

Court File No. 09-CL-8456-00CL

Estate No. 31-456351

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**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF JAMES ROBERT TUCKER, RICHARD HEIS AND
ALLAN WATSON GRAHAM OF KPMG LLP, AS JOINT ADMINISTRATORS**

Applicants

**AND IN THE MATTER OF AERO INVENTORY (UK) LIMITED
and AERO INVENTORY Plc**

Respondents

**APPLICATION UNDER SECTIONS 46 AND FOLLOWING OF THE *COMPANIES'*
CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C. C-36, AS AMENDED**

**SEVENTH REPORT OF KPMG INC.
IN ITS CAPACITY AS TRUSTEE IN BANKRUPTCY
AND INFORMATION OFFICER**

OCTOBER 22, 2013

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INTRODUCTION

1. On November 11, 2009 (the "**Administration Date**"), James Robert Tucker, Richard Heis and Allan Watson Graham, partners of KPMG LLP, were appointed Joint Administrators (in such capacity, the "**Joint Administrators**") of Aero Inventory (UK) Limited ("**Aero**") and Aero Inventory plc ("**Aero plc**" and, collectively with Aero, the "**Foreign Debtors**") pursuant to an order of the High Court of Justice of England and Wales (Chancery Division, Companies Court) (as later extended, the "**Administration Order**").
2. On the same date, the Ontario Superior Court of Justice (Commercial List) (the "**Court**") granted an order (the "**Recognition Order**"), *inter alia*, recognizing the UK administration proceedings of the Foreign Debtors (the "**Administration Proceedings**") as "foreign main proceedings" for the purposes of section 47 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"), recognizing the Joint Administrators as "foreign representatives" as defined in section 45 of the CCAA (in such capacities, the "**Foreign Representatives**") and recognizing and enforcing the Administration Order pursuant to section 49 of the CCAA. The Recognition Order also imposed a stay of proceedings in respect of the Foreign Debtors. A copy of the Recognition Order is attached hereto as Appendix "A".
3. Pursuant to the Recognition Order, KPMG Inc. ("**KPMG**") was appointed information officer (in such capacity, the "**Information Officer**").
4. On January 22, 2010, the Court issued an order temporarily lifting the stay granted in the Recognition Order and authorizing the assignment of the Foreign Debtors into bankruptcy under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "**BIA**"). The assignment documents were filed with the Office of the Superintendent of Bankruptcy on January 22, 2010 and Certificates of Appointment were issued naming KPMG as trustee in bankruptcy of each of the Foreign Debtors (in such capacity, the "**Trustee**").
5. This is the seventh report by the Trustee and the Information Officer (the "**Seventh Report**"). The Trustee and the Information Officer are filing the Seventh Report in respect of a motion by the Foreign Representatives to (a) approve Aero entering into a Bill of Sale

pursuant to which Aero will sell its right, title and interest in certain remaining surplus assets to Diversified Aero Services, Inc. (the "**Surplus Sale Transaction**"); and (b) authorize the Trustee to enter into certain consent and settlement documents associated with that Surplus Sale Transaction.

SCOPE

6. In preparing this report, KPMG has relied on financial information supplied by the Foreign Debtors. KPMG has not audited such financial information or otherwise independently attempted to verify the accuracy or completeness of such financial information. Any verifications of such financial information have been undertaken solely by the Foreign Debtors.

FACTUAL BACKGROUND

7. Aero was the main operating company of the group of companies controlled by Aero plc. This group of companies, comprised of the Foreign Debtors and their international affiliates, supplied parts to the airline industry.

8. Aero's customers were airlines, aerospace maintenance and repair companies and intermediary suppliers that operate in various locations globally.

9. Aero's assets were primarily composed of category 3 consumable and expendable spare aircraft parts ("**CAT 3 Parts**").

10. As described above, following the commencement of the Administration Proceedings and the recognition of those proceedings in Canada, the Foreign Representatives applied to the Court to lift the stay of proceedings imposed by the Recognition Order for the limited purpose of allowing the Foreign Debtors to be assigned into bankruptcy. The order sought was granted on January 22, 2010 (the "**Lift Stay Order**") and the Foreign Debtors were assigned into bankruptcy on the same day.

11. The bankruptcies of the Foreign Debtors were commenced for the express purpose of preserving the right to pursue any reviewable transactions, settlements, preferences,

undervalue transactions, or similar transactions that may have taken place during the statutory review period prescribed by the BIA.

12. Following the bankruptcies of the Foreign Debtors, the Foreign Representatives applied to the Court for an order (the "**February 10 Order**"), *inter alia*, extending until further Court order: (i) the time periods for the Trustee to perform certain statutory obligations under sections 16, 21, 22, 24, 27 and 102 of the BIA; and (ii) the time periods for the Foreign Debtors to perform certain statutory obligations under section 158 of the BIA. This relief was sought based upon the view that the Trustee's role in the global insolvency of the Foreign Debtors would be limited to pursuing certain reviewable transactions, settlements, preferences, undervalue transactions, or similar transactions, the benefit of which would accrue to the Foreign Debtors' secured lenders. Thus, limiting the obligations and cost imposed upon the Trustee appeared reasonable. The February 10 Order was granted, a copy of which is attached hereto as Appendix "B".

13. On January 6, 2011, Air Canada sought an order directing the Trustee to "regularize" the Foreign Debtors' bankruptcy proceedings, which would effectively modify the relief in the February 10 Order.

14. In an endorsement on August 18, 2011, the Court made the following statements related to the February 10 Order and Air Canada's request to "regularize" the bankruptcy proceedings:

It is also appropriate, at this time, and in view of the contemplated continuation of the preference motion, that proceedings be regularized with the Trustee taking the necessary steps to comply with its obligation under the BIA.

A copy of the August 18th endorsement of the Court (the "**August 18th Endorsement**") is attached hereto as Appendix "C".

15. During the period between the August 18, 2011 Endorsement and the date of this Seventh Report, the Joint Administrators and the Foreign Debtors were engaged in extensive negotiations in Canada and globally to:

- (a) recover possession of Aero's property, which involved finalizing certain complex computer programs to determine ownership of that property, and extensive negotiations with each of Air Canada and Aveos Fleet Performance Inc. ("Aveos") regarding ownership and asset recovery mechanisms; and
- (b) establishing a process for the marketing and realization of the Foreign Debtors' property; and
- (c) completion of a sale of substantially all of the Foreign Debtors' assets globally.

16. Negotiations among Aveos, Air Canada and the Foreign Debtors were complex and time consuming. While a commercial result was ultimately achieved, the negotiations were delicate, relations between the parties were often fragile, and the matter required the Foreign Debtors' full attention. The Foreign Representatives and the Trustee believed that attempts to move forward with other matters in the Foreign Debtors' Canadian insolvency proceedings, including the regularization of the bankruptcy, would have detracted from the goals of obtaining possession of Aero's property in Canada and completing a sale.

17. The Foreign Representatives and the Trustee intend to move forward with the regularization process in the near future.

18. No material steps that could prejudice stakeholders were taken in connection with the bankruptcy of the Foreign Debtors during the period between August 18, 2011 and the current time. The Trustee also does not believe that any steps have been taken with respect to the Foreign Debtors' assets that prejudice any interest the Trustee may have in the assets of the Foreign Debtors, which interests are for all practical purposes quite minimal (if not non-existent).

19. At this time, the Trustee has not held a first meeting of creditors pursuant to the BIA and inspectors have not been appointed in respect of the Foreign Debtors' estates. Based upon this fact, and upon the terms of the February 10 Order, the Trustee does not believe that it currently has the power, or an available means to seek authorization from inspectors, to

enter into the consent and settlement agreements contemplated by the Surplus Sale Transaction.

SURPLUS SALE TRANSACTION AND SETTLEMENT DOCUMENTS

Surplus Parts Ownership

20. Until mid-2012 substantially all of Aero's CAT 3 Parts in Canada were located at facilities under the control of Air Canada, Aveos or a third party warehouse provider contracted by Aveos.

21. Aero was able to identify those CAT 3 Parts that it owned, wherever located, based upon certain computer programs agreed upon by Aero, Aveos and Air Canada, being the only three parties who could have ownership claims to such CAT 3 Parts.

22. Once ownership of Aero's CAT 3 Parts was determined in accordance with the above computer programs, Aero had to coordinate the physical retrieval of Aero's CAT 3 Parts from Aveos, Air Canada and third party warehouse facilities. Agreements were entered into with Aveos and/or Air Canada on or about May 28, 2012, June 15, 2012 and September 5, 2012 in respect of this retrieval process. In connection with those agreements, certain security deposits (the "**Security Deposits**") were posted by Aero for the benefit of Aveos.

23. When the parts retrieval process was completed, Aero found that it was in possession of not only the Aero-owned CAT 3 Parts but also certain surplus CAT 3 Parts (the "**Overages**"). Aero did not expect to retrieve these Overages and Aero cannot confirm that it owns these Overages. The vast majority of these Overages are not accounted for in the agreed upon computer programs that determine ownership of CAT 3 Parts, the balance are owned by either Aveos or Air Canada. Aero has provided Aveos and Air Canada with a list of those parts that appear to be owned by each of them.

24. While it is not clear who specifically owns the vast majority of the CAT 3 Parts comprising the Overages, Aero believes that the only parties who could own these Overages are Aveos, Air Canada or Aero. Aero is unaware of any other party claiming an interest in these Overages. Each of Aveos and Air Canada has confirmed they are not aware of any claims of third parties (with the exception of Aveos, Air Canada and Aero) to the Overages.

25. Aero now seeks to monetize certain of the Overages and has sought the consent of Aveos and Air Canada to do so.

Settlement Documents

26. Pursuant to certain settlement and/or consent documents, each of Air Canada and Aveos would consent to the sale of a portion of the Overages¹ by Aero and to certain distributions of the proceeds of that sale. In the case of Aveos, this consent is part of a larger global settlement of all outstanding matters between the Foreign Debtors and Aveos. The consent and settlement documents to be entered into by Aero and the Trustee, among others, with each of Aveos and Air Canada are intended to be substantially in the form of Confidential Appendices “D” and “E”.²

27. A summary of the principal terms of the Aveos settlement document (the “**Settlement Agreement**”) follows³:

- (a) In return for a payment of a portion of the proceeds of the Surplus Sale Transaction:
 - (i) Aveos releases any right, title or interest that it has in any inventory currently possessed by Aero.
 - (ii) Aveos releases any claim it has to the Security Deposits.
- (b) Subject to certain conditions, Aveos, the Foreign Debtors, the Trustee, the Information Officer and others agree to mutual releases of claims.

¹ The portion of the Overages being sold at this time is that portion that can be physically segregated on a cost effective basis from parts that are owned by Aero and in which Air Canada is asserting a contingent ownership interest that has not yet been resolved.

² An executed settlement agreement with Aveos has been received. The consent agreement with Air Canada has not yet been executed but is expected to be entered into imminently.

³ In the event of any inconsistencies between the Aveos settlement document and this summary, the terms of the Aveos settlement document shall govern.

28. The Air Canada consent document (the “**Letter Agreement**”) includes the following material terms⁴:

- (a) Air Canada consents to Aero’s sale of the Overages that are the subject of the Surplus Sale Transaction and releases any right, title or interest that Air Canada may have in those particular Overages.
- (b) Air Canada is prepared to allow a portion of the proceeds of the Surplus Sale Transaction to be paid to Aveos.
- (c) The balance of the sale proceeds from the Surplus Sale Transaction will be held in trust by the Trustee and will only be released upon written consent of Air Canada and Aero or order of the Court.
- (d) Each of Air Canada and Aero agree to certain reservations of claims that they may have against each other.
- (e) The Trustee, among others, will consent to this agreement.

29. The Foreign Representatives and the Trustee believe that the Settlement Agreement with Aveos represents a reasonable compromise of the remaining commercial issues between the Foreign Debtors and Aveos and that this settlement is beneficial to reducing the issues that remain outstanding for the Foreign Debtors in Canada. The settlement also facilitates the sale of certain of the Overages and a reduction of ongoing storage costs. The Trustee is unaware of any claims that it may have against Aveos that would accrue to the benefit of the estate of the Foreign Debtors in Canada.

30. The Foreign Representatives and the Trustee believe that the Letter Agreement with Air Canada is beneficial to the Foreign Debtors as it monetizes certain of the Overages and reduces ongoing storage costs, while otherwise maintaining the status quo between Air Canada and the Foreign Debtors.

⁴ In the event of any inconsistencies between the Air Canada consent document and this summary, the terms of the Air Canada consent document shall govern.

31. As the Trustee is a required party to the settlement and consent documents and as the Trustee does not currently have the power to enter into these documents without Court authorization, the Trustee requests this Court's authorization to enter into the Letter Agreement and the Settlement Agreement.

Surplus Sale Transaction

32. The Surplus Sale Transaction is entered into between Aero and an affiliate of the party that purchased Aero's worldwide business assets in April of this year. A copy of the bill of sale governing the Surplus Sale Transaction is attached hereto as Confidential Appendix "F".

33. The purchaser under the Surplus Sale Transaction is the logical party to purchase the Overages that are the subject of the transaction. It is already familiar with Aero's CAT 3 Parts generally. It is willing and able to enter into this transaction on an expedited basis. It is able to easily integrate the Overages that are the subject of the Surplus Sale Transaction with the business assets that it has already purchased from Aero. Finally, based upon the sale process that was previously completed for the sale of Aero's worldwide business, the Foreign Representatives have a thorough understanding of the potential purchasers for the Overages and for the value of the Overages and believe that an expedited sale to the proposed purchaser is the most beneficial course of action in the circumstances and will maximize realizations to Aero.

34. The Surplus Sale Transaction benefits the Foreign Debtors estates not only due to the proceeds that would be received from the sale but also due to the fact that (a) the sale facilitates a global settlement with Aveos; and (b) the sale reduces the overall storage and/or disposal costs that would otherwise be attributable to the Overages that are the subject of the Surplus Sale Transaction, which costs are potentially material and in any case are disproportionate to the realisable value of the asset base.

35. The Foreign Representatives and the Trustee believe that it is appropriate to seek Court approval of the proposed Surplus Sale Transaction based upon the guidance provided in Part IV of the *Companies' Creditors Arrangement Act* (Canada), and in particular Section 48

thereof. The Foreign Representatives are not seeking a vesting order in connection with this transaction.

CONCLUSIONS

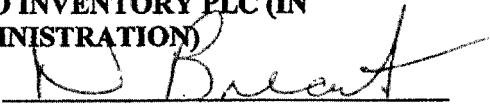
36. The Foreign Representatives and the Trustee believe that the proposed Surplus Sale Transaction would be beneficial to the estates of the Foreign Debtors and request the assistance of the Court in proceeding with this transaction and the Letter Agreement and the Settlement Agreement that are necessary to move the transaction forward.

37. The bill of sale governing the Surplus Sale Transaction, the Letter Agreement and the Settlement Agreement all contain sensitive commercial information. Public disclosure of that information would be damaging to the efforts of the Foreign Debtors to monetize the Overages in the event that the proposed Surplus Sale Transaction cannot be completed. The Foreign Representatives, the Information Officer and the Trustee are unaware of any interests that would be materially prejudiced by the sealing of these documents.

38. All of which is respectfully submitted this 22nd day of October, 2013.

**KPMG INC. AS
INFORMATION OFFICER AND
TRUSTEE IN BANKRUPTCY OF
AERO INVENTORY (UK) LIMITED
(IN ADMINISTRATION) AND
AERO INVENTORY PLC (IN
ADMINISTRATION)**

Per:



Nicholas Brearton

President