

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)**

BETWEEN:

**I.F. PROPCO HOLDINGS (ONTARIO) 23 LTD.**

Applicant

- and -

**AFM HOSPITALITY CORPORATION**

Respondent

**Second Report to the Court of Mintz & Partners Limited, in its capacity as  
Interim Receiver and Receiver and Manager of  
AFM Hospitality Corporation**

**Purpose**

1. This report is submitted to this Honourable Court by Mintz & Partners Limited (the "Receiver"), in its capacity as Interim Receiver and Receiver and Manager of the assets, property and undertaking of AFM Hospitality Corporation ("AFM"), in support of the Receiver's motion for:

- (a) an Order, if necessary, abridging the time for service of the Notice of Motion and the Motion Record herein and declaring that the motion is properly returnable on February 24, 2006, and an Order dispensing with the requirement to serve the Notice of Motion on any other party and/or validation of the Notice of Motion;
- (b) an Order determining the priority ranking of I.F. Propco Holdings (Ontario) 23 Ltd.'s ("Propco") security vis-à-vis the claim of Kevin K. Loh, Stephen Bowskill,

Nevmor LLC, Scott Campbell and Paul Bowskill, as trustee (collectively, the  
“**Lenders**”);

- (c) an Order approving the activities of the Receiver to the date hereof as described  
in this Report; and
- (d) such further and other relief as to this Honourable Court may seem just.

#### **Background**

2. Mintz & Partners Limited was appointed as Interim Receiver and Receiver and  
Manager of the assets, property and undertaking of AFM pursuant to an Order of the Ontario  
Superior Court of Justice (the “**Court**”) dated April 29, 2005 (the “**Appointment Order**”). A  
copy of the Appointment Order is attached hereto as **Appendix “A”**.

3. The Appointment Order provides, *inter alia*, the Receiver with authority to apply to the  
Court for advice and directions in the discharge of its powers and duties.

4. The Receiver filed its first report to the Court on December 29, 2005 (the “**First  
Report**”). A copy of the First Report without appendices is attached hereto as **Appendix  
“B”**.

### **Propco Debt and Security**

5. AFM's primary secured lender is Propco. Pursuant to a loan agreement dated July 31, 1996, as amended (the "**Propco Loan Agreement**"), Propco made available to AFM a loan in the amount of \$3,000,000 subject to the terms and conditions contained therein. A copy of the Propco Loan Agreement is attached hereto as **Appendix "C"**.
  
6. The loan extended under the Propco Loan Agreement was secured by a general security agreement granted by AFM to Propco dated September 29, 1995 (the "**GSA**"). A copy of the GSA is attached hereto as **Appendix "D"**.
  
7. On August 12, 1996, AFM, as evidence of its indebtedness to Propco, executed and delivered to Propco a promissory note due on August 12, 1999 in the principal sum of \$3,000,000 (the "**Promissory Note**"). A copy of the Promissory Note is attached hereto as **Appendix "E"**.
  
8. Propco registered a financing statement against AFM under the *Personal Property Security Act* (Ontario) (the "**PPSA**") on August 25, 2003 as registration number 20030825 1258 2080 1671 (reference file number 897571611) against "inventory", "equipment", "accounts", "other" and "motor vehicle included" (the "**Propco Registration**"). A copy of the PPSA enquiry certificate evidencing the Propco Registration is attached hereto as **Appendix "F"**.
  
9. AFM's indebtedness to Propco as at April 27, 2005 was approximately \$4.2 million and as at November 30, 2005 was approximately \$5,000,000, inclusive of interest and costs. This amount does not take into account the aggregate amount of \$950,000 (plus accrued and unpaid interest thereon) advanced to date by Propco to the Receiver that is secured by Receiver's Certificates.

### **Lenders' Claim**

10. Pursuant to a promissory note dated November 1, 2004 (the "**Lenders' Promissory Note**") issued by AFM BHRI (USA) Inc. ("**BHRI**"), a wholly owned subsidiary of AFM, in favour of the Lenders, BHRI promised to repay the sum of USD \$450,000 that was loaned to it by the Lenders together with interest thereon and other amounts. A copy of the Lenders' Promissory Note is attached hereto as **Appendix "G"**.

11. By the terms of a guaranty dated November 1, 2004 (the "**Lenders' Guaranty**"), AFM and AFM IP Holding Inc., a subsidiary of AFM, guaranteed the payment of all sums owing by BHRI to the Lenders. A copy of the Lenders' Guaranty is attached hereto as **Appendix "H"**.

12. In addition to the Lenders' Guaranty, AFM has delivered to the Lenders a stock assignment agreement and stock pledge agreement, both dated November 1, 2004 (together, the "**Stock Agreements**") as security for the obligations evidenced by the Lenders' Promissory Note. A copy of the Stock Agreements is attached hereto as **Appendix "I"**.

13. It is the Receiver's understanding that the documents provided by the Lenders as outlined herein represents the entirety of the instruments that have been granted by AFM to the Lenders in support of their loan.

### **Priority Dispute**

14. The Receiver received a letter through its solicitors, Chaitons LLP, dated July 25, 2005 (the "**Woolgar Letter**"), from Woolgar Van Wiechen Ketcheson Ducoffe LLP, solicitors for the Lenders. The Woolgar Letter sets out the position of the Lenders and claims that the Lenders' maintain a priority position vis-à-vis Propco with respect to the assets, property and undertaking of AFM to the extent of the amount due and owing to them by AFM. A copy of

the Woolgar Letter is attached hereto as **Appendix "J"**. The Receiver's counsel has engaged in discussions with both parties with respect to their relative claim priority positions.

15. In order for the Receiver to maximize the realization from the assets of AFM, it is critical that a determination be made as to the relative priority ranking between Propco and the Lenders. As such, the Receiver respectfully requests that this Court make a determination of same.



All of which is respectfully submitted to this Honourable Court.

DATED this 17<sup>th</sup> day of February 2006.

**MINTZ & PARTNERS LIMITED,**  
in its capacity as interim receiver and  
receiver and manager of the assets, property  
and undertaking of AFM Hospitality Corporation

Daniel R. Weisz, CA, CIRP

**APPENDIX "A"**

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

**THE HONOURABLE MR                    )     MONDAY, THE 9TH DAY**  
**JUSTICE CUMMING                    )     OF JANUARY, 2006**

**BETWEEN:**

**I. F. PROPCO HOLDINGS (ONTARIO) 23 LTD.**

**Applicant**

**- and -**

**AFM HOSPITALITY CORPORATION**

**Respondent**

**ORDER**

**THIS MOTION**, made by Mintz & Partners Limited in its capacity as Interim Receiver and Receiver and Manager (in such capacities, the "Receiver") of all of the assets, undertakings and properties of AFM Hospitality Corporation ("AFM") appointed pursuant to the Order of the Honourable Mr. Justice Campbell dated April 29, 2005 (the "Appointment Order"), for certain relief as described in the Notice of Motion, was heard this day at 393 University Avenue, Toronto, Ontario.

**ON READING** the First Report of the Receiver dated December 29, 2005 and the appendices thereto (the "First Report"), and on hearing the submissions of counsel for the Receiver, I.F. Propco Holdings (Ontario) 23 Ltd., Cendant Corporation and counsel for Kevin Loh and others,

1. **THIS COURT ORDERS AND DIRECTS** Deloitte & Touche LLP ("Deloitte") to forthwith provide to the Receiver, without compensation, the financial statements, income tax returns and other documentation relating to AFM and its subsidiaries that are in the possession or control of Deloitte, as requested by the Receiver in its letter to counsel for Deloitte dated September 28, 2005, provided that any documentation produced by Deloitte pursuant to this Order shall not be used by the Receiver for any purpose other than carrying out the terms of the Appointment Order including without limitation, providing a copy of the documentation to prospective purchasers of the shares or assets of AFM or any of the Specified Subsidiaries (as defined in the Appointment Order) unless otherwise ordered by the Court.

2. **THIS COURT ORDERS** that the right of the Receiver to request additional documentation from Deloitte and if necessary, to bring a motion to compel delivery of additional documentation by Deloitte is expressly reserved and preserved.

3. **THIS COURT ORDERS** that any additional documentation that may be produced by Deloitte at the request of the Receiver shall similarly not be used by the Receiver for any purpose other than those purposes set out in paragraph 1 above, unless otherwise ordered by the Court.

4. **THIS COURT ORDERS** that the authorized borrowings of the Receiver pursuant to paragraph 22 of the Appointment Order are hereby increased to \$1,100,000.

5. **THIS COURT ORDERS** that the balance of the motion be and is hereby adjourned to Monday January 23, 2006.

*January 18, 2006* *Peter A. Cumming J.*

ENTERED AT / INSCRIT À TORONTO  
ON / BOOK NO:  
LE / DANS LE REGISTRE NO.:

JAN 20 2006

PER/PAR: *A*

I.F. PROPCO HOLDINGS (ONTARIO) 3 LTD.  
AFM HOSPITALITY CORPORATION

and

Court File No. 05-CL-5878

APPLICANT  
RESPONDENT

ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)

Proceedings commenced at TORONTO

**ORDER**

**CHAITONS LLP**  
Barristers and Solicitors  
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**HARVEY G. CHAITON**  
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Solicitors for Mintz & Partners Limited,  
Court-appointed Interim Receiver and  
Receiver and Manger of AFM Hospitality  
Corporation

**APPENDIX "B"**

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)**

**BETWEEN:**

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**Applicant**

**- and -**

**AFM HOSPITALITY CORPORATION**

**Respondent**

**First Report to the Court of Mintz & Partners Limited, as  
Interim Receiver and Receiver and Manager of  
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SUPERIOR COURT OF JUSTICE  
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**TABLE OF CONTENTS**

<b>A.</b>	<b>INTRODUCTION</b>	<b>1</b>
<b>B.</b>	<b>BACKGROUND</b>	<b>2</b>
<b>C.</b>	<b>RECEIVER'S ACTIVITIES</b>	<b>3</b>
	(i) Possession and Security	3
	(ii) Access to Computer	6
	(iii) Leased Premises	8
	(iv) Insurance	8
	(v) Banking	9
	(vi) Employees	9
	a. Situated in Canada	9
	b. Situated in the United States	11
	(vii) Stock Exchanges/Provincial Registrations	13
	(viii) Corporate Records	14
	(ix) Unsecured Creditors	14
	(x) National Post	15
	(xi) Cedant Corporation	15
	(xii) Chapter 11 Proceedings of Dennis L. Heyde and Carol J. Heyde	16
	(xiii) Deloitte	18
	(xiv) Reports Pursuant to the <i>Bankruptcy and Insolvency Act</i>	19
	(xv) Hewlett-Packard	20
	(xvi) Specified Subsidiaries	21
<b>D.</b>	<b>ASSETS OF AFM</b>	<b>22</b>
	(i) Accounts receivable – Trade	23
	(ii) Accounts receivable – Other	24
	(iii) Prepaid expenses	25

(iv)	Investments	27
(v)	Furniture, fixtures and equipment	27
(vi)	Shareholders' loans receivable	28
(vii)	Inter-company loans receivable	29
<b>E.</b>	<b>AFM's Canadian Subsidiary Companies</b>	<b>31</b>
(i)	AFM Preferred Alliance Group Inc.	31
(ii)	Subsidiary One	32
(iii)	Best Inns Franchise Canada Inc.	33
(iv)	Hawthorn Suites Franchise Canada Inc.	33
(v)	Subsidiary Two	33
(vi)	Kelloryn Holdings Inc.	34
(vii)	Subsidiary Three	35
(viii)	La Quinta Canada Inc.	35
(ix)	Northwest Lodging International (Canada) Inc.	36
(x)	Park Inn Franchise Canada Inc.	36
(xi)	Park Plaza Franchise Canada Inc.	37
(xii)	Traveller's Inn Franchise Canada Inc.	37
(xiii)	Villager Lodge Franchise Canada Inc.	38
(xiv)	Ramada Franchise Canada Inc.	38
(xv)	AFM Asset Management Inc. / 2005947 Ontario Inc.	38
<b>F.</b>	<b>AFM's U.S. Subsidiary Companies</b>	<b>39</b>
(i)	Northwest Lodging International (USA) Inc.	39
(ii)	AFM Hospitality (USA) Corporation	39
(iii)	AFM Asset Services Inc.	40
(iv)	AFM Asset Management Services Inc.	40
(v)	Subsidiary Four	42
(vi)	Traveller's Inn Franchise (USA), Inc.	42
(vii)	AFM BHRI (USA) Inc. and AFM IP Holdings, Inc.	42
<b>G.</b>	<b>Sale of Assets</b>	<b>44</b>
<b>H.</b>	<b>Receiver's Certificates</b>	<b>45</b>
<b>I.</b>	<b>Interim Statement of Receipts and Disbursements</b>	<b>46</b>
<b>J.</b>	<b>Professional Accounts</b>	<b>46</b>
<b>K.</b>	<b>Receiver's Request to the Court</b>	<b>47</b>

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**First Report to the Court of Mintz & Partners Limited, as  
Interim Receiver and Receiver and Manager of  
AFM Hospitality Corporation**

**A. Introduction**

Pursuant to an Order of the Ontario Superior Court of Justice (Commercial List) (the "Court") dated April 29, 2005 (the "Appointment Order"), Mintz & Partners Limited ("MPL") was appointed as Interim Receiver and Receiver and Manager (the "Receiver") of all the assets, undertakings and property of AFM Hospitality Corporation ("AFM" or the "Company"). A copy of the Appointment Order is attached hereto as Appendix "A".

The Appointment Order provided the Receiver with authority to review the records of those wholly owned subsidiaries of AFM specified by I.F. Propco Holdings (Ontario) 23 Ltd. ("Propco"), and specifically AFM Preferred Alliance Group Inc., to determine if the assets of the specified subsidiaries were being used and the operations being conducted in the ordinary course of business. The Appointment Order also provided that nothing therein constituted the Receiver to be the Receiver of any wholly owned subsidiary of AFM.

By letter dated May 4, 2005, Minden Gross Grafstein & Greenstein LLP ("Minden Gross"), counsel to Propco, informed the Receiver of the names of the specified subsidiaries (collectively with AFM Preferred Alliance Group Inc. referred to herein as the "Specified Subsidiaries").

Upon its appointment, the Receiver retained Chaitons LLP ("Chaitons") as its counsel. On or about June 9, 2005, the Receiver engaged the law firm Hillis Clark Martin & Peterson ("Hillis Clark") of Seattle to represent the Receiver on matters pertaining to the receivership for which U.S. counsel was required. In addition, on or about June 21, 2005, the Receiver engaged the law firm Ruder, Ware & Michler, L.L.S.C. ("Ruder Ware") to act as the Receiver's counsel in Wisconsin in respect of litigation between AFM and Dennis L. Heyde and Carol J. Heyde (the "Heyde Litigation"). The Heyde Litigation is discussed later in this Report.

The purpose of this Report is to:

1. report on the Receiver's activities from the date of its appointment to December 19, 2005, and to seek approval of the actions of the Receiver as described herein;
2. seek approval of the Receiver's proposed marketing and sale process for certain assets of AFM;
3. seek an Order directing Deloitte & Touche LLP to forthwith provide the Receiver with certain financial statements, income tax returns and other documentation relating to AFM and its subsidiaries;
4. seek an Order increasing authorized borrowings of the Receiver from \$750,000 to \$1,100,000; and
5. seek approval of the interim accounts of the Receiver and its legal counsel.

## **B. Background**

As at the date of the Receiver's appointment, AFM was the direct and/or indirect shareholder of various subsidiary companies. Certain of the subsidiary companies were involved in hospitality management, held the master licenses in Canada of various hotel brands, operated a membership organization known as Boutique Hotels & Resorts or provided receivership and related services in the United States.

AFM is a public company listed on various stock exchanges including the Toronto Stock Exchange. Trading of AFM's common shares was halted on April 8, 2005 and suspended on May 20, 2005.

AFM directly or indirectly owns the shares of 27 subsidiary companies, situated in both Canada and the United States. Attached as Appendix "B" are corporate charts setting out AFM's Canadian and U.S. subsidiary companies. These charts have been compiled by the Receiver based on information located by the Receiver, but which the Receiver has been unable to verify.

The Company's primary secured lender is Propco. According to material filed in support of the motion for the appointment of the Receiver, AFM's indebtedness to Propco as at April 27, 2005 was approximately \$4.2 million, in support of which AFM had provided Propco with various security including a General Security Agreement. Propco has informed the Receiver that AFM's indebtedness to Propco as at November 30, 2005 was approximately \$5,000,000, inclusive of interest and costs. This amount does not take into account the aggregate amount of \$750,000 (plus accrued and unpaid interest thereon) advanced by Propco to the Receiver that is secured by Receiver's Certificates.

## C. Receiver's Activities

### i. Possession and Security

Upon its appointment, the Receiver attended at the Company's leased premises situated at 135 Queen's Plate Drive, Suite 410, Toronto, Ontario (the "Premises"). In addition to AFM, AFM's Canadian subsidiary companies also conducted operations from the Premises.

Upon its arrival at the Premises, the Receiver met with Mr. Glen Blake, Executive Vice President and COO of AFM and President and CEO of certain of AFM's Canadian subsidiary companies, and informed him of the Receiver's appointment. Locks to the Premises were changed with sole possession of the keys retained by the Receiver.

On Monday, May 2, 2005, the Receiver completed a physical count of the assets at the Premises. The Receiver was informed that one of the Company's servers was located offsite at the residence of one of the Company's consultants. That server has since been returned to the Premises.

In addition to the Premises, the Company also had an office address at 2101 Fourth Avenue, Suite 1020, Seattle, Washington (the "Seattle Office"). The lessee of those premises was Northwest Lodging International (USA) Inc. ("Northwest"), a subsidiary of AFM. It is the Receiver's understanding that AFM's U.S. subsidiary companies operated from that office, and that as of the date of the Receiver's appointment, three individuals worked from those premises.

The Receiver was also informed that a minimal amount of equipment, in quantity and value, belonging or leased to AFM, was located at the Seattle Office. The Receiver did not take possession of, or attempt to secure, the assets at the Seattle Office.

On May 12 and 13, 2005, the Receiver attended at the Seattle Office with Mr. Stephen Phillips, former Vice-Chairman of AFM, who had been engaged by AFM as a consultant prior to the date of the Receiver's appointment. Upon its arrival at the Seattle Office, the Receiver was informed by Mr. Tracy Kunday, President of Northwest, that any records of AFM located in the Seattle Office were situated in the office of Ms. Susan McIntosh, the Chief Financial Officer of AFM. The Receiver attempted to make arrangements for Ms. McIntosh to be available to the Receiver during the Receiver's attendance in Seattle. However, Ms. McIntosh sent an e-mail message to the Receiver at 9:50 p.m. on May 11, 2005, the night before the Receiver's attendance in Seattle. Ms. McIntosh informed the Receiver that she declined the Receiver's offer to be an independent consultant to the Receiver and would be willing to assist if, among other things, she was paid back wages, expenses and bonus totalling approximately \$47,000. The Receiver was not in a position to comply with Ms. McIntosh's request and, as a result, Ms. McIntosh did not meet with the Receiver.

The Receiver, together with Mr. Phillips, reviewed the files in Ms. McIntosh's office, and assembled six boxes of records. On May 13, 2005, and prior to departing Seattle, the Receiver took the six boxes to the U.S. Post Office and arranged for delivery of the boxes to the Receiver's office.

As the boxes had not arrived at the Receiver's office by May 18, 2005, the Receiver contacted the U.S. Post Office to track the location of the boxes. The Post Office representative informed the Receiver that the boxes exceeded a certain weight and for "security" reasons, the boxes were returned to the Seattle Office. The Receiver was not informed of any restriction or concern when it delivered the boxes to the Post Office. The Receiver confirmed with Mr. Kunday that the boxes were in fact returned to the Seattle Office

and the Receiver made arrangements with Mr. Kunday for the delivery of the boxes to the Receiver. The boxes of records arrived at the Receiver's office on May 25, 2005.

It is the Receiver's understanding that on or about May 31, 2005, the landlord of the Seattle Office took possession of those premises. On June 7, 2005, the Receiver put the landlord on notice that there may be certain assets at the Seattle Office that were either owned or leased by AFM and to advise the Receiver of the landlord's intention with respect to the assets located there. As no response was received from the landlord, on June 17, 2005, the Receiver sent a second letter to the landlord.

On July 12, 2005, the Receiver received correspondence from W.K. McInerney, PLLC, counsel to Martin Selig Real Estate ("McInerney"), the landlord of the Seattle Office. McInerney indicated that the landlord was in the process of leasing the premises to another party, together with all furniture and fixtures, the value of which was in McInerney's opinion negligible, taking into account the costs of removing the assets and restoring the premises. In addition, McInerney set out the landlord's position that it was claiming a Landlord's Lien on the furniture and furnishings for unpaid rent, which McInerney stated was "well in excess of \$50,000".

On July 13, 2005, McInerney wrote to the Receiver indicating that there were a number of records which "Northwest Lodging" had left on the premises which the landlord had not inventoried. He indicated that if the records were not removed by July 15, 2005, the landlord would dispose of same.

On July 14, 2005, the Receiver forwarded to McInerney the involuntary petition pursuant to Chapter 7 of the United States Bankruptcy Code issued against Northwest and advised that there was a router, firewall and possibly certain notebook computers at the Seattle Office. The Receiver requested that McInerney set these items aside in order that the Receiver could make the appropriate arrangements for their retrieval. Chaitons, on behalf of the Receiver, suggested to McInerney that in light of the pending petition against Northwest, McInerney speak to the U.S. Trustee for Northwest. In addition, in response to McInerney's enquiry regarding the phone system, Chaitons informed McInerney that the phone system may belong to Northwest or a company related to Mr. Lawrence Horwitz, the Chairman and CEO of AFM as at the date of the Appointment Order.

On July 19, 2005, McInerney informed Chaitons that the assets at the Seattle Office would be utilized by the new tenant. In view of the minimal value of the assets, and the Receiver's understanding that there were minimal owned or leased assets at the Seattle Office, the Receiver has not pursued this matter.

The Receiver has effected a mail re-direction from the Seattle Office for mail addressed to AFM.

On or about August 26, 2005, the Receiver believed, as a result of its work to that date, that it no longer required to be at the Premises on a full-time basis. The Receiver therefore provided keys to certain employees who provided the Receiver with a letter assuming responsibility for the keys received. The Receiver continues to attend at the Premises a minimum of two times per week.

#### ii. Access to Computer

AFM's information technology system is situated in the Company's Toronto office and administered by Mr. Nick Nightingale of WhiteKnight Consulting. The system supports the Company's records, e-mail system and correspondence for AFM and its Canadian and U.S. subsidiary companies. Upon the Receiver's appointment, the Receiver took steps to limit access to the computer system by the Seattle Office. As part of this process, the Receiver was careful to ensure that those other parties' ability to access information related to AFM's subsidiary companies on the computer system was not affected, however, access to the U.S. subsidiaries' records may have been temporarily inaccessible on April 29, 2005.

Subsequent to April 29, 2005, representatives of the Seattle Office communicated on numerous occasions with Mr. Nightingale to inform him of the Seattle Office's inability to access certain information. Mr. Nightingale informed the Seattle Office representatives that they had access to the computer system and that the difficulties being encountered were due to problems arising from the Seattle Office and not as a result of actions taken by the Receiver.

On June 3, 2005, Mr. Kunday informed Mr. Nightingale that he was unable to access the accounts for all "AMAC" properties. It is the Receiver's understanding that "AMAC" stands for American Hotels Acquisition Company, LLC, an entity owed by Mr. L. Horwitz and Mr. A. Tatibouet, two shareholders and former directors of AFM. On June 6, 2005, Mr. Nightingale responded to Mr. Kunday that his access had not changed.

On July 8, 2005, after becoming aware that there may have been unauthorized access to the AFM server and records contained thereon, the Receiver informed Messrs. Horwitz and Kundey that effective Monday, July 11, 2005, their ability to access the AFM server including e-mails addressed to their various addresses at AFM or other companies would end. The Receiver also requested, among other things, that they advise the Receiver of any other information that they may require from the AFM server.

On July 12, 2005, Mr. Kundey responded to the Receiver indicating that, among other things, he requested an electronic copy or access to all files on the server in any folder or e-mail relating to any AFM subsidiary that he was responsible for until all U.S. Courts have been satisfied, all legal issues resolved, and all compliance issues met. On July 13, 2005, the Receiver responded to Mr. Kundey and, among other things, asked in what capacity he was requesting this information.

On July 13, 2005, Chaitons, on behalf the Receiver, wrote separately to Messrs. Horwitz and Kundey, informing them that Chaitons was provided with a letter from a creditor dated July 11, 2005, which included as an attachment a copy of AFM's consolidated 2005 budget. Chaitons further stated that upon further review, it appeared that they may be in possession of the aforesaid budget which was downloaded from the AFM server without the Receiver's consent, and that any unauthorized use of that information was strictly prohibited.

Mr. Horwitz did not reply to the Receiver's correspondence. In Mr. Kundey's response dated July 14, 2005, Mr. Kundey indicated, among other things, "my access to data is a result of my employment, or lack of termination and therefore is an expressed consent by the Receiver." He further asked on what basis the Receiver demand that he stop using or distributing the budget and any other information as a means to ensure that creditors, investors and employees are paid. At the conclusion of his correspondence, Mr. Kundey indicated that he was "open" to immediate settlement of any AFM business activities. On July 15, 2005, Chaitons reiterated to Mr. Kundey the Receiver's position that any access to the Budget was without the Receiver's consent and that the Receiver's expectations were set out in Chaitons' earlier correspondence. No further reply was received.

### iii. Leased Premises

The Company is currently occupying the Premises pursuant to an Offer to Lease which came into effect on October 1, 2004 (the "Offer to Lease"). On May 31, 2005, Retrocom Mid-Market Properties Inc. ("Retrocom"), the Company's landlord, forwarded to AFM execution copies of a lease and requested that AFM execute those documents. The Receiver has not executed the lease, and does not intend to do so.

On or about September 1, 2005, the Receiver was advised that Retrocom was interested in taking back approximately 1,500 square feet of AFM's leased office space. The Company's rental payments would then be calculated at the rates set out in the executed Offer to Lease, and adjusted for the reduction in square footage. As a result of reduced staffing, the Company no longer required the full extent of its office space. As such, an Offer to Lease Amending Agreement between Retrocom and AFM was executed on September 23, 2005 reducing AFM's office space and reducing the rent accordingly.

Retrocom constructed a wall dividing the office space. During construction that affected the Premises, the Receiver was in attendance. Certain of AFM's assets were then sold to accommodate the reduction in office space. The sale of these assets is discussed later in this Report.

### iv. Insurance

As of the date of the Receiver's appointment, the Company maintained its insurance with Aon Reed Stenhouse Inc. ("Aon"). The Receiver contacted Aon which informed the Receiver that it would not be in a position to respond quickly to the Receiver's request to add the Receiver as an additional named insured on the Company's insurance policy. In addition, Aon required a payment of \$5,040.70 from the Receiver to provide the requested insurance coverage until the policy expiration date of July 1, 2005. Aon was also not able to commit to the Receiver that the policy would be renewed upon its expiry.

The Receiver consulted with Firstbrook, Cassie & Anderson Ltd. ("Firstbrook"), MPL's insolvency insurers, to request that Firstbrook source the insurance required by the Receiver and to obtain the cost thereof. On May 13, 2005, Firstbrook informed the Receiver that the cost of the insurance would be \$1,454 monthly (exclusive of applicable taxes), however, the coverage to be provided by Firstbrook would provide for certain reduced coverage. Firstbrook informed the Receiver that the coverage limits Aon had

provided were greater than AFM's / the Receiver's requirements, which information was verbally confirmed by Aon.

It came to the Receiver's attention that the Company's subsidiary companies may have been covered by AFM's previous insurance policy with Aon. The Receiver was not able to verify this information. Nevertheless, the Receiver confirmed that the policy it undertook with Firstbrook did not include any of AFM's subsidiary companies. The Company's active subsidiary companies informed the Receiver that they have obtained their own insurance policy. As the active subsidiaries are operating from the Premises, the Receiver has been added to the subsidiaries' policy as an additional named insured.

#### **v. Banking**

The Receiver has opened a bank account in respect of the receivership administration. The Receiver's receipts and disbursements are discussed later in this Report.

Following its appointment, the Receiver notified Bank of Montreal (the "**Bank**") of the Receiver's appointment and requested that the Bank freeze the Company's bank accounts and remit the balance of funds on hand directly to the Receiver's office. On May 12, 2005, \$316.03 was received from the Bank and deposited into the Receiver's bank account.

Upon discovering that the Company maintained bank accounts in Seattle, on May 3, 2005, the Receiver communicated with The Commerce Bank of Washington to freeze the Company's accounts and remit the balance of funds on hand directly to the Receiver. On May 19, 2005, \$12.23 (Canadian funds equivalent) was deposited into the Receiver's bank account.

#### **vi. Employees**

##### **a) Situated in Canada**

Upon arriving at the Premises at approximately 4:45 p.m. on the date of the Receiver's appointment, the Receiver met with three individuals who were at the Premises to advise them of the Receiver's appointment. On Monday, May 2, 2005, the Receiver met with the AFM employees and consultants who were at the Premises to advise them of the Receiver's appointment. In addition, on May 2, 2005, the

Receiver spoke by telephone separately with each of Mr. Horwitz, Ms. McIntosh and Mr. Kunday, all of whom resided in Seattle, to advise of the Receiver's appointment.

The Receiver was informed by the Company that as at April 29, 2005, there was approximately \$80,700 of payroll and expenses owing (covering the period March 24, 2005 to April 29, 2005) to AFM's employees and consultants engaged by the Company situated in Canada. In addition, there was approximately \$117,000 owing to former employees of the Company representing the balance of severance payments payable pursuant to agreements between AFM and those employees.

The Receiver has since its appointment paid on behalf of AFM the payroll arrears for the employees and consultants situated in Canada. The Receiver did not pay expenses or severance payments. The payment of the arrears by the Receiver (which were paid between April 29, 2005 and May 31, 2005) was made to preserve the operations and value of AFM's Canadian subsidiary companies. The Receiver has been reimbursed by certain of AFM's active subsidiaries for a portion of the payroll and payroll-related amounts paid from the date of its appointment.

As a result of the Company's arrears (as per its records) of approximately \$37,000 to Canada Revenue Agency ("CRA") on account of source deductions, the Receiver made arrangements for CRA to open a separate source deductions account in respect of AFM's payroll paid following the date of the Receiver's appointment.

On June 10, 2005, a representative of CRA attended at the Company's premises to conduct a payroll audit for each of AFM's pre-receivership and receivership payroll accounts. At that time, CRA requested that the Company's T4s and T4 Summary for the pre-receivership period be filed. The Receiver arranged for the completion of these forms, which were filed with CRA on September 26, 2005.

The Receiver has since received CRA's Notices of Assessment for each of the Company's accounts. It appears that CRA has made an error on the Notice of Assessment for the receivership payroll account. The Receiver is in discussions with CRA to correct same.

On September 28, 2005, based on an assessment made, two full-time employees and two consultants were terminated. The employees/consultants were provided with a letter setting out the amounts that they would receive as a result of the termination, including outstanding wages, pay in lieu of notice and

outstanding vacation pay, if any, which payments would be made in full and final settlement of any claims they may have against either the Receiver or AFM. The Receiver also provided each of the full-time employees with their respective Records of Employment.

The two full-time employees were receiving benefits coverage through AFM's benefits provider. Upon expiry of the required period for continuation of benefits, the coverages for each of these employees were cancelled.

It came to the Receiver's attention that the Company maintained an account with Workplace Safety and Insurance Board ("WSIB"). The WSIB has since advised the Receiver that AFM's account was automatically closed as a result of the receivership, and that the Receiver was not required to maintain an account with it. In discussions with certain of the Company's employees, the Receiver was told that the account had initially been opened when AFM, through certain of its subsidiary companies, offered property management services. As the subsidiary companies had no management contracts in place as at the date of the Receiver's appointment, the Receiver has not opened a new account with WSIB.

On or about July 22, 2005, an individual who was listed as a director of AFM provided the Receiver with a copy of correspondence from the Director of Employment Standards – British Columbia (the "Director"). The correspondence set out the claims of three (3) complainants totaling approximately \$24,000 as at the Date of Decision, being July 5, 2005. The Receiver, through Chaitons, informed the Director of the stay of proceedings in place as a result of the receivership.

**b) Situated in the United States**

The employment of the individuals in the Seattle Office was not terminated by the Receiver. However, based on the Receiver's discussions with each of Messrs. Horwitz, Kundey and Ms. McIntosh, the Receiver did not fund payment of the payroll for the individuals at the Seattle Office. In respect of these individuals:

1. Mr. Horwitz was at the date of the Receiver's appointment the Chairman and CEO of AFM. Mr. Horwitz's employment was governed by the terms of an employment agreement dated October 1, 2002 as amended on December 1, 2002, copies of which were provided to the Receiver. On May 6, 2005, Mr. Horwitz made certain claims to the Receiver for amounts Mr. Horwitz claimed were owed.

By letter dated May 9, 2005, Chaitons, on behalf of the Receiver, responded to Mr. Horwitz. On May 10, 2005, Mr. Horwitz filed a "Demand Arbitration" in respect of his claim for "\$1 million plus amounts to be determined related to indemnification" with the American Arbitration Association ("AAA") office in Seattle. On May 25, 2005 and May 31, 2005, Chaitons provided the AAA and the International Centre for Dispute Resolution (the "ICDR") with a copy of the Appointment Order and set out the Receiver's position that Mr. Horwitz's request for arbitration should not proceed without the written consent of the Receiver or leave of the Ontario Superior Court of Justice. By correspondence dated June 2, 2005, the ICDR confirmed to Chaitons that the arbitration was stayed until further notice from either the parties or the Court, unless the consent of the Receiver and Mr. Horwitz was obtained.

2. Ms. McIntosh was the CFO of AFM. According to a letter dated April 25, 2005 from AFM (as signed by Mr. Horwitz) to Propco, Ms. McIntosh resigned her position effective April 29, 2005. A copy of AFM's letter is found in Appendix "G" to the Motion Record of Propco supporting Propco's motion for the appointment of the Receiver. Notwithstanding this letter, Ms. McIntosh communicated with the Receiver that she did not resign. By letter dated May 2, 2005, Ms. McIntosh set out her claim against AFM in the amount of U.S. \$47,042.62 consisting of unpaid wages and vacation pay of \$46,759.62 and unpaid expenses of \$283.00. Chaitons, by letter dated May 9, 2005, responded to Ms. McIntosh confirming its understanding that Ms. McIntosh had not been paid by AFM for a number of months and also confirming that the Receiver would not be paying her. As a result of discussions between the Receiver and Ms. McIntosh, on May 10, 2005, the Receiver offered to engage Ms. McIntosh as an independent consultant to the Receiver. As set out in Ms. McIntosh's May 11, 2005 e-mail to the Receiver, Ms. McIntosh did not agree to be engaged by the Receiver. On May 13, 2005, Ms. McIntosh notified the Receiver that if she did not hear back from the Receiver by Monday, May 15, 2005, she would pursue her claim through the Courts. On May 16, 2005, Ms. McIntosh wrote to Mr. Justice Campbell of the Ontario Superior Court of Justice. Mr. Justice Campbell responded to Ms. McIntosh indicating that her letter had been passed on to the Receiver with a request to report to the Court in the ordinary course.
3. Mr. Kunday submitted on May 2, 2005 a claim to the Receiver in the amount of US \$260,075.53 consisting of unpaid wages and vacation pay of \$78,130.60, unpaid expenses of \$71,976.77 and a termination claim of \$109,968.16. Based on the terms of the employment agreement provided by Mr. Kunday, Chaitons notified Mr. Kunday of the Receiver's position that Mr. Kunday was not an

employee of AFM and that Mr. Kunday had no claim for wage arrears or any other amounts against AFM. By e-mail of May 19, 2005, the Receiver offered to engage Mr. Kunday as an independent consultant to the Receiver. On May 25, 2005, Mr. Kunday provided the Receiver with an invoice in the amount of US \$675.00 in respect of services provided to the Receiver. On May 27, 2005, the \$675.00 was paid to Mr. Kunday.

**vii. Stock Exchanges/Provincial Registrations**

As at the date of the Receiver's appointment, AFM was a public company whose shares were listed on various Canadian stock exchanges including the Toronto Stock Exchange ("TSX") and the Alberta Stock Exchange ("ASE"). Effective 5:01 p.m. on May 20, 2005, the Company's common shares were suspended from trading further to TSX bulletin 2005-0449 dated April 22, 2005.

The Receiver engaged Loopstra Nixon LLP ("Loopstra"), the Company's former counsel, to assist in the filing of the requisite documents in connection with the Receiver's appointment.

On May 19, 2005, a Press Release was issued by the Receiver relating to the appointment of the Receiver. A copy of the press release is attached hereto as Appendix "C". On May 20, 2005, the Receiver executed a Material Change Report that was filed by Loopstra.

The Company's extra-provincial registration in Alberta expired on June 2, 2005 and could not be renewed as there are presently no confirmed directors of AFM. The Receiver was informed by Davis & Company, Alberta counsel retained by the Receiver, that the registration can most likely be reinstated once the directors are confirmed or new directors are appointed. The Company's extra provincial registration in New Brunswick expires on January 31, 2006 and will not be renewed for the same reasons.

On July 29, 2005, the ASE issued an Interim Cease Trade Order. On August 12, 2005, the ASE issued a Cease Trade Order.

The Receiver has been informed that AFM has appeared on the delinquent filer list published by the Ontario Securities Commission. The Manitoba Securities Commission has also issued an Extension Cease Trade Order dated April 29, 2005.

On August 25, 2005, Mr. Horwitz informed the Receiver that "a general corporate search this week of Canadian Corporations continues to incorrectly show" Messrs. Horwitz, Keuhl, Erickson and Tatibouet as current directors of AFM. Mr. Horwitz requested that the Receiver provide to him and the other former directors with a copy of the applicable paperwork to complete the correction of the corporate records on file with the regulatory agencies as it was his view that only the Receiver was authorized to make those filings on behalf of AFM. It is the position of the Receiver that it is not required to effect the requested changes.

#### **viii. Corporate Records**

The Receiver corresponded with Loopstra and Lang Michener LLP ("Lang"), legal firms which had provided services to the Company, to ascertain whether either of those firms were in possession of the minute books of AFM and its subsidiaries as well as any share certificates. The Receiver has been advised by Loopstra that it is in possession of certain minute books relating to AFM and/or certain subsidiaries. However, both Loopstra and Lang advised the Receiver they are not in possession of any share certificates relating to AFM's subsidiaries. In addition, in telephone discussions with Mr. Horwitz on May 2, 2005, Mr. Horwitz advised the Receiver that he was not in possession of any share certificates relating to the subsidiary companies.

To date, while the Receiver has located the minute books for a majority of the Canadian subsidiary companies, the Receiver has not obtained possession of the share certificates.

With respect to the minute books for AFM's U.S.'s subsidiary companies, the Receiver has been informed by Holland & Knight, AFM's former U.S. counsel, that it is in possession of corporate records/minute books of eleven AFM U.S. subsidiary companies. Holland & Knight has informed the Receiver that it has an attorney's retention lien pursuant to Section 60.40.010 of the Revised Code of Washington. To date, the Receiver has not pursued obtaining possession of the corporate records/minute books in the possession of Holland & Knight.

#### **ix. Unsecured Creditors**

According to the Company's records, as at the date of the Receiver's appointment, AFM's accounts payable, before consideration of claims made against the Company by former employees, exceeded \$1,000,000. The Receiver has been informed by the Company that certain of its obligations arose from

products and services previously provided to the Company on behalf of its subsidiaries, and that as at the date of the Receiver's appointment, the Company was for the most part no longer purchasing any products or services.

**x. National Post**

The Receiver was informed that on or about April 29, 2005, National Post terminated its agreement with AFM that provided for newspapers to be delivered to individual franchised hotels that paid fees to Canadian subsidiary companies of AFM. The termination resulted from AFM's unpaid indebtedness to National Post. The Receiver was advised by a representative of the Canadian subsidiary companies that if the newspaper service was not restored, franchisees/licensees of the Canadian subsidiary companies might have claimed a breach of the franchise/license agreements, which would have had a detrimental effect on the value of those subsidiary companies.

In an effort to have service restored, Chaitons, on behalf of the Receiver, communicated with National Post advising of the Appointment Order. As a result of arrangements made by the Receiver with National Post, including an advance payment of \$3,500, National Post resumed service on or about May 16, 2005.

The Receiver understands that AFM earns certain advertising entitlements as part of its agreement with National Post. On or about September 12, 2005, the Receiver engaged in discussions with National Post to obtain the requested credits. On or about October 11, 2005, National Post provided the Receiver with the quantum of advertising credits earned to August 31, 2005. At the request of an AFM subsidiary, the Receiver provided National Post with an insertion order request for advertising placements to appear in the National Post for the period from October 31, 2005 to December 31, 2005.

The agreement with National Post is scheduled to expire on January 21, 2006. The Receiver is presently reviewing the status of the agreement with the subsidiary companies.

**xi. Cendant Corporation ("Cendant")**

Cendant is the parent corporation of Cendant Hotel Group Inc., which is the master franchisor/licensor of many hotel brands.

On May 5, 2005, the Receiver attended a conference call with representatives of Propco and Cendant and their respective counsel. During the conference call, Cendant expressed its concern with respect to certain of the licensees that were subsidiary companies of AFM not meeting their obligations pursuant to the terms of the respective license agreements.

At that time, it was agreed that representatives of Cendant would attend at AFM's office in Toronto to perform the audit provided for in the various Master License Agreements. It was also contemplated at that time that Cendant may, following its audit, present an offer to either Propco or the Receiver that would result in Cendant obtaining the Canadian rights to the Master License Agreements.

Representatives of Cendant attended at AFM's office between May 23 and 25, 2005 to perform the audit and continued to gather information after May 25, 2005 through telephone enquiries made.

On June 9, 2005, counsel to Cendant, Blake Cassels and Graydon LLP, informed Chaitons that Cendant would not be presenting an offer at that time.

On June 21, 2005, a meeting was held in Toronto with Mr. Phillips, representatives of Cendant (from New Jersey), Propco and the Receiver, with counsel to the Receiver and Cendant also in attendance. At that meeting, Cendant's concerns were raised and possible resolutions discussed. No agreement was reached between the parties but discussions later continued.

In the absence of an agreement between the parties and given the passage of time, the Receiver now wishes to begin a process to request offers for AFM's shares in certain of its Canadian subsidiaries. The Receiver's proposed plan to request offers is discussed later in this Report.

**xii. Chapter 11 Proceedings of Dennis L. Heyde and Carol J. Heyde**

Prior to April 2002, Dennis L. Heyde and Carol J. Heyde (the "Heydes") operated ten hotels (the "Heyde Hotels") located in Minnesota and Wisconsin through Heyde Hospitality, Inc., a corporation owned by the Heydes. On April 25, 2002, the Heydes entered into an acquisition agreement (the "Acquisition Agreement") with AFM and Northwest.

Contemporaneously with the Acquisition Agreement, it is the Receiver's understanding that the Heydes entered into a management agreement (the "Management Agreement") with Northwest pursuant to which Northwest agreed to assume the management of the Heyde Hotels. The Management Agreement provided for certain minimum management fees to be paid to Northwest in consideration of its managing the Heyde Hotels. On December 20, 2002, AFM, Northwest and the Heydes entered into an amending agreement (the "Amending Agreement") which modified and amended the terms of the Acquisition Agreement, providing *inter alia* that the Heydes would jointly and severally warrant that Northwest would earn management fees of not less than \$4,000,000 during the period commencing May 1, 2003 and ending April 30, 2007. In consideration of entering into the Amending Agreement, the Heydes were to receive an equity interest in AFM in the form of stock and stock options.

The Heydes put forward a Plan of Reorganization (the "Plan") in U.S. Chapter 11 proceedings. The Plan indicates that the claims of unsecured creditors cannot be estimated with any certainty because this class consists primarily of deficiency claims arising out of under-secured claims in other classes of the Plan. The Plan provides that in full satisfaction of its claim, each unsecured creditor shall receive its pro rata share of a pool into which the Heydes will pay \$75,000 per quarter until the earlier of (i) payment in full of allowed claims in the class plus interest as set out therein, or (ii) the total sum of \$1,500,000 U.S. has been paid into the unsecured creditors' pool.

On February 9, 2005, AFM filed an unsecured proof of claim (the "AFM Proof of Claim") in the amount of \$4,000,000 U.S. in the Heydes' Chapter 11 proceedings.

On May 5, 2005, the Heydes filed an Objection to the AFM Proof of Claim seeking that it be disallowed and a Complaint seeking *inter alia* judgment for damages in the amount of U.S. \$2,750,000 against AFM, Northwest and a corporation called MinWis Acquisition Company LLC. The Heydes based their Objection on their claims that: (1) any management fees owed by the Heydes are payable to Northwest and not AFM (and that accordingly, there is no debt owing by the Heydes to AFM); and (2) Northwest was, according to the Heydes, in default of the Management Agreement and was not managing the Heyde Hotels after December 2003. The Heydes also claimed that even if Northwest was not in breach of the Management Agreement, Northwest was paid at least \$923,128.22 for the period between May 2002 and November 2003 for which it would have no claim against the Heydes. Prior to its bankruptcy, Northwest had not filed a proof of claim in the Heydes' Chapter 11 proceedings.

On June 7, 2005, a bankruptcy petition was filed against Northwest in the United States Bankruptcy Court for the Western District of Washington (Seattle).

As the Receiver was having difficulty hiring U.S. counsel due to conflicts of interest raised by various law firms it had attempted to retain, Chaitons was able to obtain an extension until June 23, 2005 of the June 6, 2005 deadline to file an answer (the "Answer") to the Heydes Objection and Complaint. The Receiver was ultimately able to retain Hills Clark and Ruder Ware to represent its interests. The Receiver had wanted more time to review the matter and gather information so as to enable it to develop a position. However, the Heydes were not prepared to recognize the stay provisions in the Appointment Order and refused to grant any further indulgences to the Receiver. Accordingly, the Receiver's U.S. counsel filed a Notice of Appearance on behalf of AFM which counsel had thought would preclude the Heydes from obtaining default judgment without further notice to counsel, thereby giving the Receiver further time before having to file a formal answer, should it decide to do so.

However, in August 2005, the United States Bankruptcy Court granted default judgment dismissing AFM's US \$4,000,000 claim against the Heydes. An answer to the Heyde complaint was filed by AFM's Wisconsin counsel. A confirmation hearing on the Heyde bankruptcy and status hearing on the Heyde Objection were both continued to February 6, 2006.

**xiii. Deloitte**

On May 31, 2005, the Receiver requested access to the working papers of Deloitte & Touche LLP ("Deloitte"), the Company's external accountants, to obtain additional information as to the composition of this account.

On June 22, 2005, the Receiver requested from Deloitte additional information as well as a response to its May 31, 2005 letter. On July 20, 2005, the Receiver made a further request for information from Deloitte. Deloitte did not provide the Receiver with the information requested.

On September 28, 2005, the Receiver was contacted by Mr. Steven Lamont of Morris Brown Sosnovitch LLP ("MBS"), who informed the Receiver that MBS had been retained as counsel by Deloitte. By letter dated September 28, 2005, the Receiver informed MBS that the information being requested from Deloitte at that time were copies of:

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1. the last income tax return filed by AFM together with the non-consolidated balance sheet of AFM for that taxation year;
2. the last financial statements prepared by Deloitte for AFM (both non-consolidated and consolidated);
3. the last financial statements prepared for each subsidiary company of AFM;
4. the last income tax return filed by each subsidiary company of AFM; and
5. details as to the amounts included in AFM's accounts receivable from AFM Asset Management Inc. and from AFM Asset Management Services Inc.

On October 25, 2005, MBS replied to the Receiver that while Deloitte did not oppose the release of the documents, Deloitte required that a specific motion be brought by the Receiver, on notice to Deloitte, and the former officers and directors of AFM, requesting that Deloitte produce the specific documents in its possession. MBS also asserted its position that Deloitte is entitled to compensation for producing these documents, including external counsel fees. On December 6, 2005, Chaitons responded to MBS' position. Copies of MBS' letter and Chaitons' response thereto are attached as **Appendix "D"** to this Report. In subsequent discussions between counsel for Deloitte and the Receiver, counsel for Deloitte confirmed that it would not oppose an Order requiring Deloitte to provide the requested information without compensation.

#### **xiv. Reports Pursuant to the Bankruptcy and Insolvency Act ("BIA")**

On May 9, 2005, Notices of Receiver pursuant to Section 245(1) of the BIA ("**BIA Notices**") were mailed to creditors of the Company. On that date, a Report of Receiver pursuant to Section 246(1) of the BIA was forwarded to the Office of the Official Receiver (the "**OR**"). In addition, on November 14, 2005, a Report of Receiver pursuant to Section 246(2) of the BIA was forwarded to the OR.

Copies of the BIA Notice and reports forwarded to the OR (without the creditor lists) are attached to this Report as **Appendix "E"**.

**xv. Hewlett-Packard ("HP")**

As at the date of the Receiver's appointment, the Company was subject to three leases with HP in respect of computer equipment used by the Company and its Canadian subsidiary companies. The computer equipment consisted of the Company's network and other equipment, all of which was primarily located in Toronto and Seattle. The leases provided for aggregate monthly payments of \$10,481.39, inclusive of applicable taxes.

The Receiver was informed by AFM that in September 2004, the Company had made arrangements with HP to reduce the monthly payments to approximately \$4,178.15, inclusive of applicable taxes. The Receiver exchanged correspondence with HP with respect to the use by the Receiver of the leased assets and referred to correspondence between AFM and HP relating to an apparent reduction in the monthly lease payment amounts. HP took the position that there was no agreement with AFM with respect to reduced payments since the agreement to reflect the reduced rates had not been executed by the Company. AFM was not able to provide the Receiver with fully executed documents to reflect the lease reduction. In addition, according to HP, lease payments had not been made to HP since around June 2004.

In further review of its position, and after obtaining legal advice, the Receiver notified HP of its position that, based on the terms of the Appointment Order and the lease terms, the Receiver was not required to make payments to HP on account of the leases. HP was not in agreement with the Receiver's position.

The parties agreed on October 28, 2005 that the Receiver would pay \$22,000 plus applicable taxes to purchase from HP the equipment subject to the leases and to obtain a release from HP. The Receiver has completed the purchase of the assets from HP on an "as is, where is" basis and obtained the release.

The HP assets that are not in the possession of AFM consist mainly of laptop computers. In view of the estimated realizable value of these assets and the potential costs to attempt to locate and retrieve the equipment, the Receiver has not pursued these assets.

**xvi. Specified Subsidiaries**

Paragraph 2 of the Appointment Order provided the Receiver with the authority to review the records of the Specified Subsidiaries and to determine if the assets of the Specified Subsidiaries were being used and the operations of the Specified Subsidiaries were being conducted in the ordinary course of business.

In order to preserve the goodwill associated with the brand names of three of the Specified Subsidiaries by not disclosing their names in the public domain, the three such Specified Subsidiaries are referred to in this Report as "Subsidiary One", "Subsidiary Two" and "Subsidiary Three". In addition, there is one U.S. subsidiary that has a name similar to that of Subsidiary One, which for purposes of this report will be referred to as "Subsidiary Four".

The Receiver focused its review on the cash disbursements from the respective bank accounts of AFM and the Specified Subsidiaries for the period prior to April 29, 2005.

Attached as the following Appendices are schedules of disbursements (cheques or debits) greater than \$10,000 (a threshold amount chosen by the Receiver) for the period April 1, 2004 to April 29, 2005 from the bank accounts of each of AFM and the Specified Subsidiaries identified to the Receiver:

Specified Subsidiary	Appendix reference
AFM	F
Subsidiary One	G
Subsidiary Two	H
Subsidiary Three	I
La Quinta Canada Inc.	J
AFM Preferred Alliance Group Inc.	K

The Receiver noted in its review approximately nine payments/transfers to Northwest in 2004, totaling approximately US \$333,000. The Receiver notes that for some payments made, the cheque numbers on those disbursements were handwritten and notes on the cheques indicate "loan".

The Receiver was informed by Mr. Blake that he was not aware of disbursements between April 1, 2004 and April 29, 2005 that were out of the ordinary course of business. However, Mr. Blake noted that he was not required to authorize all transactions, and that he would not have been involved in any transactions through the Commerce Bank accounts that were in Seattle.

The Receiver does not propose to do any further work in connection with the disbursements of AFM and the Specified Subsidiaries unless otherwise requested.

#### D. Assets of AFM

According to AFM's internal unaudited non-consolidated balance sheet as at April 29, 2005, the assets of the Company are summarized below:

Description	Amount
Cash	\$ 520
Accounts receivable – Trade	156,572
Accounts receivable – Other	59,679
Input Tax Credits	2,929
Prepaid expenses	103,726
Investments	16
Furniture, fixtures and equipment (net)	114,947
Shareholders' loans receivable	2,820,976
Inter-company loans receivable	33,132,520
	<u>\$ 36,391,885</u>

A copy of the balance sheet is attached hereto as Appendix "L". Details of these assets, and their estimated realizable value, are discussed below.

The Receiver has reviewed the Company's records and engaged in discussions with AFM employees in an attempt to identify the recorded assets that may have some realizable value. For purposes of this Report, the Receiver has only reviewed accounts having net positive balances on the Company's balance sheet.

In performing its review, the Receiver noted that certain of the Company's financial information was not current and therefore certain of the Receiver's below-noted comments are subject to amendment.

The Receiver notes that the financial information it reviewed is dated April 30, 2005. However, as April 30, 2005 was a Saturday, the Receiver has assumed that this financial information is the same as it was on April 29, 2005, the date of the Appointment Order.

*i. Accounts receivable – Trade*

The Company's trade accounts receivable consist of amounts due from the following parties:

	<b>Book Value</b>
Cendant Corporation	\$ 149,806
Northwest Lodging USA	2,101
Ramada Franchise Systems	3,834
Trigild Corporation	831
	<b>\$ 156,572</b>

The receivable from Cendant relates to the sale of a Ramada Hotel to Cendant, and in particular, sales and marketing salaries and expenses incurred by AFM as part of a Transition Agreement between Cendant and AFM. The Receiver also located subsequent correspondence from Cendant suggesting that Ramada had an outstanding receivable from AFM which amount the Receiver has been unable to determine. In addition, as set out later in this Report, there is a credit balance of \$51,908 recorded in "Accounts Receivable – Other" relating to Cendant.

The receivables from Northwest and Trigild Corporation ("Trigild") represent newswire charges paid by AFM for press releases relating to those companies. As set out earlier in this Report, a bankruptcy petition was issued to Northwest on or about June 7, 2005. The Receiver has not filed a Proof of Claim in the bankruptcy. The U.S. Trustee has informed the Receiver that since no funds are expected to be distributed, foreign creditors need not file a Proof of Claim.

According to the Company, the receivable from Ramada Franchise Systems represents fees incurred in assisting with the audit for the 2002 fiscal year end relating to the sale of the Ramada Hotel. In view of the amount of this account, and the limited supporting documentation provided to the Receiver, the Receiver will not pursue collection of this account.

Since the cost to effect collection of the receivable from Trigild will likely exceed the receivable amount, the Receiver will not pursue collection of this account. Trigild is discussed later in this Report.

*ii. Accounts receivable – Other*

According to the Company's records, the Company's "Accounts receivable – other" consist of:

	Note Reference	Book Value
Account receivable – Canmac Hotels Corporation	1	\$ 71,247
Account receivable – Park Plaza Vancouver Airport	2	18,227
Accrued interest on shareholders loans		15,880
GST refund filed	3	<u>6,233</u>
		111,587
Account receivable – Cendant	4	<u>(51,908)</u>
		<u>\$ 59,679</u>

**Notes:**

1. The \$71,247 is due from Canmac Hotels Corporation ("Canmac"), a corporation the Receiver understands is controlled by Mr. Horwitz. The receivable amount is in respect of legal fees incurred on Canmac's behalf. The Receiver understands that AFM executed promissory notes with the respective legal firms in respect of outstanding legal fees including the Canmac indebtedness. The Receiver has reviewed this information to ascertain whether any legal fees were actually paid by AFM. Given the quantum of legal fees paid by AFM, which total approximately \$2,100, the Receiver does not intend to pursue collection of this account.
2. This amount represents the balance of funds from a renovation loan provided to Park Plaza Vancouver Airport ("Park Vancouver") by AFM. It appears that AFM attempted collection of this

account in February 2005. At that time, Park Vancouver claimed that the balance of the renovation loan should be offset against signage fees paid by Park Vancouver which, according to Park Vancouver, were AFM's responsibility. The Receiver is currently attempting collection of this account.

3. On April 28, 2005, the Company filed a Goods and Services Tax return in the amount of \$6,233 for the period January 1, 2005 to March 31, 2005. In addition, as at April 29, 2005, the Company's records reflect GST input tax credits of \$2,929, included in "Accounts Payable - Other". The Company filed a GST return for this amount on June 10, 2005. It appears that CRA will offset those amounts against AFM's indebtedness to CRA for payroll related liabilities.
4. It would appear that this credit of \$51,908 would reduce the account receivable from Cendant referred to earlier herein.

### iii. Prepaid expenses

AFM's prepaid expenses as at April 29, 2005 are comprised of the following:

	Note Reference	Book Value
Leased premises – last month's rent	1	\$ 9,560
Toronto Stock Exchange	2	5,840
Leased equipment	3	5,702
Prepaid insurance	4	4,717
Prepaid acquisition costs	5	62,907
Other	6	<u>15,000</u>
<b>Total</b>		<b><u>\$ 103,726</u></b>

#### Notes:

1. The Receiver understands that the \$9,560 prepayment represents the last month's rent deposit. The Company's "lease" for the Premises expires in September 2009. In view of AFM's receivership, it is likely that this amount is not collectible and the Receiver will therefore not pursue its collection.

2. This amount represents the annual TSX Sustaining Fees. Although recorded as a prepaid expense, this amount was not paid by AFM. Accordingly, this account has no realizable value.
3. Leased equipment includes a deposit in the amount of \$5,127 made to E.O.E., Leaseco Ltd. ("E.O.E.") for the last quarter's lease payment in respect of two leased photocopiers. On October 5, 2005, at the Receiver's request, representatives of E.O.E. attended at AFM to collect the photocopiers. In view of AFM's receivership, it is likely that this amount is not collectible and the Receiver will therefore not pursue its collection. The balance of \$575 represents a prepaid expense to LaserNetworks Inc. ("LaserNetworks") in respect of a leased colour printer which was not paid by AFM. Accordingly, this account has no realizable value. On September 30, 2005, at the Receiver's request, representatives of LaserNetworks attended at AFM to collect the colour printer.
4. The Receiver understands that the Company did not pay the amount shown for prepaid insurance. Accordingly, this account has no realizable value.
5. The Receiver has been advised that the Company's prepaid acquisition costs include legal fees relating to the acquisition of various entities. As the legal fees have been expended and the Receiver is not aware of a reason to request repayment of these fees, this "asset" will not be pursued by the Receiver.

Other prepaid expenses include a \$5,000 commission in respect of Mr. Trevor Dear and a \$10,000 retainer for Loopstra, former solicitors to the Company. The \$5,000 represents a commission paid to Mr. Dear in 2003 for securing a new Traveller's Inn location. According to the Company, the commission was initially paid out by Travellers Inn Franchise Canada Inc. The brand was subsequently lost and the commission was transferred to AFM to be expensed. The Company is of the view that this amount should be written off, and the Receiver will not pursue its collection. The \$10,000 retainer to Loopstra is not considered collectible since the Company's indebtedness to Loopstra, according to the Company's accounts payable listing, is significantly higher than the \$10,000.

#### *iv. Investments*

According to AFM's detailed trial balance, investments are recorded in two separate entries in the amounts of \$15 and \$1, respectively, that were transferred from the Company's previous accounting system.

The Company's records do not provide any details to indicate to which investments the aforementioned amounts relate.

Notwithstanding AFM's accounting records, as set out earlier herein, AFM appears to be the parent corporation of 27 direct or indirect subsidiary companies. A review of the Receiver's findings to date on the subsidiary companies is set out later in this Report.

#### *v. Furniture, fixtures and equipment*

According to the Company's records, furniture, fixtures and equipment as at April 29, 2005 was comprised of the following:

Description	Cost	Depreciation	Net Book Value
Furniture & fixtures	\$ 122,943	\$ (122,943)	\$ Nil
Telephone equipment	230,648	(284,245)	(53,597)
Computer equipment	297,460	(296,566)	894
Software	369,001	(201,351)	167,650
Office equipment	<u>77,360</u>	<u>(77,360)</u>	<u>Nil</u>
	<u>\$ 1,097,412</u>	<u>\$ (982,465)</u>	<u>\$ 114,947</u>

The Company's software account consists primarily of a Great Plains accounting software package (purchased in 2001) and twenty-one related user licenses owned by AFM. Licensed users of Great Plains are required to pay annual maintenance fees, which entitle them to software updates, fixes and technical support. The Company has not made any maintenance payments for Great Plains since November 2003 and, as a result, has not received any software updates or support since that date. Accordingly, the realizable value of the software is uncertain at this time.

On September 15, 2005, MPL received a written expression of interest from Benefits Plan Administrators Group ("BPA"), which was situated in the same office building as AFM, for the purchase of certain of AFM's furniture and equipment for a purchase price of \$2,900 plus applicable taxes. The Receiver proceeded to obtain an appraisal of the Company's fixed assets. The appraisal itemized the value of the assets owned by AFM, as well as the assets subject to various lease agreements. The Receiver then requested two additional offers for the purchase of the assets from Benaco Sales Ltd. and Canam-Appraiz Inc. As BPA's offer was the most favourable, and was consistent with the appraised value of the various items, the assets were sold to BPA on September 28, 2005.

*vi. Shareholders' loans receivable*

According to information available to the Receiver, it appears that the Company provided two of its shareholders with the following loans during 2001 and 2002:

	Amount
Lawrence Horwitz – December 28, 2001	\$ 1,356,249
Lawrence Horwitz – January 31, 2002	95,000
Andre Tatibouet – 2001	1,828,636
Andre Tatibouet – 2002	<u>124,070</u>
	<u>\$ 3,403,955</u>

According to the Company's balance sheet as at April 29, 2005, the Shareholders' loans receivable, adjusted for payments received and accrued interest, was as follows:

	Amount
Lawrence Horwitz	\$ 1,286,448
Andre Tatibouet	<u>1,534,528</u>
	<u>\$ 2,820,976</u>

On May 31, 2005, the Receiver requested from Deloitte copies of Deloitte's working papers as they relate to the shareholders receivable in order for the Receiver to review the basis for the reduction in the above-noted shareholder loan accounts.

On April 5, 2005, Mr. Tatibouet filed for Chapter 11 Reorganization in Hawaii. On August 4, 2005, at the instance of the Receiver, a proof of claim was filed in the reorganization on behalf of AFM. At this time, the Receiver is not in a position to estimate the realizations, if any, that may be received from this loan receivable.

On June 6, 2005, Mr. Horwitz filed a Chapter 7 case in the United States Bankruptcy Court. AFM's U.S. counsel has filed a proof of claim with the U.S. Trustee. At this time, the Receiver is not in a position to estimate the realizations, if any, that may be received from this account receivable.

**vii. Inter-company loans receivable**

The inter-company accounts include, inter alia, both payments made by AFM directly on behalf of the respective subsidiaries, as well as the allocation to the subsidiaries of a share of AFM's expenses.

The Company's liabilities reflect a credit balance of \$29,882,351 recorded as "Due to Affiliates". Included in these accounts are accounts due from various related companies (as recorded in AFM's accounts) totaling \$33,132,520 as follows:

Name	Note Reference	Amount
Subsidiary One	1	\$ 976,686
Subsidiary One Marketing Fund	1	149,969
Best Inns FCI	1	588,681
Best Inns Marketing Fund	1	90,371
Hawthorne Suites FCI	1	721,186
Hawthorne Suites Marketing Fund	1	27,647
Subsidiary Three	1	715,289
Subsidiary Three Marketing Fund	1	209,360
La Quinta Canada Inc.	1	575,928
La Quinta Canada Inc. Marketing Fund	1	31,688
Park Inn FCI	1	650,373
Park Inn Marketing Fund	1	101,425
Park Plaza FCI	1	586,340

First Report to the Court of Mintz & Partners Limited as  
Interim Receiver and Receiver and Manager of  
AFM Hospitality Corporation

December 29, 2005  
Court File No. 05-CL-5878  
Page 30

Name	Note Reference	Amount
Park Plaza Marketing Fund	1	135,961
Travellers FCI	1	319,908
Travellers Marketing Fund	1	14,702
Villager FCI	1	749,135
Villager Marketing Fund	1	88,572
AFM Preferred Alliance Group	1	1,068,933
NWLI (USA)	2	11,159,094
NWLI (Canada)	1	1,687,463
Trigild	3	156,664
AFM Asset Management	4	4,721,459
AFM Hotel Acquisition	4	1,211
Kelloryn Holdings Inc.	1	6,913,613
Kelloryn - North Bay	1	443,107
Kelloryn - Inn in the Valley	1	247,755
		<u>\$ 33,132,520</u>

The Receiver has completed a detailed review of these accounts and, where possible, has segregated the components of the various accounts contained therein. As is detailed below, these accounts receivable do not appear to be collectible.

The Receiver understands that the Company changed its accounting software in or around December 2001. As a result, the majority of these accounts have lump sum opening balances, which were transferred from the previous accounting software. As information on the opening balances is not readily available to the Receiver, the Receiver has not reviewed the details of those opening balances, comprising of transactions posted prior to December 2001.

**Notes:**

1. The records for these companies were maintained at AFM. Based on information provided to the Receiver, and as explained in this Report, these companies do not have the funds at this time to repay their recorded indebtedness to AFM. As a result, the Receiver has not pursued collection of these accounts.
2. A bankruptcy petition was issued against Northwest on June 7, 2005. According to the Notice of Chapter Case dated November 24, 2005, "foreign creditors" were informed not to file a Proof of Claim at this time, as there did not appear to be any funds available to the Trustee to pay creditors. Therefore, the Receiver has not filed a Proof of Claim.
3. The Receiver has located certain information regarding this account receivable, however, this information does not appear at this time to be sufficient to commence collection proceedings. Unless additional information is provided to the Receiver, the Receiver will not pursue collection of this account.
4. The Receiver has made enquiries but has not been able to confirm whether these companies have any assets to repay their obligations to AFM.

**E. AFM's Canadian Subsidiary Companies**

**(i) AFM Preferred Alliance Group Inc. ("Preferred")**

Preferred was incorporated on December 6, 2001. Its operations consist of assisting in the procurement of equipment and supplies for the hospitality industry. It maintains a listing of Approved/Preferred Vendors (the "Vendors") that, combined, provide products and services for all levels of operations, from large-scale capital expenditures to daily use supplies.

Customers purchase products and services using an AFM identification number and in turn receive pre-negotiated rates from the Vendors. There are no fees to customers. Preferred collects commissions from the Vendors' sales resulting from the efforts of Preferred.

According to the internal balance sheet of Preferred as at April 29, 2005, the company has a deficit of \$1,014,592, the majority of which is represented by Preferred's indebtedness to AFM of \$1,068,933. Cash on hand is approximately \$2,500. The company's primary asset is "licenses and management contract", which had a cost of approximately \$290,000 but which is fully amortized. This asset consists primarily of a license agreement between Hospitality Franchise Systems Inc. and Accommodex Franchise Management Inc. ("**Accommodex**") dated March 31, 1995. The license agreement allowed for a non-transferable, exclusive (as to Canada only) use of the name and marks HFS Purchasing Services ("**HFS**") and its methods of operation, vendor lists, purchasing catalogues and know how. The initial license fee was US\$250,000 for a twenty-year term ending March 31, 2015.

With the incorporation of Preferred in December 2001, Preferred stopped using the HFS name and marks and, accordingly, the net book value of the "licenses and management contract" was amortized in full.

(ii) **Subsidiary One**

This subsidiary was incorporated on August 16, 1999 and offers franchise and license arrangements to three and four star accommodation facilities. It also maintains a Master License Agreement ("**MLA**") for Canada, which came into effect on August 16, 1999.

There are currently four properties licensed under this brand, three of which are actively operating and one of which is expected to open during 2005.

According to the internal balance sheet as at April 29, 2005, the company had a deficit of \$655,426, the majority of which is represented by Subsidiary One's indebtedness to AFM of \$976,686. There is no cash on hand. The company's primary asset is "licenses and management contract", which has a cost of approximately \$212,000 and a net book value of approximately \$153,000. This asset consists primarily of the initial license fee required for the above-referenced MLA, as well as legal fees incurred in acquiring the MLA. Subject to termination provisions contained in the MLA, the agreement is scheduled to end on December 31, 2019, at which time it may be renewed for an additional twenty-year period.

**(iii) Best Inns Franchise Canada Inc. ("Best Inns")**

Best Inns was incorporated on April 5, 2000 to maintain an MLA with Best Worldwide, Inc. for the development of the Best Inns brand in Canada. However, lack of support for the brand name in the Canadian market, together with other factors, resulted in a mutual agreement to terminate the MLA, which occurred on January 19, 2005.

According to the internal balance sheet of Best Inns as at April 29, 2005, the company had a deficit of \$600,124, the majority of which is represented by Best Inns' indebtedness to AFM of \$588,681. The company's recorded assets are under \$1,300, including cash on hand of under \$50.

**(iv) Hawthorn Suites Franchise Canada Inc. ("Hawthorn")**

Hawthorn was incorporated on April 5, 2000 to maintain an MLA with Hawthorn International, Inc. Hawthorn is an "all suite" brand that experienced a lack of support from the Canadian market. As such, a mutual agreement was reached to terminate Hawthorn's MLA, effective January 19, 2005. According to the internal balance sheet of Hawthorn as at April 29, 2005, the company had a deficit of \$710,973, the majority of which is represented by Hawthorn's indebtedness to AFM of \$721,186. The company's recorded assets are under \$100, including cash on hand of under \$60.

**(v) Subsidiary Two**

Subsidiary Two maintains a Second Amended and Restated MLA for Canada, which came into effect on June 30, 1999.

Subsidiary Two has forty-seven licensed properties, with one additional application pending approval. The status of these properties is summarized as follows:

	Open	Awaiting opening	Pending	Totals
License agreement	45	2	0	47
Application submitted	0	0	1	1
Totals	45	2	1	48

According to the internal balance sheet of Subsidiary Two as at April 29, 2005, the company had retained earnings of \$2,120,970. Included in Subsidiary Two's assets are: cash of hand of approximately \$80,000; its receivables from AFM and on account of the marketing fund, in the amounts of \$1,674,349 and \$1,019,038, respectively; and "licenses and management contract" having a net book value of \$737,751. The marketing fund receivables recorded represent marketing related payments made by Subsidiary Two which are payable by its franchisees, net of accounts receivable collected by Subsidiary Two from its franchisees.

"Licenses and management contract" consists primarily of the initial license fee required for the above-referenced MLA, as well as legal fees incurred in acquiring the MLA. Subject to termination provisions contained in the MLA, the agreement is scheduled to end on December 31, 2013, at which time it may be renewed for an additional twenty-year period.

**(vi) Kelloryn Holdings Inc. ("Kelloryn")**

Kelloryn was incorporated on May 11, 1993 and was used to acquire hotel properties. The Receiver understands that these hotels would then be provided with management services by other subsidiaries of AFM.

As at the date of the Receiver's appointment and according to its internal financial statements as at April 29, 2005, Kelloryn did not own any properties.

According to Kelloryn's internal balance sheet, the company had a deficit of \$6,061,100, the majority of which is represented by Kelloryn's indebtedness to AFM of \$6,912,286. The company's recorded assets are under \$4,300, including cash on hand of \$20.

**(vii) Subsidiary Three**

Subsidiary Three maintains an MLA for Canada, which became effective on June 30, 1999.

Subsidiary Three currently has ten licensed properties, which are open and actively operating.

In addition, on September 30, 2004, this subsidiary and Villager Franchise Canada Inc. ("VFC") entered into an agreement whereby VFC merged with Subsidiary Three's licensor, which resulted in all Villager Territory System Units effectively being converted to the licensor's system (the "Village Merger"). This is further discussed under the subheading for Villager Lodge Franchise Canada Inc. below.

According to the internal balance sheet of Subsidiary Three as at April 29, 2005, the company had a deficit of \$479,482, the majority of which is represented by its indebtedness to AFM of \$715,289. Cash on hand is approximately \$8,600.

The company's primary asset is "licenses and management contract", which has a cost of approximately \$225,000 and a net book value of approximately \$173,000. This asset consists primarily of the initial license fee required for the above-referenced MLA, as well as legal fees incurred in acquiring the MLA. Subject to termination provisions contained in the MLA, the agreement is scheduled to end on December 31, 2024, at which time it may be renewed for up to two additional ten-year periods.

**(viii) La Quinta Canada Inc. ("LQCI")**

On September 28, 2001, LQCI entered into an MLA for Ontario, Canada.

On January 4, 2005, LQCI received a Notice of Default from its licensor advising that the MLA will be terminated effective July 6, 2005.

There is currently one licensed property under that brand name, which is open and actively operating.

The licensor requested that the Receiver consent to the termination of the aforementioned MLA. The Receiver informed the licensor that while it would not oppose the termination, it would not be in a position

to consent thereto. The licensor made an application to the Court for the termination of the MLA and was granted an Order lifting the stay of proceedings to permit the licensor to terminate it.

According to the internal balance sheet of LQCI as at April 29, 2005, the company had a deficit of \$372,789, the majority of which is represented by its indebtedness to AFM of \$575,928. Cash on hand is \$35. The company's primary asset is "licenses and management contract", which has a cost of approximately \$272,000 and a net book value of approximately \$227,000. This asset consists primarily of the initial license fee required for the above-referenced MLA, as well as legal fees incurred in acquiring the MLA. Subject to termination provisions contained in the MLA, the agreement was scheduled to end on December 31, 2021, at which time it could be renewed for an additional twenty-year period.

**(ix) Northwest Lodging International (Canada) Inc. ("Northwest Canada")**

Northwest Canada was incorporated on October 13, 2000 and operated as a management service provider for the hospitality industry. There are currently no active management contracts in place with Northwest Canada.

According to the internal balance sheet of Northwest Canada as at April 29, 2005, the company had a deficit of \$1,659,270, the majority of which is represented by Northwest Canada's indebtedness to AFM of \$1,687,463. The company's recorded assets (net of credit balances) are under \$4,000, including cash on hand of \$19.

On July 26, 2005, Loopstra informed the Receiver that the extra-provincial registration of Northwest Canada would be cancelled on July 31, 2005, if the 2004 Annual Returns were not filed. These returns were not filed by the Receiver.

**(x) Park Inn Franchise Canada Inc. ("Park Inn")**

Park Inn was incorporated on September 8, 1999 under the name Wellesley Inn & Suites Franchise Canada Inc., which name was amended to the current name on November 21, 2000. Park Inn maintained an MLA between Park of Canada, Inc., Park Inn International LLC, Park Inn and AFM, which became effective on January 30, 2001.

