

**IN THE MATTER OF THE PROPOSAL OF  
MADOC CO-OPERATIVE ASSOCIATION  
OF THE TOWN OF MADOC, IN THE PROVINCE OF ONTARIO**

**TRUSTEE'S SUPPLEMENTARY REPORT TO CREDITORS  
DATED JUNE 26, 2010**

**TO THE CREDITORS OF MADOC CO-OPERATIVE ASSOCIATION:**

This report is prepared in conjunction with the Proposal under Part III, Division I, of the *Bankruptcy and Insolvency Act* which has been lodged with A. Farber & Partners Inc. ("**Farber**" or the "**Trustee**"), filed with the Official Receiver in Ottawa, Ontario, on April 12, 2010 and forwarded on April 23, 2010 by regular mail to all known creditors.

Also included in the package mailed to creditors was the Trustee's Report to Creditors dated April 23, 2010 (the "April 23 Report"). A copy of that entire package is available on our website at [www.farberfinancial.com](http://www.farberfinancial.com). If you are unable to access those documents from the website but would like a copy, please contact Annette Chopowick at [achopowick@farberfinancial.com](mailto:achopowick@farberfinancial.com) or 416-496-3733.

The following is an outline of the background and financial dealings of Madoc Co-operative Association ("**Madoc**" or the "**Company**"), including relevant information that we feel will be of assistance to creditors in considering their position with respect to the Proposal. Unless otherwise indicated herein, capitalized terms in this report have the same meaning as in the Proposal.

**1. Background**

On May 3, 2010, a meeting of Creditors was held to consider the Proposal. Given that the realization of a number of significant assets of Madoc had not yet been completed at the time of that meeting, and there remained unresolved issues regarding the status of claims of debenture holders, the Creditors voted in favour of adjourning the meeting to July 6, 2010.

This supplementary report is being provided to Creditors to assist them in considering the Proposal at the July 6, 2010 meeting.

## 2. Creditors' Claims

The Notice to Creditors of the meeting of creditors included in the April 23 Report package provides detailed instructions for completion and submission of the Proof of Claim, Proxy and Voting Letter.

**Creditors that have already filed those documents do not need to re-submit them, unless they wish to amend the information contained therein.**

## 3. Realizations on Assets

As reported in the April 23 Report, the Interim Receiver executed asset purchase agreements in respect of transactions to sell certain of Madoc's assets, namely the real property and other assets located at each of the Madoc St. Lawrence and Tweed locations, and Madoc's interest in the joint venture with UPI Energy LP. Court approval for each of those transactions was received on April 30, 2010, the transactions have closed, and the proceeds have been deposited in the Interim Receiver's trust account.

The following is a summary of the status of realizations on Madoc's remaining assets of significance:

Grain dryer system in Foxboro (the " <b>Grain Dryer</b> ")	An asset purchase agreement in respect of the Grain Dryer has been executed and Farber has received a deposit. The transaction is subject to Court approval. The Grain Dryer is subject to security interests in favour of a number of persons and it is not expected that any of the proceeds from the sale of the Grain Dryer will be available to be distributed to unsecured creditors.
Real property at Foxboro, Ontario (the " <b>Foxboro Property</b> ")	Madoc is negotiating a transaction in respect of the Foxboro Property. The Foxboro Property is subject to a charge/mortgage in favour of Concentra and it is not expected that any of the proceeds from the sale of the Foxboro Property will be available to be distributed to Madoc's unsecured creditors, unless Concentra security is found to be not properly perfected (see discussion below).

Real property at 42 Durham St. in Madoc, Ontario (the " <b>Madoc Durham Property</b> ")	No offers were received for the Madoc Durham Property. The Madoc Durham Property is subject to a charge/mortgage in favour of the Estate of M Maynes (the "Maynes Estate"). Based on the proof of claim filed by the Maynes Estate, it appears that there is no equity in the Madoc Durham Property and Madoc will be turning the Madoc Durham Property over to the Maynes Estate.
Shares of GROWMARK Inc. (" <b>GROWMARK</b> ")	Madoc is negotiating with GROWMARK with respect to the redemption of the GROWMARK shares. There is no public market for the GROWMARK shares. It appears that the shares are subject to the rights of secured creditors. Thus, net proceeds from the realization of the shares will not be available to unsecured creditors, but will reduce the shortfall to secured creditors and therefore increase the pro rata distribution to unsecured creditors.
Shares of Tru*Serv Canada Cooperative Inc. (" <b>Tru*Serv</b> ")	Madoc is in the process of determining whether the shares of Tru*Serv have any value. There is no public market for the Tru*Serv shares. It appears that the shares are also subject to the rights of secured creditors.

In addition, there are outstanding accounts receivable that Farber is continuing to collect.

#### 4. Secured Debentures

In or about 2004, Madoc issued secured debentures for the purpose of raising funds. As security for the obligations owing under the debentures, Madoc provided a charge/mortgage over the Foxboro Property and a specific charge over the Grain Dryer. As set forth further below, the security granted to Concentra Trust ("**Concentra**") to secure the obligations owing under the secured debentures was, as a result of an error, not perfected until December 7, 2009, five years after the debentures were issued and after the proposal proceedings were commenced by Madoc.

While Farber was generally aware of the fact that Madoc had issued debentures, a certain amount of confusion resulted from the fact that individuals filed claims asserting obligations owing under these secured debentures. It is generally the case that when secured debentures are issued, a collateral agent is appointed to administer the security granted in connection with the debentures. It is not common for the holders of secured debentures to have direct rights as against the assets of the issuer that are pledged as security for the obligations owing under the debenture.

At and subsequent to the meeting of creditors on May 3, 2010, Farber received documents relevant to the secured debentures.

Pursuant to a Collateral Agency Agreement dated December 1, 2004 (the “**Agency Agreement**”), Concentra was appointed as collateral agent in respect of the debentures and the security granted by Madoc to secure the obligations owing under the debentures is being held by Concentra and the security, which is attached to the Agency Agreement, has been granted to Concentra. The Agency Agreement, *inter alia*: (a) provides that in the event of a default, enforcement rights and remedies are to be exercised by Concentra and Concentra will effect any distributions to the debentureholders; and (b) restricts the rights of the debentureholders to take individual actions to enforce the obligations owing under the debentures.

Subsequent to the meeting of creditors on May 3, 2010, Concentra filed a proof of claim in respect of the obligations owing under the debentures.

## 5. Secured Creditors

As noted in the April 23 Report, based on the results of a Personal Property Security Registration search conducted in respect of Madoc and information provided to Farber by Madoc, Madoc’s significant secured creditors are:

Creditor	Approx/Proven Debt
GROWMARK	\$4,000
GE Commercial Distribution Finance Canada (“GE”)	\$50,000
Desjardins Credit Union (“Desjardins”), subsequently assigned to OMAFRA – see below	\$2,200,000
Tru* Serv	\$97,057
Concentra	\$206,762
Yamaha Motor Canada Ltd. (“Yamaha”)	\$200,000
Maynes Estate	\$230,000

Secured Creditors will be required to prove their claims as part of the Proposal process, and the Trustee will obtain opinions on their respective securities once claims have been submitted. At this time, Farber is not aware of any subordination or priorities agreements that might impact the priorities as between the secured parties. On this basis, Farber is proceeding on the basis that the relative priority of the secured claims is to be determined by the date of registration.

**A. GROWMARK**

Based on Madoc's books and records, GROWMARK is owed approximately \$4,000 and has security over all of Madoc's personal property. GROWMARK filed a financing statement against Madoc to perfect its security on January 14, 2002.

GROWMARK has not yet filed a proof of claim.

**B. GE**

The obligations owing by Madoc to GE are in respect of inventory purchased by Madoc and financed by GE. The obligations owing to GE appear to be secured against Madoc's personal property. GE filed a financing statement against Madoc to perfect its security on June 5, 2007.

GE has not yet filed a proof of claim.

**C. Desjardins**

Desjardins was Madoc's primary lender and, based on Madoc's records, is owed approximately \$2.2 million. Desjardins appears to have been granted security over all of Madoc's personal property to secure the amounts owing by Madoc. Desjardins registered a financing statement against Madoc to perfect its security on June 5, 2007.

An Assignment of General Security was executed in May 2010 between Desjardins and Her Majesty The Queen in Right of Ontario, represented by the Minister of Agriculture, Food and Rural Affairs ("OMAFRA") with respect to the obligations owing by Madoc to Desjardins. As a result, OMAFRA now stands in the place of Desjardins and has security over all of Madoc's personal property.

Desjardins/OMAFRA has not yet filed a proof of claim.

**D. Tru\*Serv**

Tru\*Serv has filed a proof of claim asserting a claim of \$97,057.04 in respect of product supplied to Madoc. Tru\*Serv is asserting security over all of Madoc's personal property based on a Security Agreement dated October 14, 1998 between Madoc and Cotter Canada Hardware and Variety Cooperative, the former name of Tru\*Serv. Tru\*Serv filed financing statements against Madoc to perfect its security on July 24, 2007 and July 13, 2009.

**E. Concentra**

Concentra has filed a proof of claim asserting a claim of \$206,762. The proof of claim filed by Concentra is consistent with Madoc's records with respect to the obligations owing in respect of the debentures. Some debentureholders have also filed proofs of claim in respect of the obligations owing under the debentures. Farber will consider only the proof of claim filed by Concentra in respect of the secured debentures in respect of which Concentra has been appointed.

**F. Yamaha**

Madoc purchased inventory from Yamaha on credit and provided Yamaha with security over the inventory purchased from Yamaha. Based on Madoc's records, Yamaha is owed approximately \$200,000 in respect of inventory sold to Madoc. Yamaha requested that Madoc return its collateral – the inventory supplied to Madoc. Madoc determined that there was no equity in Yamaha's collateral and, pursuant to an Order dated April 30, 2010, Madoc has returned Yamaha's collateral.

Yamaha has not yet filed a proof of claim in respect of any shortfall.

**G. Maynes Estate**

The Maynes Estate has filed a proof of claim asserting a claim of \$230,000. The Maynes Estate has a charge/mortgage registered over the Madoc Durham Property. The Maynes Estate has requested that Madoc turn over the Madoc Durham Property to the Maynes Estate. As set forth above, there have been no offers received for the Madoc Durham Property and it does not appear that there is any equity in the Madoc Durham Property.

## H. Estimated Recoveries

The estimated recovery to Secured Creditors is summarized as follows:

Secured Creditor	Proven (or Estimated) Claim	Realizations from Collateral	Unsecured Portion
Yamaha	\$200,000	\$200,000	\$0
Concentra	\$206,000	\$206,000	\$0
Maynes Estate	\$230,000	\$230,000	\$0
GROWMARK	\$4,000	\$4,000	\$0
GE	\$50,000	\$50,000	\$0
Desjardins/OMAFRA	\$2,200,000	\$585,000	\$1,615,000
Tru*Serv	\$97,000	\$0	\$97,000

## 6. Unsecured Creditors

According to the Company's statement of affairs, and taking into account the estimated shortfalls to secured creditors set forth above, it appears that claims of unsecured creditors may total approximately \$2,700,000. The Trustee notes that this estimate has been derived from the Company's records, and that creditors will be required to prove their claims in order to participate in any distributions.

## 7. Estimated Recoveries

The following is a summary of realizations to date, net of professional fees and disbursements (numbers are approximate):

Net realizations potentially subject to security interests	\$635,000
Net realizations on unsecured assets	<u>\$410,000</u>
Total net realizations to date (*)	<u>\$1,045,000</u>

\* Excludes future realizations and ongoing costs associated with the administration of the estate

## 8. Estimated Dividends to Unsecured Creditors

Based on this information, the Trustee is estimating a distribution to unsecured creditors from net realizations to date of approximately **15%**. The Trustee notes that this estimate does not take into account any future realizations or costs. **The above are estimates only and are subject to change as a result of creditors proving their claims. The above estimates also do not include any potential future realizations on other assets, or any future fees and disbursements relating to the administration of the estate.**

## 9. Potentially Attackable Transactions

The Proposal does not restrict the ability of Madoc's creditors to attack transactions entered into by Madoc for the purpose of increasing recoveries. Farber has identified three potentially attackable transactions.

### A. Termination Pay and Severance to Employees

As set forth in Farber's First Report to Court dated December 18, 2009, on December 7, 2009 Madoc paid vacation pay, termination and severance pay in the amount of approximately \$131,000 to former employees. In its capacity as proposal trustee, Farber was not able to stop Madoc from making the payments. However, on December 4, 2009, upon becoming aware that Madoc was contemplating making the payments, Farber sent a letter to Madoc advising that certain of the payments would constitute preferences and recommending that Madoc seek legal advice before making the payments. Madoc made the payments on December 7, 2009 notwithstanding Farber's letter.

Madoc's employees were entitled to a limited priority in respect of vacation pay. The BIA contemplates that unpaid wages and vacation pay up to \$2,000 per employee, other than officers and directors, is secured by a charge against a debtor's cash, inventory and receivables in a bankruptcy or receivership. The amounts secured by this charge must be paid to the employees in proposal proceedings under the BIA. Ten employees received payments in excess of \$2,000 that total approximately \$17,000. It also appears that certain of the employees who received payment may have been officers of Madoc.

Farber has also identified two issues with the payment of termination and severance pay by Madoc.

Madoc calculated termination and severance pay based on the Canada Labour Code (the "CLC"). This was done on the assumption that because Madoc operated a grain elevator, the CLC applied. Gowling Lafleur Henderson LLP ("**Gowlings**") has advised Farber that it is likely the case that the CLC does not apply and termination and severance should have been calculated based on the Employment Standards Act (Ontario) (the "ESA"). In some cases, the difference, on a percentage as opposed to absolute basis, between the employees' entitlement under the CLC and the ESA is significant.



Regardless of how the claim is calculated, any claims by Madoc's former employees for termination and severance pay would be unsecured and the payment of termination and severance pay by Madoc resulted in Madoc's employees receiving a preference over Madoc's other creditors. The payments to Madoc's former employees could be challenged as preferences in proceedings against the employees. However, in assessing the value of these claims, creditors should weigh the costs and likelihood of recovery:

- Without considering the professional fees and expenses that would be incurred, if the payments made to Madoc's former employees in excess of the \$2,000 "secured" claim and respect of termination and severance pay were to be successfully challenged and the judgments rendered against the employees collected, there would be a small increase in the estimated distribution to unsecured creditors. The funds recovered from the employees would be added to the funds available for distribution to unsecured creditors, but the employees' claims would also be added to the "pool" of unsecured creditors.
- Gowlings has advised Farber that the chances of successfully challenging the payments in excess of the employee's \$2,000 "secured" claim, and the termination and severance pay is relatively high and obtaining judgment against the employees is also relatively high.
- Farber notes, however, that, in many cases, the cost of pursuing the employees will likely exceed the potential recovery to the estate – eleven of the former employees received less than \$5,000. Farber also notes that it is not certain that judgments against Madoc's former employees would be recoverable– Farber is not aware of the financial situation of Madoc's former employees who were the recipients of these amounts.

In the event that the payments to the employees were to be set aside and the approximately \$100,000 that appears to have been improperly paid to the employees were to be recovered, the amount available to be distributed to unsecured creditors would increase by \$100,000, but the "pool" of unsecured creditors would also increase by \$100,000 and there would be professional fees and expenses incurred in challenging the payments and recovering the amounts paid to the employees.

Without taking into account the professional fees and expenses that would be incurred to challenge the payments to employees and assuming the full amount paid to the employees was recovered, the estimated distribution to unsecured creditors would increase to approximately 18% if the payments to the employees were to be set aside and the funds recovered. The Trustee notes that this estimate does not take into account any future realizations or costs. **The above are estimates only and are subject to change as a result of creditors proving their claims. The above estimates also do not include any potential future realizations on other assets, or any future fees and disbursements relating to the administration of the estate or the proceedings to challenge the payments to the employees.**

## **B. GST and PST Remittances, and WSIB Premiums**

On or about December 21, 2009, Farber became aware that Madoc intended to pay approximately \$32,000 in PST and GST remittances and WSIB premiums that related to the period prior to the filing of the NoI. Pursuant to a letter dated December 21, 2009, Farber advised Madoc that the payment of unsecured obligations owing in respect of PST and GST remittance and WSIB premiums would constitute preferences. Farber, in its capacity as proposal trustee, was not, however, in a position to stop Madoc from making the payments. Immediately upon being appointed as interim receiver of Madoc, Farber took steps to reverse/stop the payments and stopped \$13,500 of the \$32,000 from being paid.

While there is a case pending at the Supreme Court of Canada that may impact the matter, there appears to be a strong likelihood that the payment of the PST and GST remittances and the WSIB premiums could be challenged. Taking into account the amounts involved and cost of taking proceedings to recover the payments, challenging the payments would not likely result in any recovery for unsecured creditors.

The costs of taking proceedings to challenge the payments made in respect of GST and PST remittance, and WSIB premiums likely outstrips any potential benefit to the unsecured creditors by way of potential increase in the distribution to unsecured creditors.

## **C. Registration of Concentra Security**

As at the date Madoc filed the Notice of Intention on December 2, 2009, Concentra's security over the Foxboro Property and the Grain Dryer were not perfected. Concentra registered the charge/mortgage as against the Foxboro Property and a financing statement against Madoc on December 7, 2009. As a result, Farber has identified Concentra's security as being potentially subject to challenge. Gowlings has advised Farber that the chances of proceedings to set aside Concentra's security being successful based on the timing of the registration of Concentra's security as against Madoc are likely small. The registration of the charge/mortgage was likely not stayed when Madoc commenced proceedings under the BIA and it is likely that a Court considering the matter would find that the registration of the charge/mortgage is not caught by the provisions of the BIA (or other applicable legislation) dealing with preferences and other attackable transactions.

In that event Concentra's security over the Grain Dryer was to be set aside, the result would not be an increase in the estimated distribution to Madoc's unsecured creditors as the proceeds from the sale of the Grain Dryer will be distributed to others secured creditors, namely Desjardins/OMAFRA.

Farber notes, however, that in the event that Concentra's charge/mortgage over the

Foxboro Property was to be set aside, there would be an increase in the recoveries to Madoc's unsecured creditors. Aside from the Court-ordered charge in favour of Farber for professional fees and disbursements, there are no other creditors with security over the Foxboro Property. As a result, if Concentra's charge/mortgage over the Foxboro Property was set aside, the net proceeds from the sale of the Foxboro Property – estimated at approximately \$200,000 – would be available for distribution to Madoc's unsecured creditors. The amount of Concentra's claim that would otherwise have been paid from the net proceeds from the sale of the Foxboro Property – also approximately \$200,000 – would be added to the "pool" of unsecured claims and would be entitled to their pro-rata share of the proceeds from the sale of Madoc's property not subject to the claims of the secured creditors. Farber also notes that professional fees and expenses would have to be incurred in connection with any proceedings to have Concentra's charge/mortgage over the Foxboro Property set aside.

Without taking into account the professional fees and expenses that would be incurred to challenge the validity of Concentra's charge/mortgage, the estimated distribution to unsecured creditors would increase to approximately 21% if Concentra's charge/mortgage were to be set aside. The Trustee notes that this estimate does not take into account any future realizations or costs. **The above are estimates only and are subject to change as a result of creditors proving their claims. The above estimates also do not include any potential future realizations on other assets, or any future fees and disbursements relating to the administration of the estate or the proceedings to challenge Concentra's charge/mortgage.**

## 10. Recommendations and Summary

The Trustee recommends acceptance of the Company's Proposal, believing it to be the best alternative for the following reasons:

- (a) The Proposal offers the best prospect for realization on Madoc's assets by providing adequate time to complete an orderly sales process, and a recovery for Unsecured Creditors based upon the anticipated Proposal Proceeds.
- (b) Recoveries under the Proposal are no worse than what can be expected in a bankruptcy.

**DATED AT TORONTO** this 26<sup>th</sup> day of June, 2010.

**A. FARBER & PARTNERS INC.  
IN ITS CAPACITY AS TRUSTEE *IN RE*  
THE PROPOSAL OF MADOC CO-OPERATIVE ASSOCIATION**

A handwritten signature in black ink, appearing to be 'Allan Nackan', written in a cursive style.

Per: Allan Nackan, CA•CIRP

TOR\_LAW\7411151\1