

COURT FILE NUMBER 1403-10990
COURT COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE EDMONTON
PLAINTIFF ROYAL BANK OF CANADA
DEFENDANT SPRAGUE-ROSSER CONTRACTING CO. LTD.,
SPRAGUE-ROSSER DEVELOPMENTS INC., PACIFIC
FEDERATION EQUITY GROUP INC., JEFFERY JESSAMINE,
DANIEL EDWARDS AND MATTHEW MACKAY

Clerk's Stamp

DOCUMENT **FOURTH REPORT OF ALVAREZ & MARSAL CANADA
INC., IN ITS CAPACITY AS COURT APPOINTED
RECEIVER OF SPRAGUE-ROSSER CONTRACTING CO.
LTD., SPRAGUE-ROSSER DEVELOPMENTS INC.,
PACIFIC FEDERATION EQUITY GROUP INC.**

June 5, 2015

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ALVAREZ & MARSAL

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INTRODUCTION AND BACKGROUND

1. Alvarez & Marsal Canada Inc. was appointed Receiver (the “**Receiver**” or “**A&M**”) of all of the assets, undertakings and properties of Sprague-Rosser Contracting Co. Ltd. (“**Contracting**”), Sprague-Rosser Developments Inc. and Pacific Federation Equity Group Inc. (“**Pacific**”) (collectively, “**SR**” or the “**Companies**”) pursuant to an order of Honourable Madam Justice J. B. Veit (the “**Receivership Order**”) granted on July 31, 2014 (the “**Receivership Date**”).
2. Sprague-Rosser Leasing Inc. (“**Leasing**”) is a wholly owned subsidiary of Pacific and the shares of Leasing constitute Property as defined in the Receivership Order.
3. On August 7, 2014 this Honourable Court amended and restated the Receivership Order (the “**Amended Receivership Order**”) to provide for certain rights to Western Surety Company in respect of ongoing bonded construction contracts undertaken by SR in Alberta and Saskatchewan that the Receiver does not intend to complete.
4. The Receiver’s legal counsel will be filing a notice of application to be heard on June 16, 2015 seeking:
 - a) an order approving a settlement agreement (the “**Settlement Agreement**”) between Contracting , Edmonton Heavy Equipment Rentals Ltd. (“**EHER**”) and Sprague-Rosser Leasing Inc. (“**Leasing**”) which provides for, among other things, agreement as to the distribution of net proceeds from the disposition by EHER of certain construction equipment (the “**Settlement Order**”); and
 - b) an order approving an allocation of costs incurred by the Receiver to secure and safeguard heavy equipment not only owned by Contracting but, also, heavy equipment that is subject to ownership claims by EHER and Leasing together with secured claims asserted by the equipment lessors of such heavy equipment (the “**Cost Allocation**”) and directing each of the lessors and equipment financiers (collectively, the “**Equipment Lenders**”) to pay their obligations in respect of the Cost Allocation to the Receiver (the “**Cost Allocation Order**”).
5. Further background including a copy of the Amended Receivership Order, the previous three Reports of the Receiver and other motion materials are posted on the Receiver’s website at www.alvarezandmarsal.com/sprague.
6. Capitalized terms not defined in this fourth report of the Receiver (the “**Fourth Report**”) are as defined in the Amended Receivership Order.
7. All references to dollars are in Canadian currency unless otherwise noted.

TERMS OF REFERENCE

8. In preparing the Fourth Report, the Receiver has relied upon unaudited financial information, company records and discussions with management of Sprague-Rosser. The Receiver has not performed an audit, review or other verification of such information.

PURPOSE OF REPORT

9. The Fourth Report is a special purpose report intended to provide this Honourable Court with information with respect to:
 - a) the Receiver's application for the Settlement Order; and
 - b) the Receiver's application for the Cost Allocation Order.

SETTLEMENT ORDER

Claim against EHER

10. EHER is a related party to the Company in that it is owned and controlled by the same shareholders (the "**Shareholders**") as SR. EHER, Leasing and SR share Jeffery Jessamine as sole director. We understand from discussions with representatives of the Shareholders that EHER's and Leasing's primary business activity was to act as the pass through entity to provide heavy equipment to SR and that neither entity has ongoing business operations.
11. As at the Receivership Date, the books and records of SR showed a balance owing by the Contracting to EHER of approximately \$82,000. However, during the period from May to July 2014, book entries totaling approximately \$4.4 million were credited to the account, eliminating amounts booked as owing by EHER to Contracting (the "**Eliminating Entries**"). A copy of the related party account ledger as per the books and records of Sprague is attached as Appendix "**A**".
12. The Receiver refutes the Eliminating Entries as it is not aware of any substantiating agreements, calculations or other valid support. The Receiver also believes that Contracting has additional claims against EHER resulting from transactions occurring before the Receivership Date including, but not limited to, the following:
 - a) equipment purchases by EHER that were funded by Contracting;
 - b) cash advances to EHER by Contracting to fund EHER's operating expenses, lease payments and financing payments;

- c) direct payment by Contracting of various financing and operating expenses on behalf of EHER;
 - d) management services provided to EHER by Contracting;
 - e) transfers of equipment to EHER from Contracting at below market value; and
 - f) substantial in the money equipment purchase options assigned by Contracting to EHER and subsequently exercised by EHER.
13. Accordingly, the Receiver is of the view that Contracting has a claim against EHER in excess of \$4.4 million.

EHER Equipment Proceeds

14. Subsequent to the Receivership Date, EHER disposed of certain pieces of construction equipment for net proceeds, after payment of secured claims in respect of the construction equipment, of approximately \$811,000 (the "**Net Proceeds**"). The Net Proceeds are currently held in trust by EHER's legal counsel, McLennan Ross LLP.
15. Substantially all of the Net Proceeds (\$808,000) are derived from the disposition of piling equipment and tooling (the "**Piling Equipment**") that was acquired in December 2013.
16. The equipment had been purchased from North American Construction (1993) Ltd. ("**NAC**") on December 13, 2013 for \$3.0 million plus GST and was financed as follows:
- a) vendor financing provided by NAC for approximately \$800,000 (the "**Vendor Financing**"); and
 - b) a cash payment upon closing of approximately \$2.2 million (the "**Closing Payment**") sourced by EHER from Contracting.
17. The accounting entries booked the Closing Payment as a payable by EHER to Contracting. However, as indicated above, the Eliminating Entries reversed the payable.
18. A copy of the asset purchase agreement is attached as Appendix "**B**".
19. Concurrent with closing of the acquisition of the Piling Equipment:
- a) EHER and Contracting entered into a lease agreement for the Piling Equipment (the "**Piling Equipment Lease**"), a copy of which is attached as Appendix "**C**"; and
 - b) EHER assigned the Piling Equipment Lease to NAC pursuant the Assignment of Lease and Rents agreement, a copy of which is attached as Appendix "**D**".

20. Contracting transferred funds equal to the Closing Payment to EHER and made the Vendor Financing payments to NAC totaling approximately \$200,000 during the period from December 13, 2013 to the Receivership Date, each of which were made directly by Contracting to NAC. The Vendor Financing Payments correlated directly to the sublease payments and the sublease was thus a synthetic flow through transaction. Accordingly, the cash component of the purchase price of the Piling Equipment was paid entirely and directly by funds of Contracting.
21. In February 2014 EHER obtained additional financing secured against the Piling Equipment for net proceeds of \$750,000. These proceeds were directed by EHER to be paid directly to Contracting.
22. On the basis of the foregoing facts, the Receiver instructed counsel to issue a Statement of Claim by Contracting against EHER. The Statement of Claim is attached as Appendix "E". The claims asserted by the Receiver include, among others, a claim that the Net Proceeds are impressed with a constructive or resulting trust in Contracting's favour.
23. EHER disputes the allegations made by the Receiver and has also asserted a counter claim against SR for entitlement to the net proceeds realized from the Receiver's disposition of a 2011 Caterpillar D6N dozer and two Caterpillar generators (collectively, the "**Caterpillar Equipment**") that EHER claimed ownership of for net proceeds of \$165,000 after payment of certain secured creditors.
24. In order to avoid costly and what is likely to be protracted litigation, the Receiver entered into settlement discussions with EHER and effective April 29, 2015, the Receiver and EHER agreed to the terms of a Settlement Agreement, subject to terms and conditions including approval of this Honourable Court. Key commercial terms of the draft Settlement Agreement are as follows:
 - a) the net proceeds of \$812,000 shall be divided between the Receiver and EHER with 65% disbursed to the Receiver (\$525,000) and 35% disbursed to EHER (\$287,000);
 - b) in the event EHER have acquired or subsequently acquire additional net proceeds from disposition of other construction equipment that was subleased to or otherwise possessed by the Debtor, the net proceeds shall be divided on the same percentages as agreed for the Net Proceeds;
 - c) the Receiver will disburse \$58,000 to EHER representing 35% of the net proceeds realized from the sale of the Caterpillar Equipment; and

- d) EHER, Mr. Jeff Jessamine and any other corporation under Mr. Jessamine's control shall support the Receiver in its application to have the Cost Allocation determined.
25. A copy of the draft Settlement Agreement is attached as Appendix "F".
26. The Receiver considers the terms of the Settlement Agreement to be commercially reasonable and in the best interests of stakeholders of Contracting. The Settlement Agreement provides for a net cash payment to Contracting of approximately \$467,000 in a timely manner and obviates the need for Contracting to pursue a claim against EHER through what would undoubtedly be expensive and protracted litigation.
27. The Receiver's legal counsel has been advised by EHER's counsel that EHER's only asset is the Net Proceeds and EHER's unsecured creditors are comprised solely of unsecured claims that Equipment Lenders might have against EHER for any deficiencies that might arise in connection with the realization against the various collateral by the equipment lessors. To be clear, NAC and General Electric Canada Equipment Finance G.P. ("GE") were repaid in full in respect of the Piling Equipment.
28. The approximate shortfalls incurred by John Deere Financial ("**John Deere**"), Canadian Western Bank and GE were \$132,000, \$243,000 and \$220,000, respectively. The Receiver has not been provided with the amount of the shortfalls incurred by the balance of the Equipment Lenders comprised of Derrick Dodge (1980) Ltd. ("**Derrick Dodge**") and Komatsu Financial (Canada) Inc. ("**Komatsu**") but in this case expects that they may have incurred deficiencies in an aggregate amount of approximately \$250,000.
29. The amounts recovered by Equipment Lenders in respect of their unsecured claims against EHER if the Settlement Agreement is approved are likely to exceed what would otherwise be recovered absent the Settlement Agreement, due to the substantial amount of Contracting's claim against EHER. An illustrative scenario, based on the estimated shortfalls incurred by the Equipment Lenders and the estimated minimum claim against EHER by Contracting, shows estimated recoveries to Equipment Lenders of 41% under the Settlement Agreement and only 15% without the Settlement Agreement, before costs to administer the estate of EHER, as shown in the following table:

Sprague-Rosser Contracting Co. Ltd. et al. - in Receivership		
Estimate of Recoveries to Unsecured Creditors of EHER (Illustrative Scenarios)		
(\$000's)		
	Settlement Agreement	No Settlement Agreement
Amounts available for EHER unsecured creditors	\$ 344	\$ 811
Shortfalls to equipment lenders		
John Deere	132	132
Canadian Western Bank	243	243
GE	220	220
Unknown (Komatsu and Derrick Dodge)	250	250
	<u>845</u>	<u>845</u>
Minimum Contracting claim	-	4,400
Estimated total unsecured creditors	<u>845</u>	<u>5,245</u>
Estimated recovery to unsecured creditors of EHER under illustrative scenarios	41%	15%

30. As indicated above, potential recoveries to other known unsecured creditors of EHER are greatly enhanced by the commercial arrangement proposed under the Settlement Agreement, largely at the expense of SR and ultimately the other creditors of SR.
31. The Receiver acknowledges and specifically notes for this Honourable Court that there has not been a formal process (such as a bankruptcy proceeding of EHER) to determine the potential universe of all unsecured claims against EHER but is satisfied that given the materiality of SR's claim against EHER and EHER's representations that they are not aware of any further material claims against EHER, that there is no material prejudice to other unsecured creditors of EHER that may not have been identified.

COST ALLOCATION ORDER

32. The Receiver incurred substantial costs and expenses (as described in more detail below) in taking possession of, preserving and protecting such heavy equipment. The Receiver has proposed to allocate such costs amongst all equipment that was in possession of Contracting on the date of the receivership.
33. Upon its appointment on July 31, 2014, the Receiver undertook extensive activities to locate, secure and determine entitlement to the fixed assets in the possession of Contracting as at the Receivership Date. These activities included, but are not limited to, the following:
- a) securing possession and preparing an inventory of the capital assets in the possession of Contracting which included numerous pieces of machinery and equipment held at various locations in Alberta and Saskatchewan;

- b) locating and arranging for storage of machinery and equipment located at job sites and third-party locations;
 - c) relocating and arranging and paying for transportation costs relating to numerous pieces of machinery and equipment to the Company's shop facility in Acheson, Alberta and elsewhere;
 - d) reviewing claims to security interests and/or ownership with respect to machinery and equipment in possession of the Receiver; and
 - e) reviewing property insurance coverage relating to the machinery and equipment, adding the Receiver as named insured and loss payee under the applicable policies and arranging for replacement insurance.
34. A number of the pieces of equipment in the possession of Contracting as at the Receivership Date were subject to claims of ownership and/or claims of security interest pursuant to lease and equipment financing agreements that Equipment Lenders held either with Contracting, Leasing or EHER. In order to secure the release of the subject equipment to respective claimants, the Receiver entered into collateral disposition agreements (the "**Disposition Agreements**") with a number of the Equipment Lenders. Copies of the Disposition Agreements are attached as Appendix "G".
35. While certain terms vary amongst the Disposition Agreements, the key commercial terms are generally as follows:
- a) the Receiver consents to the Equipment Lenders effecting a seizure of the collateral and proceeding with the disposition of the Collateral pursuant to the Alberta, and if applicable, Saskatchewan *Personal Property Security Act*;
 - b) the Receiver is to notify the Equipment Lender of the amount of the Receiver's costs and expenses that it proposes to allocate to the collateral in payment of the Receiver's Charge and Borrowing Charge as defined in the Amended Receivership Order for the reasonable fees and disbursements incurred by the Receiver to locate, secure and to determine the validity of the Equipment Lender's security;
 - c) the Receiver agrees that it shall not claim a cost allocation amount greater than the aggregate of 1.5% of the realizable value of the collateral or 1.5% of the loan payout value of the debt, whichever is greater, plus specific disbursements agreed to by the Lenders. In certain of the

agreements the 1.5% limit was applicable to only the realizable value of the collateral or the loan payout value and not both (the “Allocation Limit”); and

d) sales proceeds shall be held in trust by the Receiver or the Lessor’s legal counsel pending determination as to entitlement.

36. The Receiver notified each of the Equipment Lenders of the proposed allocation in November 2014. A summary of the proposed allocation is set out below. The actual direct costs, indirect costs and professional fees associated with securing and safeguarding the equipment total approximately \$373,000 and are summarized in the table below:

Sprague-Rosser Contracting Co. Ltd. et al. - in Receivership								
Cost Allocation Summary								
(\$000's)								
	EHE	JD	GE	Komatsu	CWB	Derrick	Receiver	Total
Loan payout and estimated realization value	3,271	1,816	967	3,475	3,867	993	5,000	19,389
<i>Loan payout and estimated realization value (%)</i>	<i>17%</i>	<i>9%</i>	<i>5%</i>	<i>18%</i>	<i>20%</i>	<i>5%</i>	<i>26%</i>	<i>100%</i>
Indirect costs								
Insurance	\$ 10	\$ 8	\$ 4	\$ 16	\$ 12	\$ 4	\$ 29	\$ 83
Security	4	2	1	5	5	1	8	27
Storage	-	0	0	0	0	0	0	1
Contractors	9	5	3	10	11	3	18	59
Utilities	2	2	1	3	3	1	6	17
Total indirect costs	25	18	9	34	32	10	61	188
Professional fees allocation	31	17	9	33	37	9	49	185
Total indirect costs and professional fees	\$ 56	\$ 35	\$ 18	\$ 66	\$ 68	\$ 19	\$ 110	\$ 373
Allocation Limit	49	27	15	52	58	15	n/a	216
Direct transportation costs	-	-	-	-	29	-	n/a	29
Total cost allocation	\$ 49	\$ 27	\$ 15	\$ 52	\$ 87	\$ 15	n/a	\$ 245
Funds held in trust	\$ 49	\$ 27	\$ -	\$ 52	\$ 87	\$ -	\$ -	\$ 215

37. As reflected in the table, in all cases the allocated costs exceed the Allocation Limit and as such, the Receiver is requesting a recovery of \$215,000 or 58% of the total costs. The \$215,000 sought by the Receiver for recovery is 1.5% of the loan value or, in the case of Derrick Dodge, estimated realization value of the assets secured and safeguarded.

38. Detailed cost allocation calculations are attached as Appendix “H”.

RECOMMENDATIONS

39. The Receiver respectfully recommends that this Honourable Court approve the following Orders:

- a) the Cost Allocation Order; and
- b) the Settlement Order.

All of which is respectfully submitted to this Honourable Court this 5th day of June, 2015.

**Alvarez & Marsal Canada Inc.,
in its capacity as Receiver and Manager of
Sprague-Rosser Contracting Co. Ltd,
Sprague-Rosser Developments Inc. and
Pacific Federation Equity Group Inc.**



Per: Todd M. Martin
Senior Vice President



Per: Tom Powell
Director