performed the following primary activities:

- Oversaw the necessary destruction of DVDs and books held in inventory that the Trustee's counsel determined were subject to restrictive license agreements and could not be sold; negotiated the reimbursement of Trustee fees and payroll costs related to the inventory destruction from DBI;
- Oversaw records retention, including various discussions with Iron Mountain regarding the destruction of information technology storage media and records held as at the Date of Bankruptcy;
- Had various discussions and correspondence with Canada Post regarding the re-direction of DB Media Distribution's mail and related issues regarding mail delivery;
- Oversaw the return of third party owned assets to Canada Post and Quebecor;
- Finalized the issues related to vacating the premises, including termination of the Trustee's insurance coverage, transition of security, maintenance, office cleaning and waste removal accounts to the property manager and other issues;
- Oversaw clean-up of warehouse and the orderly transition of the leased premises to the property manager. and
- Oversaw the disposal of customer records on a confidential basis.

v. Review of Potential Preferences and Potential Transfers at Undervalue

22. As part of its administration, the Trustee reviewed the Companies' transactions prior to the Date of Bankruptcy for potential preferences and transfers at undervalue pursuant to s. 95 and 96 of the BIA.

23. Based on its review, the Trustee did not find any evidence of a preference being given in favour of one creditor over another creditor for either arm's length or non-arm's length creditors. Further information on the Trustee's review of potential transfers at undervalue is provided later in this report.

vi. Administering the Proof of Claim Process

24. The Trustee performed the following key activities:

- Mailed the notice of bankruptcy and first meeting of creditors to over 2,800 creditors;
- Reviewed proofs of claim received and prepared a schedule for same;

- Held various discussions with DB Media's former employees regarding their proofs of claim and the calculation of their severance and termination entitlements; discussions with the Ontario Ministry of Labour regarding same;
- Prepared correspondence to and had discussions with certain DB Media retirees regarding post-employment health, dental and insurance benefits and proofs of claim for same;
- Held ongoing discussions with PricewaterhouseCoopers ("**PwC**"), the administrator appointed by the Financial Services Commission of Ontario ("**FSCO**") concerning DB Media Distribution's defined benefit pension plans, including information requirements, the status of their claims, and potential dividends from the Companies;
- Held various discussions with the Canadian Musical Reproduction Rights Agency ("**CMRRA**") regarding CMRRA's claim and supporting documentation for same;
- Held numerous discussions with creditors regarding the status of their claims;
- Reviewed proofs of claim with the inspectors; and
- Considered whether substantive consolidation of the four estates was applicable in the circumstances.

vii. Reporting and Communications

25. The Trustee performed the following primary activities:

- Prepared the First Report in support of the Procedural Consolidation Orders and December 10th Orders;
- Prepared the Second Report summarizing the Trustee's preliminary administration; presented same to creditors at the First Meeting of Creditors on December 23, 2010;
- Prepared for and conducted five meetings of DB Media Distribution's inspectors, and conducted numerous calls and meetings with Mr. Lewis Lau, as an independent Inspector concerning potential transfers at undervalue;
- Numerous discussions with DBI and its counsel regarding estate issues;
- Established communications with creditors and other interested parties through a special website at www.alvarezandmarsal.com/DBMD (later changed to www.amcanadadocs.com/DBMD) and through individual responses to telephone and email inquiries. Copies of the Trustee's Reports, Orders made by this Honourable Court and other relevant documents in the DB Media Distribution proceedings are posted on the Trustee's website;

- Had various discussions with the Office of the Superintendent of Bankruptcy regarding estate issues; and
- Prepared correspondence to government agencies including Statistics Canada and Service Canada regarding their information requests.

SIGNIFICANT ESTATE ISSUES

26. The Trustee encountered numerous extraordinary issues and complexities throughout the course of the bankruptcy proceedings. These matters added significant time and requirements to the proceedings, as described below.

State of Books and Records of the Estates

27. The Companies' accounting and other records as well as their information technology systems were poorly maintained and incomplete. This was a significant impediment to the administration of many aspects of the estate, and ultimately resulted in material additional time and costs being incurred.

28. Available financial and accounting records were unreliable:
    i. Financial statement information was inconsistent (particularly accounts receivable and inventory balances and related reserves) and had not been properly maintained;
    ii. Financial information from prior years had not been retained or was not readily accessible;
    iii. Bank reconciliations had not been completed;
    iv. Detailed records supporting intracompany and intercompany transactions had not been maintained; operational records did not match accounting records (i.e. inventory);
    v. Supporting documentation for certain asset balances was either not available or inaccurate (e.g. MF Global Canada Co. account balances, Desjardins deposit account, outstanding rent payments from subtenants, etc.); and
    vi. Certain royalties payable had not been reconciled and paid.

29. As a result of the Companies' inadequate information technology systems, the Trustee experienced increased costs with obtaining information and winding down the systems:
    i. The IT equipment was old and the infrastructure was not streamlined;
    ii. The Companies' financial records and customer files were stored on several servers and the volume of information was significant; in order for the Trustee to continue collecting

accounts receivable and to be able to access certain financial information to carry out its statutory duties after vacating the premises, the financial records and customer account information had to be transferred onto equipment that could be used independently of the Companies' existing IT infrastructure; developing a solution to this issue was time consuming and required the services of an IT consultant;

iii. There was a large volume of used computer hardware that had been mothballed but not decommissioned properly (i.e. scrubbed of confidential information) that the Trustee had to address; and

iv. The Companies' information technology systems were partially integrated with the subtenant's systems, requiring the development of a plan to wind-down the Companies' systems without disrupting the on-going operations of the subtenants.

30. Further, individual customer account information had not been kept current, making it very difficult to manage collection of outstanding receivables, primarily given that there were over 35,000 outstanding customer accounts to deal with. Records were also not maintained regarding the status of thousands of individual accounts previously turned over to collection agencies.

31. Payroll records were incomplete and inaccurate and certain information needed to issue T4 slips had not been prepared.

32. Corporate records had not been properly managed. The Companies retained accounting, human resources, operations and other records in their warehouse dating from the mid-1990's to the Date of Bankruptcy. The records, primarily stored in filing cabinets and bankers' boxes, had not been indexed. As a result, and given the gaps in readily available financial information, the Trustee was required to review the contents of approximately 2,000 boxes of records, ultimately disposing of over 1,000 and cataloguing 940 boxes that needed to be retained. In addition, the Trustee reviewed several skid loads of electronic storage devices which were ultimately disposed of based on the confidential customer information stored within.

33. Post-employment benefits and entitlements data was not maintained, which made it more difficult to properly adjudicate proofs of claims submitted by the Companies' retirees.

Nature of the Companies' Accounts Receivable

34. As indicated, due to the nature of the book club and DVD club businesses, the Companies had an extraordinarily high number of individual customer accounts receivable balances (approximately 35,000), but with a very low average value (approximately $30.00). Along with the deficiencies with the Companies' books and records, this made the cost of oversight and administration of collections exceedingly high. It was essential that a call centre be maintained in order to respond to hundreds of customer inquiries that were received, in order to facilitate payment. Given the high cost associated with collections, the ongoing cost/benefit of maintaining the call centre was frequently reviewed by the Trustee in consultation with the Inspectors in order to ensure that the call centre was not maintained beyond an optimal point.

Large Number of Inventory Units and Restrictions on Sale

35. As at the Date of Bankruptcy, DB Media Canada had approximately 448,000 DVDs in inventory. Further, an additional 15,000 pieces of other inventory units owned by the Companies were also located at the Finch Avenue East premises. The inventory needed to be identified, sorted and disposed of, including the destruction of approximately 460,000 DVDs and books that the Trustee was unable to realize upon due to strict licensing restrictions.

36. The Trustee's counsel reviewed the Head Licence Agreements between various recording studios or publishers and DBI and determined that on the basis of restrictions contained in their agreements that it could not recommend to the Trustee or the Inspectors that the Trustee attempt to sell related DVD and book inventory. Further, DBI required such inventory to be destroyed in order to comply with its obligations; however, the Trustee did not consider it appropriate for the cost of destruction to be borne by the estates. Accordingly, the Inspectors instructed the Trustee to enter into an agreement with DBI whereby:

    i. DBI would be responsible for the fees, expenses and costs associated with the destruction and removal of the licenced inventory;

    ii. DBI would agree to reduce their intercompany claims (being Bookspan's claim in the DB Media estate and DBI's claim in the DB Media Canada estate) in an amount equivalent to the book value of the licensed inventory; and

    iii. The Trustee would not purse the distribution and sale of the licenced inventory.

37. DBI reimbursed the estates approximately $27,000 and $25,000 for payroll costs and Trustee fees, respectively, related to the DVD and book destruction. DBI and Bookspan reduced their

intercompany claims by $884,443 and $27,876 for DB Media Canada and DB Media, respectively, to reflect the book value of the licenced inventory that was destroyed.

Investigation of Pre-bankruptcy Matters

38. At the first meeting of creditors held on December 23, 2010, several allegations were made by creditors concerning the conduct of the Companies' pre-bankruptcy, including that:
    i. Cash was transferred from DB Media Distribution to its parent company in 2008 in excess of the intercompany balances owing for book and DVD inventory;
    ii. Approximately 550,000 units of DVD inventory were destroyed during the week immediately prior to the Date of Bankruptcy;
    iii. There was a change in the transfer pricing between Bookspan and DB Media, resulting in Bookspan overcharging DB Media for book inventory in 2009 and 2010;
    iv. Several skids of computer hardware and related items were disposed of on December 8, 2010 (the day prior to the Date of Bankruptcy);
    v. The Companies sent $2.5 million to the parent company of DBI in January 2010 which was not related to any intercompany balances owing; and
    vi. Customer returns of books and DVDs were not processed during the period October 2009 to January 2010.

39. The Trustee conducted a thorough investigation of each of the matters raised. While a number of these concerns ultimately proved to be unsubstantiated, the Trustee pursued two of the matters further based on the evidence available: (i) the destruction of certain DVD inventory immediately prior to the Date of Bankruptcy; and (ii) certain non-arm's length transactions as potential transfers at undervalue.

i. Pre-bankruptcy Destruction of DB Media Canada Inventory

40. As requested by the creditors of the estates at the First Meeting of Creditors, the Trustee conducted an investigation of an allegation that DVD inventory had been destroyed immediately prior to the Date of Bankruptcy.

41. Based on discussions with former management and a review of DB Media Distribution's records, the Trustee determined that 553,330 units of DVD inventory with a book value of approximately $634,000 had been destroyed during the week prior to the Date of Bankruptcy with no notification to the Trustee.

42. In explaining this action, former management of the Companies and management of DBI indicated that:

    i. In the normal course of business, certain DVD titles would be disposed of, provided that DB Media Canada, among other things: (i) no longer had the rights to sell the titles; (ii) held excess stock based on the current level of sales; and/or (iii) determined the titles were no longer selling due to the length of time since their release date (collectively, the "**Obsolete DVD Inventory**");
    ii. Obsolete DVD Inventory had to be destroyed as there was no right of return of the inventory to the recording studios or publishers and restrictions in the licence agreements (the "**Head Licences**") between various publishers or recording studios and DBI prohibited sales to third parties; and
    iii. Former employees had been compiling the list of Obsolete DVD Inventory for several months prior to the date it was destroyed; that is, the destruction of the Obsolete DVD Inventory had been planned over time and for some time, consistent with past practices.

43. While it may indeed have been an event undertaken on past occasions by the Companies in the ordinary course, the destruction of the Obsolete DVD Inventory took place immediately before the Date of Bankruptcy and involved approximately 42% of total dollar value of DVD inventory on hand at the time. While the Trustee's counsel ultimately ascertained that the Trustee had no ability to realize on the DVD inventory (including the obsolete DVD inventory) in any event due to strict licensing restrictions, the Trustee's position had not been determined at the time that the inventory was destroyed.

ii. Investigation of Potential Transfers at Undervalue

44. As part of its administration of the Companies, the Trustee reviewed transactions entered into by the Companies.

45. Although plagued by inadequate accounting records, the Trustee conducted a thorough review of payment to creditors covering the 3 month period prior to the Date of Bankruptcy and the 12 month period prior to the Date of Bankruptcy for related parties. Based on its review, the Trustee did not find any preference payments.

46. However, the Trustee did identify (through a series of intercompany transactions) significant cash transfers from the Companies in July and August 2008 that were in excess of the recorded intercompany balances owed to related companies (the "**2008 Transfers**"). The 2008 Transfers took place immediately before the sale of the shares of the Companies' ultimate parent company, Direct Group North American Inc., ("**DGNA**," which later changed its name to DBI) to JMCK Corp. on August 11, 2008. The related parties who were the recipients of the 2008 Transfers remain in place and continue to be active operating entities carrying on business in the United States.

47. Based on the Companies' accounting records, the 2008 Transfers exceeded the intercompany amounts due at the time with the net result that approximately US$2.7 million was effectively transferred by DB Media to Bookspan and DGNA, and US$6.8 million was effectively transferred by DB Media Canada to DGNA, in excess of the respective intercompany accounts. At the time, DGNA and Bookspan were wholly owned subsidiaries of Bertelsmann, Inc.

48. DGNA transferred US$2.0 million back to DB Media Canada on August 11, 2008 in exchange for a promissory note, adding US$2.0 million in liabilities to DB Media Canada's balance sheet. Accordingly, the net cash transfers made by the Canadian entities were approximately US$2.7 million from DB Media and approximately US$4.8 million from DB Media Canada for a total of US$7.5 million.

49. The Trustee reviewed the 2008 Transfers as potential transfers at undervalue ("**TUVs**"). According to s. 96 of the BIA, a TUV is a disposition of property for which no consideration is received by the debtor or for which the consideration received is conspicuously less than the fair market value of the consideration given by the debtor. For parties not at arm's length, the look back period is five years prior to the date of bankruptcy if the debtor was insolvent at the time of the transfer or rendered insolvent by the transfer.

50. One of the two estate inspectors was an employee of the Companies' ultimate parent company (DBI), and, as such, was determined to have a conflict of interest with respect to this matter. Accordingly, the Trustee consulted with and sought instructions only from the second Inspector of the estate, Mr. Lewis Lau, the independent Inspector with respect to the TUV investigation (the "**Independent Inspector**").

51. The Trustee conducted numerous telephone calls and in-person meetings with the Independent Inspector during the course of the investigation to: (i) update the Independent Inspector as to the Trustee's findings and status of the process; and (ii) seek instructions from the Independent Inspector on an on-going basis.

52. With the concurrence of the Independent Inspector, the Trustee spent a significant amount of time investigating the TUVs and, in particular, the solvency issue, since the Trustee had concluded that the parties involved in the transaction were not at arm's length. Considerable dialogue took place during the investigation between the Trustee and representatives of DBI and its counsel in an attempt to address certain alleged deficiencies in the books and records of the Companies, and to provide an opportunity for DBI to respond to the findings of the Trustee. DBI retained a financial advisor to provide assistance with such matters. The issues were complex and considerable time was taken to ensure that all relevant information to the issue at hand was available for consideration.

53. After considering the Trustee's findings and DBI's submissions, the Independent Inspector, based on a number of considerations, instructed the Trustee to attempt to negotiate a settlement with DBI in order to avoid a costly and drawn out litigation process.

54. After protracted discussions over several months, the Companies' ultimate parent company, DBI, proposed a settlement of CAD$200,000 cash, the withdrawal of its claims against the Companies totaling approximately US$3.9 million and mutual releases in a form to be negotiated as an alternative solution to litigation. Further, DBI agreed to reimburse a further CAD$22,000 to the estate in respect of joint third party services that had been paid by DB Media Canada pre-bankruptcy. In aggregate, the value of the settlement of such matters with DBI to the estates (the "**Direct Brands Settlement**") was as follows:

Cash	$222,000
Claims withdrawn by DBI and its affiliates[1]	509,806
	$731,806

[1] Increased value of estate available to non-DBI creditors

55. Further, as set out in paragraph 36, DBI had previously agreed to reduce its outstanding claims against DB Media and DB Media Canada by the book value of the licensed inventory that had

been destroyed after the Date of Bankruptcy, being $27,876 and $884,443 for DB Media and DB Media Canada, respectively.

56. After careful consideration, the Independent Inspector instructed the Trustee to accept the Direct Brands Settlement.

57. With the concurrence of the Independent Inspector, the Trustee subsequently reviewed the settlement terms and TUV review process with representatives of PwC, who as administrator of both the DB Media and DB Media Canada defined benefit pension plans represent the largest third-party creditors in both estates. The administrator has informed the Trustee that they are satisfied with the TUV review process undertaken by the Trustee and Independent Inspector and are supportive of the proposed Direct Brands Settlement.

58. As a condition to the Direct Brands Settlement, DBI has indicated that they require a mutual release substantially in the form attached hereto as "**Exhibit "E**" (the "**Mutual Release**"). The key terms of the Mutual Release are as follows:
    i. The Trustee, on behalf of the Companies, releases DBI and all related or affiliated companies, including their respective directors, officers, servants, agents, employees, successors and assigns from any and all claims arising out of or in connection with their affiliation as a direct or indirect parent company and subsidiary ("**Claims**");
    ii. DBI, on its own behalf and on behalf of all related or affiliated companies, including their respective directors, officers, servants, agents, employees, successors and assigns (the "**DBI Releasors**") release the Trustee, the Companies and all related or affiliated companies, including their respective directors, officers, servants, agents, employees, successors and assigns from any and all Claims; and
    iii. The DBI Releasors agree to withdraw all proofs of claim filed against the Companies and agree not to file any further proofs of claim against any of the Companies.

59. The Trustee supports the view of the Independent Inspector that the Direct Brands Settlement is, on balance, in the best interest of the Companies' creditors and recommends that this Honourable Court approve the settlement. In addition, the Trustee is of the view that the Mutual Release is necessary to the successful implementation of the Direct Brands Settlement. Accordingly, the Trustee requests that this Honourable Court authorize and direct the Trustee to execute the Mutual Release with such minor amendments as the Trustee may deem necessary or appropriate.

TAXATION OF FEES

60. The fees and disbursements of the Trustee and its legal counsel are summarized in the following affidavits:

    i. The McIntosh Affidavit, which details fees and disbursements of the Trustee for the period December 9, 2010 to September 15, 2012 in the total amount of $960,450.95. A copy of the McIntosh Affidavit with Appendices is attached hereto as **Exhibit "F"**; and

    ii. The Wasserman Affidavit, which details the fees and disbursements of the Trustee's legal counsel for the period December 9, 2010 to September 15, 2012 in the total amount of $188,441.84. A copy of the Wasserman Affidavit with Appendices is attached hereto as **Exhibit "G".**

61. An interim draw for the Trustee and its legal counsel's fees for the period December 9, 2010 to January 31, 2011 was approved by the Inspectors at the Third Meeting of Inspectors on February 16, 2011. The Trustee and its legal counsel's fees and out-of-pocket disbursements (excluding HST) for this period were $619,507.00 and $90,054.55, respectively. The fees were paid on February 28, 2011. As indicated previously, DBI reimbursed the estates for the professional fees of $25,000 incurred by the Trustee and its counsel relating to the destruction of the licensed inventory (which were included in the above amounts).

62. Accrued professional fees and out-of-pocket disbursements for the period February 1, 2011 to September 15, 2012 are $340,943.95 and $98,387.29 for the Trustee and for Osler, respectively.

63. The vast majority of the fees of the Trustee and its legal counsel were incurred during the four month period after the Date of the Bankruptcy, primarily while the Trustee remained in possession of, and needed to conduct asset realizations out of, the Companies' premises and wind down operations.

64. This is the only fee approval application in these proceedings.

65. As described above, the Trustee encountered numerous, extraordinary issues and complications throughout the course of the bankruptcy proceedings. These matters significantly increased the complexity of the proceedings resulting in increased costs of the bankruptcy, including professional costs. The Trustee and the Inspectors were aware of the challenges and corresponding cost issues related to the estate and, accordingly, the Trustee kept the Inspectors informed as to the ongoing costs of the estates. As a result of the Trustee not being able to realize

on the Companies' inventory due to strict licensing restrictions, the Trustee and the Inspectors recognized that generating a positive return to the estates was going to be challenging, particularly in view of:

a) the significant costs associated with winding down and vacating the Company's premises wherein it was essential that:
   i. from a logistical perspective, the IT system and call centre had to continue to be maintained for a period of time onsite in order to provide a reasonable opportunity to collect accounts receivable owed by the Companies' customer base of over 35,000 accounts;
   ii. an enormous number of records had to be reviewed, catalogued and either shipped out or destroyed;
   iii. a large number of returns from Canada Post had to be reviewed and processed through individual customer accounts and a significant amount of inventory had to be destroyed;
   iv. numerous assets marked to be identified and ownership confirmed as between the estates; and
   v. sufficient time was required to conduct investigations relating to the numerous allegations against the Companies that were made at the First Meeting of Creditors.

b) The costs associated with investigating the numerous allegations made in connection with the conduct of the Companies, including the investigation of potential TUVs. The Trustee worked closely with, and sought ongoing instructions from, the Independent Inspector with respect to the latter matter in particular, which was hindered by poor financial records.

66. As indicated, the Inspectors were kept informed of the ongoing costs of the estates and were diligent in providing the Trustee with instructions concerning numerous matters where the cost/benefit of pursuing a certain course of action was a key consideration.

67. The Trustee has reviewed the detailed accounts and is of the view that the fees and disbursements of the Trustee and its legal counsel are reasonable and appropriate in the circumstances of this matter, recognizing that the costs of administering the estates has been significant.

68. At the Fifth Meeting of Inspectors, held on September 17, 2012, the Inspectors approved the Final Statement of Receipts and Disbursements. The Inspectors also approved the fees and disbursements of the Trustee and of its counsel.

69. Given the difficult nature of this bankruptcy proceeding, the complexity of the issues addressed by the Trustee and its counsel, the numerous stakeholder issues and other related challenges, the Trustee submits that the hours and rates of the professionals were both necessary and consistent with remuneration of other insolvency professionals in the city of Toronto in respect of such matters.

70. Assuming no unforeseen expenses, the Trustee estimates that there are approximately $13,500 (excluding HST) in total disbursements to conclude the bankrupt estates, including the fees and disbursements of Osler (approximately $12,000) from the date of this Third Report to the date of discharge, bank charges and other miscellaneous other costs ("**Final Fees and Disbursements**"). Assuming the administration of the estates is finalized in the ordinary course, and in recognition of the costs incurred to date, and with the concurrence of the Inspectors, the Trustee will not be charging the estates for any fees incurred after September 15, 2012 to discharge.

71. The Trustee therefore seeks an order of this Court approving the fees and disbursements of the Trustee and Osler and the Final Fees and Disbursements.

FINAL STATEMENT OF RECEIPTS AND DISBURSEMENTS

72. A copy of the Trustee's Final Statement of Receipts and Disbursements for the period December 9, 2010 to September 15, 2012 is attached hereto as **Exhibit "H"**, showing funds available for distribution by the Trustee, including amounts in respect of the proposed settlement with DBI concerning the TUV issue, subject to this Honourable Court's approval, and the settlement with the Ontario Ministry of Finance regarding the retail sales tax issue, of $1,502,785.92 for DB Media and $308,108.22 for DB Media Canada.

73. Both DB Media and DB Media Canada operated out of the same premises and shared certain costs and realization-related issues, including the procedural consolidation of the estates. As a result, a cost allocation arrangement was needed in connection with certain shared expenditures, including, among others, payroll costs for the former employees who assisted the Trustee with the wind-down of the estates, insurance costs, security costs, and professional fees. At the first meeting of Inspectors held on December 23, 2010, the Inspectors approved an interim cost

allocation of 72% to DB Media and 28% to DB Media Canada, based on a preliminary assessment of relative gross realizable proceeds. The Trustee indicated that on conclusion of the administration of the estates, the Trustee would provide a final cost allocation formula to the Inspectors for their consideration.

74. At the Fifth Meeting of Inspectors held on September 17, 2012, the Inspectors approved a final cost allocation regime as follows:

    i. 76% to DB Media and 24% to DB Media Canada for shared general and administrative costs; costs specific to each estate were allocated 100%;
    ii. 60% to DB Media and 40% to DB Canada for the fees of the Trustee and its counsel, and for salaries and wages for the operating wind-down employee team for the period December 9, 2010 to January 31, 2011; and
    iii. 50% to DB Media and 50% to DB Canada for the fees of the Trustee and its counsel for the period February 1, 2011 to September 15, 2012.

75. The Final Cost Allocation (collectively, the "**Final Cost Allocation**") took into consideration the value of the accounts receivable recoveries and the Trustee's assessment of the professional time spent by the Trustee and Osler on specific estate issues.

76. Gross estate proceeds, before and after including the cash proceeds from the proposed DBI settlement, are as follows:

	DB Media	**DB Media Canada**	**Total**
A/R collections	$1,142,698	$360,234	$1,502,932
Other asset realizations	952,781	560,460	1,513,241
Input tax credit refunds	94,684	14,040	108,724
Subtotal	**$2,190,163**	**$934,734**	**$3,124,897**
DBI Settlement (net)	216,805	5,195	222,000
Total	**$2,406,968**	**$939,929**	**$3,346,897**

77. Based on the Final Cost Allocation, the Trustee incurred disbursements, prior to and including accrued and projected professional fees and expenses, as follows:

	DB Media	DB Media Canada	Total
Trustee and legal fees	$426,367	$284,245	$710,612
Payroll and consulting	133,447	88,965	222,412
Other disbursements (1)	123,952	38,195	162,148
Subtotal	**$683,766**	**$411,405**	**$1,095,172**
Accrued and projected Trustee and legal fees	220,416	220,416	440,832
Total	**$904,182**	**$631,821**	**$1,536,004**

(1) Consists of expenses related to the wind-down of the estates including Canada Post, insurance, utilities, maintenance and administrative fees.

78. Accordingly, provided the proposed Direct Brands Settlement is approved, and subject to receiving Ontario PST settlement proceeds of $108,852, the Trustee expecting to have approximately $1,502,786 and $308,108 in net funds available for distribution for DB Media and DB Media Canada, respectively.

PROOF OF CLAIMS PROCESS

79. Pursuant to the Order granted on December 10, 2010, the Trustee sent notice of the DB Media Distribution bankruptcy and first meeting of creditors to all known creditors of the Companies who were owed $100 or more, which amounted to approximately 2,850 creditors.

80. In addition, the Trustee established a website for DB Media Distribution's creditors at www.alvarezandmarsal.com/DBMD (the website was subsequently moved to www.amcanadadocs.com/DBMD) which contains a complete list of creditors, a proof of claim form, instructions for completing the proof of claim form as well as other information related to the bankruptcy proceedings.

81. The following provides a summary of the proofs of claim received:

(i) Secured Claims

82. The Trustee has not received any secured claims and is not aware of any secured creditors.

(ii) Claims to Property in Possession of the Bankrupt

83. Prior to vacating the leased premises in January 2011, Canada Post and Quebecor submitted Reclamation of Property claims pursuant to s. 81(4) of the BIA for storage containers in possession of the Companies at the date of bankruptcy. The Trustee and its counsel reviewed the Reclamation of Property claims and determined that they were valid. Upon approval of the Inspectors, the storage containers were returned to Canada Post and Quebecor.

(iii) Claims from DBI

84. Bookspan submitted a proof of claim in DB Media and DBI submitted a proof of claim in DB Media Canada, with the two claims totaling approximately $3.9 million. As indicated, these claims were subsequently withdrawn by DBI as part of the proposed Direct Brands Settlement.

(iv) Direct Brands Settlement

85. As indicated, the Independent Inspector instructed the Trustee to attempt to negotiate a settlement with DBI with respect to potential TUVs. The settlement terms included:
    i. the withdrawal of Bookspan's claim against DB Media and DBI's claim against DB Media Canada of CAD $1,315,772 and CAD $2,661,676, respectively, both claims net of the value of licensed inventory that was destroyed after the Date of Bankruptcy;
    ii. $200,000 cash; and
    iii. reimbursement of $22,000 from DBI in respect of professional fees paid to its counsel that related to services provided to DBI after the Date of Bankruptcy.

86. Based on the Final Statement of Receipts and Disbursements, the value provided to the other creditors of DB Media and DB Media Canada estates by the withdrawal of Bookspan / DBI's claims was approximately $138,098 and $371,708, respectively. The Trustee and the Independent Inspector have considered how the value of the settlement with DBI should be allocated as between the estates, given the circumstances of each potential case. The Trustee has recommended, and the Independent Inspector has approved, an allocation of 50/50 between the two estates. In order to equalize the value received by each estate, the entire $200,000 cash consideration has been allocated to DB Media and the Trustee would transfer $16,805 from DB Media Canada to DB Media.

(v) Intracompany Claim

87. The Trustee was advised that prior to the Date of Bankruptcy, DB Media and DB Media Canada each paid operational and administrative costs that were subsequently reallocated on a monthly basis through an intracompany account between the two entities. At the Date of Bankruptcy, the Companies' books and records showed an outstanding balance owed by DB Media to DB Media Canada of approximately $6.3 million. Based on the Trustee's review of the intracompany account, discussions with former management of the Companies and approval of the Inspectors, the Trustee has admitted the claim.

(vi) Claims from Unsecured Creditors

88. The Trustee has received proof of claims from various unsecured creditors in the DB Media and DB Media Canada estates, including former employees and PwC in its capacity as the pension plan administrator of the two defined benefit retirement plans.

89. As of the date of this report, a summary of the claims approved by the Inspectors and admitted by the Trustee is as follows:

Claim Filed by	**DB Media**		**DB Media Canada**	
	# of Claims	**$ Value**	**# of Claims**	**$ Value**
Trade creditors/customers	46	$819,065	32	$1,801,625
Pension Plan Administrator	1	1,832,028	1	2,618,338
Former employees	94	1,379,862	-	-
DB Media retirees	35	594,403	-	-
Intracompany claim	1	6,330,883	-	-
Totals	**177**	**$10,956,241**	**33**	**$4,419,963**

90. The Ontario Ministry of Labour (the "**MOL**") reviewed the severance and termination benefit entitlements for DB Media Distribution's former employees. Except in the case of two former employees who were terminated prior to the date of bankruptcy but still receiving salary continuance pay at the Date of Bankruptcy, the Trustee admitted the amounts determined by the MOL for the former employees who filed proofs of claim with the Trustee. For the two terminated employees, the Trustee admitted their proofs of claim as filed.

SCHEME OF DISTRIBUTION AND DIVIDEND SHEET

91. Funds available for distribution will be distributed to the creditors in accordance with their priority pursuant to the BIA and the Orders of the Court made in the DB Media Distribution proceedings.

92. By s. 147(1) of the BIA, a levy is payable to the Superintendent of Bankruptcy on all payments made by the Trustee by way of a dividend or otherwise on account of the claims of creditors whether unsecured, preferred or secured. The levy is considered to be a preferred claim. Where the amount of payments exceeds $1 million but is not more than $2 million, the levy payable is five per cent of the first million dollars plus one and one quarter per cent of the amount in excess of $1 million.

93. The Trustee is not aware of any priority claims.

94. Claim amounts for the former employees were reduced by any entitlements paid under the Wage Earner Protection Program.

95. Based on the dividend sheet (the "**Dividend Sheet**") approved by the Inspectors attached hereto as **Exhibit "I"**, unsecured creditors will receive dividends of approximately $0.13 and $0.24 on the dollar for DB Media and DB Media Canada, respectively.

RECOMMENDATION

96. Based on the foregoing, the Trustee respectfully requests and recommends that an Order be made by this Honourable Court approving, *inter alia*:
    i. Approving the Direct Brands Settlement between the Trustee and DBI regarding potential TUVs and the Mutual Release;
    ii. Approving the Trustee's final statement of receipts and disbursements and the allocation of disbursements between DB Media and DB Media Canada;
    iii. Approving the proof of claim process and dividend sheet;
    iv. Authorizing and directing the Trustee to distribute the funds available for distribution to the DB Media's and DB Media Canada's creditors;
    v. Declaring that all steps taken by and activities of the Trustee and all amounts distributed by the Trustee are hereby approved, and the A&M shall have no further liability in respect thereof;

vi. Approving the activities of the Trustee from the Date of Bankruptcy to the date of this Third Report; and

vii. Approving the Final Fees of the Trustee and its legal counsel, Osler, and authorizing the Trustee to pay its fees and disbursements and those of its counsel.

ALL OF WHICH IS RESPECTFULLY SUBMITTED, at Toronto, Ontario this 16th day of October, 2012.

Alvarez & Marsal Canada Inc. in its capacity
as trustee in bankruptcy of DB Media
Distribution Inc., DB Media Distribution
(Canada), CH LLC (Canada) and
CH SUB LLC (Canada) and not in
its personal or corporate capacity

Per: ______________________________
Douglas R. McIntosh