

**ONTARIO
SUPERIOR COURT OF JUSTICE – COMMERCIAL LIST**

B E T W E E N :

JAMES RYAN

Applicant

-and-

6356095 CANADA INC.

Respondent

**APPLICATION UNDER SECTION 211(8) OF THE CANADA BUSINESS
CORPORATIONS ACT, R.S.C. 1985, c. C-44, AS AMENDED, AND RULE 14.05(2) OF
THE RULES OF CIVIL PROCEDURE**

**SUPPLEMENT TO THE
FIRST REPORT TO THE COURT OF
XMT LIQUIDATIONS INC.**

Date of Report: October 30, 2008

A. INTRODUCTION

- (a) Pursuant to an order of the Ontario Superior Court of Justice – Commercial List (the “**Court**”) dated November 30, 2006 (the “**Original Order**”) the Court made an order pursuant to section 211(8) of the *Canada Business Corporations Act* (the “**CBCA**”) to continue the voluntary dissolution and liquidation of the Respondent, formerly known as

Excapsa Software Inc. ("**Excapsa**") under the supervision of the Court. On December 22, 2006, the Court issued an Amended and Restated Order (the "**Amended and Restated Order**") which, in part, made the appointment of the former liquidator, Mintz & Partners Limited, effective from January 15, 2007.

- (b) On August 21, 2008, the Court issued a subsequent order (the "**Substitution Order**"), *inter alia*, replacing the initial liquidator with XMT Liquidations Inc. (the "**Liquidator**"). XMT Liquidations Inc. is a subsidiary of the Montreal-based accounting firm of WSBG LLP, a firm established in 1964 which has become a highly successful mid-sized boutique accounting firm with over 60 people.
- (c) On October 14, 2008, the Court issued an order approving the Amendment to Sale Documents Agreement with Blast Off Limited ("**Blast Off**") and Tokwiro Enterprises ENRG dated as of September 22, 2008 (the "**Amending Agreement**"), subject to the Liquidator filing a further report (the "**Supplemental Report**") to satisfy the Court that all of the conditions precedent in the Amending Agreement have been met and the basis on which the Liquidator has concluded that such conditions precedent have been met (the "**Approval Order**"). A copy of the Approval Order is attached hereto as **Appendix A**. A copy of the Court's endorsement in connection with the Approval Order (the "**Endorsement**") is attached hereto as **Appendix B**.
- (d) This report is the Supplement Report filed pursuant to the Approval Order.
- (e) The Approval Order also required that particulars of the Endorsement be communicated to the shareholders of Excapsa and that counsel may return before Justice Mesbur on a 9:30 a.m. appointment for final approval upon filing of the Supplemental Report with the

date of such 9:30 a.m. appointment and the Supplemental Report to be posted on the Liquidator's website.

- (f) As Justice Mesbur had indicated that Her Honour would not be sitting on the Commercial List the weeks of October 27 and November 3, a 9:30 a.m. appointment was subsequently scheduled before Justice Mesbur on October 24, 2008. At this appointment, Justice Mesbur made a further endorsement acknowledging that the Supplemental Report had not yet been filed, that Her Honour would be away from the bench until November 12, 2008, and that therefore another judge would need to take carriage of the matter. A copy of the October 24, 2008 endorsement is attached as **Appendix C**. Justice Mesbur ordered that counsel should return before Justice Pepall on October 28, 2008 at a 9:30 a.m. appointment to schedule a further hearing, if necessary, to address whether the Amending Agreement should be approved.
- (g) At the 9:30 a.m. appointment before Justice Pepall on October 28, 2008, a hearing was scheduled for 10:00 a.m. on November 3, 2008 in connection with the filing of this Supplemental Report.

B. BACKGROUND

1. The background leading up to the Amending Agreement was set out in the First Report of the Liquidator to this Honourable Court dated October 6, 2008 (the "**First Report**"). A copy of the First Report, without appendices, is attached hereto as **Appendix D**. Capitalized terms used in this Supplemental Report that are not otherwise defined herein shall have the meaning ascribed to them in the First Report.

2. A copy of the Amending Agreement is attached hereto as **Appendix E**.

3. The completion of the transaction foreseen by the Amending Agreement is conditional upon and subject to receipt, in form reasonably satisfactory to the Liquidator and its counsel, of the following nine (9) items as conditions precedent set forth in Section 13 of the Amending Agreement:
 - 3.1 the consent of the shareholders of Excapsa by written instrument signed by the holders of 66 $\frac{2}{3}$ ^{rds} of the outstanding shares or by special resolution passed at a meeting as required by Section 13(i) of the Amending Agreement;

 - 3.2 approval of the Amending Agreement by the Court as required by Section 13(ii) of the Amending Agreement;

 - 3.3 receipt of the stock powers, share certificates and such other documentation with respect to approximately 6,900,000 shares in the capital stock of Excapsa for cancellation (the "**Cancelled Shares**") as required by Section 13(iii) of the Amending Agreement;

 - 3.4 receipt of no less than an aggregate total of 49,300,000 shares in the capital of Excapsa by way of a pledge as collateral security for the next US \$10,250,000.00 of payments under the Note (as defined in the First Report) (the "**Pledged Shares**") in accordance with the terms of the Amending Agreement as required by Section 13(iii) of the Amending Agreement;

- 3.5 receipt of satisfactory evidence that Blast Off is a viable business entity capable of continuing to carry on its business in the normal course thereof as required by Section 13(iv) of the Amending Agreement;
- 3.6 delivery of the release contemplated by the Amending Agreement as required by Section 13(v) of the Amending Agreement;
- 3.7 satisfactory due diligence evaluation of the validity of the Claim (as defined in the First Report) as required by Section 13(vi) of the Amending Agreement;
- 3.8 delivery of the copyright assignment as required by Section 13(vii) of the Amending Agreement; and
- 3.9 delivery of counterparts to the Amending Agreement executed by certain subsidiaries as required by Section (viii) of the Amending Agreement.

C. NOTICE TO SHAREHOLDERS

- 4. A copy of the Endorsement was posted on the Liquidator's website within a day of it being issued.
- 5. Particulars of the Endorsement were communicated to the shareholders of Excapsa by way of a letter distributed to the shareholders of Excapsa through its transfer agent, Computershare Trust Company of Canada ("**Computershare**"). A copy of this letter is attached hereto as **Appendix F**. A copy of this letter together with an unofficial typewritten version of the Endorsement was also subsequently posted on the Liquidator's website.

6. As described in the First Report, in an attempt to ensure that all registered shareholders of Excapsa were aware of the initial motion for approval of the Amending Agreement made on October 14, 2008, a letter was sent through Computershare to all registered shareholders informing them of the relief being sought. In conjunction with sending this letter, a copy of the First Report including all of its appendices (which includes a copy of the Amending Agreement) was posted on the Liquidator's website.

D. FULFILLMENT OF THE NINE CONDITIONS PRECEDENT

7. In satisfaction of the requirement described in Section 3.1 above, the Liquidator confirms receipt of irrevocable shareholder consents in excess of the amount required by the Amending Agreement.

7.1 The Liquidator is in receipt of irrevocable written consents from shareholders of Excapsa signed by the holders representing in excess of 70% of the issued and outstanding shares of Excapsa, not counting the Cancelled Shares in either the number of shares consenting or the total of issued and outstanding shares. Even if the Cancelled Shares were included in the total number of issued and outstanding shares but not included in the number of shares consenting, the percentage consenting would still be greater than 67%.

7.2 The irrevocable consents were not solicited by the Liquidator, but were instead solicited by shareholders. The Liquidator understands that the irrevocable consent form solicitation included a copy of the Amending Agreement, together with a two page summary drafted by Inspector's counsel to ensure that the shareholders understood the transaction. The Liquidator understands that the

form of the irrevocable consents solicitation package that was sent to shareholders was in the form attached hereto as **Appendix G**.

7.3 One shareholder, SC Fundamental LLC, which the Liquidator understands holds less than 4% of the total issued and outstanding shares of Excapsa, raised the concern with the Liquidator that such irrevocable consents were obtained by misrepresentation or otherwise inadequate disclosure. Other than this allegation, the Liquidator is not aware of any activity which would independently substantiate this concern. No specific information was provided to the Liquidator by SC Fundamental or its counsel in this regard. No one else has made such an allegation to the Liquidator. No shareholder has sought to revoke their consent (or otherwise raise any issue with such consent) up to the date of this Supplemental Report.

7.4 Given its review of what it understands was the irrevocable consents solicitation package sent to shareholders (attached in Appendix H) together with the fact that it provided a letter to shareholders and had posted the First Report (which also included a copy of the Amending Agreement) on its website prior to the motion on October 14, 2008 and subsequently posted the Endorsement (as outlined above) which has as an exhibit thereto a letter from SC Fundamental LLC outlining its concerns, the Liquidator is of the view that there was also and has been sufficient independent information in the public domain and available to shareholders if they wished to access it.

- 7.5 In addition, the Liquidator also mailed out to registered shareholders a proxy circular dated October 20, 2008 calling a special meeting of shareholders for November 14, 2008 which also contained a summary of the terms of the Amending Agreement and a rationale for the Liquidator's recommendation that shareholders approve it, and referral to the Liquidator's website for a detailed review of the First Report and related orders of this Honourable Court. A copy of this notice and proxy circular is attached hereto as **Appendix H**.
- 7.6 Given the foregoing, the Liquidator is of the view that it is reasonable to rely on the receipt of the irrevocable written consents from shareholders of Excapsa signed by the holders representing in excess of 70% of the issued and outstanding shares of Excapsa as fulfilling the requirement described in Section 3.1 above.
8. To satisfy the requirement described in Section 3.2 above, the Liquidator sought and obtained the Approval Order.
- 8.1 The Approval Order approved the Amending Agreement subject to the Liquidator filing this Supplemental Report to satisfy the Court that all conditions precedent to the Amending Agreement have been met.
- 8.2 Accordingly, if this Honourable Court is satisfied that all conditions precedent to the Amending Agreement have been met as set out in this Supplement Report, then the Liquidator will have complied with the caveat in the Approval Order.
9. In satisfaction of the requirement described in Section 3.3 above, the Liquidator confirms that agreements for the transfer back to Excapsa for cancellation of 6,923,272 shares have

been entered into by both parties and approved by way of resolution. Of the 6,923,272 shares, documentation to reflect the transfer for 2,618,552 shares are in the process of being deposited with Computershare and will be recorded by Computershare as soon as received. With respect to the remainder of 4,304,720 shares, the certificate in respect of same has been lost. Given that these shares are being cancelled (as opposed to transferred), Excapsa will not require the issuance of a replacement share certificate, as this would necessitate an expenditure in excess of \$20,000 to provide the requisite insurance bond to Computershare. However, Computershare has been instructed by the Liquidator and has confirmed that it will not allow such shares to vote, nor to share in any dividend, nor to receive proxy materials. The Liquidator notes that the tendering shareholders provided their shares for cancellation on the condition that their names not be publicly disclosed by the Liquidator. Given the foregoing, the Liquidator is of the view that it is reasonable to conclude that the requirement described in Section 3.3 above has been satisfied.

10. In satisfaction of the requirement described in Section 3.4 above, the Liquidator confirms that agreements for the sale and transfer of 49,312,566 shares of Excapsa have been entered into with A Aggregated 63 Holdings Limited (the "**Pledgor**"). Of such shares, the appropriate documentation necessary for Computershare to effect the transfer and issue new share certificates in the name of the Pledgor has been received for approximately 28,602,427 shares. Of the remaining 20,710,139 shares to be pledged, the appropriate documentation has been received by the Liquidator, but the signatures on such documentation has been guaranteed by a Schedule 1 Canadian bank, rather than the "Medallion" signature guarantee required by Computershare. The Medallion signature

guarantee has proved very difficult to obtain due to the jurisdictions of the transferring shareholders, and counsel for the transferring shareholders is cooperating with the Liquidator's counsel to obtain such Medallion signature guarantees or other supporting documents requested by Computershare to effect such transfer. Computershare is in the process of determining what supporting documents are required. The Liquidator expects the Medallion signature guarantees or other required supporting documentation to be received and for such shares to be pledged prior to the closing of the transactions contemplated by the Amending Agreement. The Liquidator notes that the tendering shareholders provided their shares to the Pledgor on the condition that their names not be publicly disclosed by the Liquidator. Given the foregoing, the Liquidator is of the view that it is reasonable to conclude that the requirement described in Section 3.4 above will be satisfied on or before closing of the transactions contemplated in the Amending Agreement.

11. In satisfaction of the requirement described in Section 3.5 above, and conditional upon the timely closing of the Amending Agreement, the Liquidator is reasonably satisfied that Blast Off is a viable business entity capable of continuing to carry on its business in the normal course thereof.

- 11.1 The Liquidator has examined certain financial statements and internal documents of Blast Off including quarterly actual and projected income statements and balance sheets and certain key performance indicators, on a confidential basis, and based on this information is reasonably satisfied of the viability of the business of Blast Off. Based on its review of this information, the Liquidator has no reason to believe that Blast Off will not be able to make at least the requisite

payments contemplated by the Amending Agreement. The Liquidator will file with the Court, on a sealed and confidential basis, a copy of its internal report in this regard. Based on this confidential report, the Liquidator is of the view that it is reasonable to conclude that the requirement described in Section 3.5 above has been satisfied.

11.2 The Liquidator has concluded that the greatest risk to Blast Off's continued viability and, in turn, its ability to stay current in its required future payments to Excapsa, is the requirement of Blast Off to commence the refund of its customers on or before November 3, 2008 (the "**KGC Refund Deadline**") as mandated by the Kahnawake Gaming Commission (the "KGC"), its licensing body. This deadline was set out in a press release dated September 29, 2008 issued by the KGC and attached as Appendix K to the First Report. This press release is attached hereto as **Appendix I**.

11.3 The Liquidator has since engaged in discussions with representatives of the KGC and the KGC has clarified and provided some grace in respect of the KGC Refund Deadline by written confirmation to the Liquidator dated October 28, 2008 (the "**KGC Letter**"). A copy of the KGC Letter is attached hereto as **Appendix J**. In summary, the KGC Letter states that it will not revoke Blast Off's operating permit if, on or before November 3, 2008, the KGC is provided with evidence that Blast Off will be provided with adequate funds for the purposes of reimbursing players affected by the "cheating scandal", which evidence the KGC indicates should be a true copy of this Honourable Court's order that it is satisfied that all conditions precedent to the Amending Agreement have been met.

- 11.4 Assuming the KGC does not revoke Blast Off's operating permit, by virtue of the transactions contemplated by the Amending Agreement, the Liquidator is of the view that it is reasonable to conclude that Blast Off will be provided with adequate funds and have sufficient liquidity for the purposes of reimbursing players affected by the "cheating scandal".
- 11.5 The Liquidator anticipates supervising the customer refund process to ensure that the refunds are timely paid by Blast Off.
12. In satisfaction of the requirement described in Section 3.6 above, the Liquidator confirms receipt of the necessary executed releases in the form drafted by Excapsa counsel.
- 12.1 The form of the release is attached as **Appendix K**. Blast Off and the subsidiaries designated by Excapsa have executed and delivered the release, in escrow pending the closing of the transactions contemplated in the Amending Agreement, in a form approved by the Liquidator and Excapsa.
13. In satisfaction of the requirement described in Section 3.7 above, Excapsa and the Liquidator have completed to their satisfaction their due diligence evaluation of the Claim.
- 13.1 The Claim is summarized in a demand letter from counsel acting for Blast Off and its sole shareholder dated August 23, 2008 and addressed to the Liquidator (the "**Claim Letter**"). A copy of the Claim Letter is attached hereto as **Appendix L**. In the Letter, Blast Off alleges that it has suffered significant damages as a result of the unfair play referred to above and claims damages from Excapsa in an

amount of US \$81,400,00 for direct losses incurred and to be incurred in the form of reimbursements to customers/players who were the victims of the unfair play, as well as for overpayment in the purchase of the shares, out-of-pocket expenses, opportunity costs and damage to the reputation to the sole beneficial shareholder of Blast Off. The Claim Letter alleges that such cheating was possible as a result of a tool hidden in the internet gambling software code, that Excapsa had knowledge of the tool and of its illegitimate use and failed to disclose such facts to Blast Off and made a number of related material misrepresentations to Blast Off during the negotiation and implementation of the Stock Purchase Agreement.

- 13.2 A copy of the Stock Purchase Agreement is attached hereto as **Appendix M**. Section 6.1 of the Stock Purchase Agreement is reproduced for convenience below as it appears in the actual Stock Purchase Agreement:

6.1 Warranty Limitation. EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, THE STOCK AND THE ASSETS OF THE COMPANIES ARE CONVEYED AS IS WHERE IS AND WITHOUT WARRANTY OF ANY NATURE. ALL OTHER EXPRESS AND IMPLIED WARRANTIES, INCLUDING BUT NOT LIMITED TO ANY IMPLIED WARRANTIES OF MERCHANTABILITY, NON-INFRINGEMENT, AND/OR FITNESS FOR A PARTICULAR PURPOSE ARE HEREBY DISCLAIMED. THE WARRANTY OF PEACEFUL POSSESSION IS HEREBY DISCLAIMED.

- 13.3 Counsel for Blast Off has alleged that the warranty limitation described in Section 6.1 of the Stock Purchase Agreement does not apply with respect to the Claim because the Claim involves, amongst other allegations, fraud and material misrepresentations.
- 13.4 The satisfactory due diligence evaluation of the validity of the Claim was a condition precedent to the Amending Agreement because the Liquidator primarily

wished to have evidence as to the quantum of player losses which arose as a result of the unfair play. Accordingly, the Liquidator has not obtained a legal opinion in respect of the legal strength of the Claim or any legal defences thereto because the Liquidator is of the view that even if Excapsa had a strong legal defence to the Claim, defending against the Claim would not be the recommended course of action. The Liquidator believes that shareholders will benefit more from the resumption of payments under the Note. The Liquidator believes that defending against the Claim will mean that any further payments under the Note would be very unlikely.

13.5 Furthermore, choosing to defend against the Claim will mean that no distributions to Excapsa shareholders can be made (even on an interim basis) until the Claim is finally resolved by final court order or settled given the size of the Claim relative to the funds on hand with the Liquidator (which are approximately US \$36 million). This litigation may take years and whether or not the Claim would be fully or only partially defeated is uncertain. Accordingly, notwithstanding the merits of any defences that the Excapsa may have, choosing to litigate the Claim will result in almost certain lengthy delay, will result in substantial costs as the litigation will be complex, and will have an uncertain financial result.

13.6 Lastly, from the Liquidator's investigations into the matter as confirmed by the independent investigations of the KGC (with the assistance of certain third parties engaged by the KGC) and outlined in a press release of the KGC contained as Appendix J to this Supplemental Report, it appears that the unfair play was occurring as early as May 2004. Accordingly, defending the Claim may also

leave Excapsa directly exposed to claims from players who suffered losses as a result of the unfair play between May 2004 and the date of the sale transaction to Blast Off, being October 2006. From the Liquidator's information and investigations, it appears that a substantial portion of the refunds being processed by Blast Off relate to player losses incurred before the sale to Blast Off. The failure of Blast Off to timely refund its customers could result in the above-described substantial third party claims being advanced directly against Excapsa which would be very costly to defend, regardless of the merits of such claims.

13.7 Given the foregoing, choosing to defend against the Claim will likely mean that there will be no distributions to shareholders for some time and that the amount of money available to distribute to shareholders after a final determination of the Claim may range from US \$36 million less all defence costs (which will not be immaterial) to potentially \$0 if the Claim is ultimately successful and Excapsa is exposed to additional successful claims from players who suffered losses as a result of the unfair play between May 2004 and October 2006.

13.8 The Liquidator has also received a report from RealTime Edge Software ULC ("**RTE**") which was engaged by the Liquidator to independently verify the losses incurred by players who were the victims of the unfair play discussed above by analyzing all of the historical playing data on the UltimateBet.com website retained by Blast Off. A redacted copy of this report from RTE dated October 27, 2008 (the "**Loss Report**") is attached hereto as **Appendix N** in order to preserve the confidentiality of the estimated loss number. An un-redacted version of the Loss Report will be filed with the Court on a sealed and confidential basis.

