

D. Gray #4  
Sworn: March 17, 2009

No. S-088488  
Vancouver Registry

**IN THE SUPREME COURT OF BRITISH COLUMBIA**

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

AND

IN THE MATTER OF THE *Canada Business Corporations Act*  
R.S.C., 1985 c. C-44

AND

IN THE MATTER OF HYDROXYL SYSTEMS INC.

PETITIONER

**AFFIDAVIT**

I, DAVID GRAY, CA-CIRP, of 1000 - 570 Granville Street, Vancouver, British Columbia,  
MAKE OATH AND SAY AS FOLLOWS:

1. I am the President of The Summit Group Business Consultants Ltd. ("Summit") and, as such, I have personal knowledge of the matters hereinafter deposed to, except where stated to be on information, in which case, because of my belief in the veracity of the informant I identify, I believe both the information and the resulting statement I make to be true.
2. Capitalized terms used in this Affidavit have the same meaning as ascribed to in my earlier Affidavits in this proceeding.

3. I submit this Affidavit in support of an application by the Petitioner for an extension of the stay of proceedings first granted to the Petitioner on December 5, 2008.

*Operations*

4. The stay was last extended by the Court on February 5, 2009, to March 19, 2009.
5. Since February 5, 2009, I and/or my partner, Harvey Lee, have, among other things:
  - (a) attended at the Petitioner's premises on several occasions, and met with Hydroxyl's management team to discuss operations;
  - (b) assisted the Petitioner in preparing a pro-forma budget to the end of December 2009;
  - (c) reviewed the Petitioner's potential projects to determine the likelihood of those projects going forward, for the purpose of preparing the budget;
  - (d) reviewed the Petitioner's supplier costs relating to the budget;
  - (e) assisted the Petitioner's COO and Marketing Manager to put in place sales reporting procedures;
  - (f) reviewed the Petitioner's cash flow up dates on a weekly basis with the COO and the Petitioner's accountant;
  - (g) assisted the Petitioner's management to review and further reduce expenses by eliminating unnecessary operating and infrastructure costs, including leased vehicles, office furniture, cell phones and other non-essential expenses.
6. Now shown to me and marked as Exhibit "A" to this my Affidavit is a copy of the pro-forma budget that I have assisted the Petitioner to prepare. As can be seen from Exhibit "A", the Petitioner is projecting revenues of just over \$8 million for the 10 months ending December 31, 2009, with net income of just over \$1 million.
7. Now shown to me and marked as Exhibit "B" to this my Affidavit is a copy of an updated cash flow for the Petitioner, showing its anticipated receipts and disbursements to

May 8, 2009.

8. I am satisfied, based on the work that Summit has done with the Petitioner, as described above, that both the cash flow and the pro-forma budget represent reasonable estimates of the Petitioner's probable operations during the time frames reflected therein.

***Review of Agreements***

9. In addition to preparing budgets and cash flow forecasts, I have assisted the Petitioner with a review of certain of its critical, long-term agreements, including its agreements with RCCL and Infilco Degremont, Inc. ("IDI").
10. In the result, with the consent of the Monitor, the Petitioner has elected to terminate its existing agreements with RCCL, for the supply of wastewater treatment systems to six RCCL ships currently under construction or being retrofitted. In this regard, now shown to me and marked as Exhibit "C" to this my Affidavit is a copy of a letter dated March 5, 2009, from the Petitioner's counsel, Scott Turner, to RCCL, formally notifying the latter of the termination.
11. The termination was done following consultation with, and with the consent of, the Monitor.
12. As set out in Mr. Turner's letter, the Petitioner has offered to complete the contracts in issue on a time and materials basis.
13. In addition to the RCCL contracts, I have reviewed the Petitioner's license agreement with IDI. That agreement was entered into in August 2005, for a term of 10 years. It grants IDI an exclusive license to market, sell, install and service certain Hydroxyl products for use in municipal wastewater systems in the United States. I am informed by Mr. Major that the Petitioner has not benefited from the license agreement to the extent that it had hoped when the agreement was first entered into.
14. I have participated in conversations among representatives of Summit, the Petitioner and IDI. The focus of those discussions has been to encourage IDI to consider making a more substantial investment in the Petitioner on a going forward basis. As part of those discussions, the Petitioner has advised IDI that it may elect to terminate the existing

license agreement, although no final decision has yet been made in that regard. (Any final decision would of course also have to include the Monitor).

15. I expect, however, that each of the three potential bidders that we have now identified (as I describe below), will necessarily want to take a critical look at the IDI license agreement as part of their assessment of any investment in the Petitioner.

*Legal Matters*

16. As has been reported to the Court, the Petitioner is engaged in an on-going arbitration matter with Kan-Pak LLC ("Kan-Pak").
17. I am informed by Mr. Major that cross-examinations in that proceeding were completed on March 9, 2009. I am further informed by Mr. Major that final arguments are scheduled for April 20 and 21, 2009, and that a final decision is expected within three weeks of that date, or by early to mid-May 2009.
18. The Petitioner also has been involved in ongoing patent infringement litigation in Finland.
19. On the advice of intellectual property counsel, the Petitioner had been pursuing a claim against a competitor, Kruger-Kaldenes (formerly Anox Kaldenes) ("Kaldenes"), seeking to have the latter's patent claims over certain products or processes which compete with those of the Petitioner declared invalid. The proceeding was initiated by the Petitioner on the advice of intellectual property counsel, as a result of threats by Kaldenes to bring patent infringement proceedings against the Petitioner in Finland.
20. I am informed by Mr. Major that a decision was rendered on March 13, 2009, dismissing the Petitioner's application to have Kaldenes' patents declared invalid.
21. I have not yet had an opportunity to review the decision of the Finnish tribunal. (The decision is in Finnish, and has not yet been translated). I am informed by Mr. Major that, at this time, Kaldenes has not initiated any formal legal proceedings against the Petitioner.
22. I have had preliminary discussions with the Petitioner's Canadian intellectual property

counsel, Gowlings. Gowlings have provided the Petitioner with some very preliminary advice as to how best to proceed in the face of the decision, including a very preliminary assessment of the Petitioner's prospect of success on appeal.

23. In due course, the Petitioner will have to assess the impact of the Kaldenes decision, and the extent to which it may affect its operations, particularly in Finland, where of course it has ongoing contracts with Aker. The Petitioner also will have to consider whether to appeal from the decision.

***Discussions with Potential Investors***

24. Along with Harvey Lee and Charles Croft, I have participated in ongoing discussions with potential investors in, or purchasers of, the Petitioner. In this regard, I have supplied these potentially interested parties with updated financial information, including budgets, cash flows and other requested documents.
25. I have attended numerous meetings and conference calls to discuss the Petitioner and its prospects.
26. As a result of those discussions, Summit has received three letters of interest from potential investors.
27. I have delivered copies of the letters of interest that we have received to the Monitor.
28. As well, we are engaged in ongoing discussions with IDI regarding their interest in purchasing the Petitioner's technology, or the company as a whole.
29. At this point, I can say that each of the letters of interest that we have received to date contemplates a structure whereby the Petitioner's existing receivables, and particularly its anticipated recoveries from Aker, net of certain expenses, would be made available to satisfy the claims of existing secured and unsecured creditors. At the same time, a new entity may be created to acquire the Petitioner's intellectual property, goodwill, employees and other assets, with a view to developing new business.
30. Each of the interested bidders also is interested in acquiring and maintaining the Petitioner's tax losses, which are considerable.

- 31. Given the confidential nature of the discussions (to this point) with these potential investors, I am reluctant to reveal their identity or the contents of their proposals to the Court at this point.
- 32. Assuming the Court may be prepared to grant a further extension of the stay of proceedings, it is Summit's intention to invite the parties who have provided letters of interest to enter into a formal due diligence phase commencing on March 23, 2009, for a period of 30 days, following which they will be required to submit a binding offer. The best offer will form part of the Plan.
- 33. Given the anticipated timing of an award in the Kan-Pak Arbitration, and in order to account for possible extensions of the bid process on behalf of the Petitioner, I request an extension of the stay to May 8, 2009.

SWORN BEFORE ME at the City of )  
Vancouver, British Columbia, )  
on March 17, 2009 )  
)  
)  
)  
)  
A commissioner for taking )  
affidavits in British Columbia )

  
\_\_\_\_\_  
DAVID GRAY

Affidavit #1 - Lee.rtf

**SCOTT A. TURNER**  
*Barrister & Solicitor*  
1400-510 BARRARD STREET  
VANCOUVER, B.C. V6C 3A8

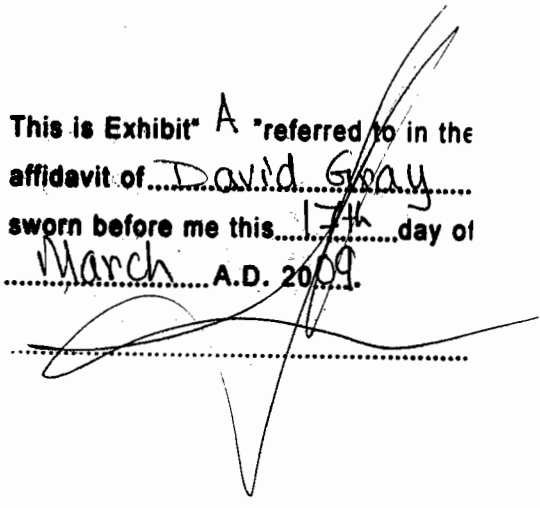
HYDROXYL SYSTEMS INC  
 PROJECTED STATEMENT OF INCOME - SUMMARY  
 FOR THE 10 MONTHS ENDING DECEMBER 31, 2009  
 (UNAUDITED - INFORMATION SUPPLIED BY MANAGEMENT)

4-Mar

\$ Canadian

	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER	TOTAL
REVENUE	386,607	1,147,155	249,849	1,719,481	263,927	300,129	136,978	1,759,256	585,429	1,603,440	8,152,249
COST OF SALES	221,219	233,471	196,774	14,400	16,400	74,359	152,002	1,200,183	1,578,939	1,219,101	4,906,849
GROSS PROFIT	165,388	913,684	53,075	1,705,081	247,527	225,770	(15,025)	559,072	(993,511)	384,339	3,245,399
Gross margin %	43%	80%	21%	99%	94%	75%	-11%	32%	-170%	24%	40%
SELLING COSTS	13,935	20,364	36,421	15,714	36,920	27,917	38,948	22,666	42,796	29,524	285,206
SALARIES & BENEFITS	102,095	113,104	144,942	115,216	148,018	122,463	111,535	111,209	110,666	111,209	1,190,457
GENERAL EXPENSES	90,174	78,820	35,062	161,538	35,062	35,487	35,538	35,062	35,062	42,663	584,469
INCOME BEFORE OTHER EXPENSES	(40,816)	701,396	(163,350)	1,412,613	27,526	39,902	(201,046)	390,135	(1,182,035)	200,942	1,185,268
OTHER EXPENSES	60,000	40,000	20,000	-	-	-	-	-	-	-	120,000
NET INCOME	\$ (100,816)	\$ 661,396	\$ (183,350)	\$ 1,412,613	\$ 27,526	\$ 39,902	\$ (201,046)	\$ 390,135	\$ (1,182,035)	\$ 200,942	\$ 1,065,268

This is Exhibit "A" referred to in the  
 affidavit of David Gray  
 sworn before me this 17th day of  
March A.D. 2009.



March 19, 2009 Cash Flow for Monitor		HYDROXYL SYSTEMS INC. PROJECTED CASH FLOW FOR THE PERIOD MARCH 23 - MAY 8, 2009											
3/17/2009 8:57		Mar09			Apr09			BUDGET			WORK IN PROGRESS		
		Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of
		Mar 23-27	Mar 30 - Apr 3	Apr 6-10	Apr 13-17	Apr 20-24	Apr 27-May 1	May 4-8	Mar 23 - Dec 31	2010	2010	2011	Jan 1 - Dec 31
		BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	BUDGET	2009	2010	2010	2011	Jan 1 - Dec 31
<b>CASH FLOW SUMMARY</b>													
Funds available beginning of period:													
Cash in bank	\$												
Operating line of credit available		310,534.69	290,866.21	161,653.19	403,717.80	376,350.30	325,996.68	308,326.32					
<b>Total funds available beginning of period</b>		<b>310,534.69</b>	<b>290,866.21</b>	<b>161,653.19</b>	<b>403,717.80</b>	<b>376,350.30</b>	<b>325,996.68</b>	<b>308,326.32</b>					
Funds received:													
Accounts receivable		53,478.10	62,422.35	436,142.26									
New projects													
<b>Total funds received</b>		<b>53,478.10</b>	<b>62,422.35</b>	<b>436,142.26</b>									
Funds dispersed:													
Operating expenses		61,766.16	37,921.70	39,504.00	11,815.00	50,353.62	49,728.89	39,260.00					
Payments to suppliers		11,380.42	112,713.68	134,573.64	15,562.50		96,944.68	50,750.10					
Other payments				20,000.00				20,000.00					
Advisor fees			41,000.00					41,000.00					
<b>Total funds dispersed</b>		<b>73,146.58</b>	<b>191,635.37</b>	<b>194,077.64</b>	<b>27,367.50</b>	<b>50,353.62</b>	<b>187,673.57</b>	<b>110,010.10</b>					
<b>Increase (decrease) in funds</b>		<b>(19,668.48)</b>	<b>(129,213.02)</b>	<b>242,064.62</b>	<b>(27,367.50)</b>	<b>(50,353.62)</b>	<b>(17,670.37)</b>	<b>(10,010.10)</b>					
Funds available end of period:													
Cash in bank				242,064.62									
RBC LOC bank adjustments													
Operating line of credit available		290,866.21	161,653.19	161,653.19	376,350.30	325,996.68	308,326.32	198,315.22					
<b>Total funds available end of period</b>		<b>290,866.21</b>	<b>161,653.19</b>	<b>403,717.80</b>	<b>376,350.30</b>	<b>325,996.68</b>	<b>308,326.32</b>	<b>198,315.22</b>					
Operating line of credit before cash in bank account		209,133.79	338,346.81	338,346.81	123,649.70	174,003.32	191,673.69	301,683.79					
Less: cash in bank account													
Remaining cash in bank account				242,064.62									
<b>OPERATING LINE OF CREDIT</b>		<b>\$ 209,133.79</b>	<b>\$ 338,346.81</b>	<b>\$ 96,282.20</b>	<b>\$ 123,649.70</b>	<b>\$ 174,003.32</b>	<b>\$ 191,673.69</b>	<b>\$ 301,683.79</b>					
<b>CASH FLOW DETAIL</b>													
Accounts Receivable													
STX Finland - Aker													
Other - GST refund													
BC Ferries - Service - All													
Catalyst Paper													
Agropur													
Landau Associates													
RCCL - Maintenance/Media Tsr													
RCCL - Damage Claim													
RCCL - Contract													
RCCL - Labour													
United Oil Meriden, CT													
All receivables POST March 23		53,478.10	62,422.35	436,142.26									
<b>Total Accounts Receivable</b>		<b>\$ 53,478.10</b>	<b>\$ 62,422.35</b>	<b>\$ 436,142.26</b>									
New Projects - Deposits and Payments													
Puerto Rico Brewery													
Letter Kenny													
<b>Total New Projects</b>													

This is Exhibit B referred to in the affidavit of DAVID SMYTH sworn before me this 17th day of MARCH A.D. 2009

986,781

64,911

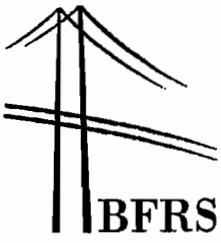
1,952,784.41

\$ 986,781.15

\$ 64,910.90



	Mar/09		Apr/09		May/09		2009 Mar 23 - Dec 31	2010 Jan 1 - Dec 31	2011 Jan 1 - Dec 31
	Week Of	Week Of	Week Of	Week Of	Week Of	Week Of			
Other supplier & Supplier Totals	Mar 23-27	Mar 30 - Apr 3	Apr 6-10	Apr 13-17	Apr 20-24	Apr 27-May 1	Mar 23 - Dec 31	Jan 1 - Dec 31	Jan 1 - Dec 31
	11,380.42	112,713.68	134,573.64	15,562.50	-	96,944.68	965,418.80	75,000	-
<b>Total Supplier Payments</b>	<b>\$ 11,380.42</b>	<b>\$ 112,713.68</b>	<b>\$ 134,573.64</b>	<b>\$ 15,562.50</b>	<b>\$ -</b>	<b>\$ 96,944.68</b>	<b>\$ 965,418.80</b>	<b>\$ 284,304.00</b>	<b>-</b>
<b>Other Payments</b>									
Royal Bank Construction Loan payments									
Legal fees for contract disputes			20,000.00						
<b>Total Other Payments</b>			<b>20,000.00</b>						
<b>Advisor Fees</b>									
Legal Fees Scott Turner (Burns Fitzpatrick)		10,000.00				10,000.00			
Summit Group Consulting		21,000.00				21,000.00			
Monitor Fees		10,000.00				10,000.00			
<b>Total Advisor Fees</b>	<b>\$ -</b>	<b>\$ 41,000.00</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 41,000.00</b>			
<b>Funds increased (decreased) during period</b>	<b>\$ (19,668.48)</b>	<b>\$ (129,213.02)</b>	<b>\$ 242,064.62</b>	<b>\$ (27,367.50)</b>	<b>\$ (50,353.62)</b>	<b>\$ (17,670.37)</b>	<b>\$ 887,365.61</b>	<b>\$ 602,477.15</b>	<b>\$ 44,910.90</b>
							<b>Total Net WIP</b>		<b>\$ 1,534,753.66</b>



**BURNS  
FITZPATRICK  
ROGERS &  
SCHWARTZ LLP**  
Barristers and Solicitors

DARRELL E. BURNS  
DENNIS K. FITZPATRICK \*  
SAMUEL D. HYMAN \*  
J. CHRISTOPHER CHAN

JOHN E. ROGERS  
STEPHEN Z. SCHWARTZ \*  
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Direct Line: 604.685.0121 local 320

File No. 016071

March 5, 2009

BY POST

Royal Caribbean Cruises Ltd.  
1050 Caribbean Way  
Miami, Florida 13132-2096  
U.S.A.

Attention: Kevin Douglas, Associate Vice President,  
Newbuild and Revitalisation

This is Exhibit C referred to in the  
affidavit of David Gray  
sworn before me this 17<sup>th</sup> day of  
March A.D. 2009

Dear Mr. Douglas:

**Re: Termination of Agreements between Royal Caribbean Cruises Ltd. ("RCCL") and  
Hydroxyl Systems Inc. ("Hydroxyl")**

Please be advised that we are counsel for Hydroxyl. We are advised that RCCL and Hydroxyl are parties to two separate written agreements for the supply of wastewater treatment systems onboard certain of RCCL's ships. The first agreement is dated as of December 23, 2005, and sets out the terms upon which Hydroxyl agreed to install CleanSea® wastewater treatment systems onboard RCCL's vessels "Radiance of the Seas" and "Summit". The second agreement is dated as of June 27, 2006, and sets out the terms upon which Hydroxyl agreed to install CleanSea® wastewater treatment systems onboard RCCL's vessels "Brilliance of the Seas", "Jewel of the Seas", "Celebrity Constellation" and "Celebrity Millenium". We will refer to these agreements, together as the "Agreements".

On December 5, 2008, Hydroxyl sought and obtained protection from its creditors pursuant to a Canadian statute called the *Companies' Creditors Arrangement Act* (the "CCAA"). The purpose of the CCAA is to facilitate compromises between debtor companies and their creditors. In this regard, the CCAA is, as we understand it, similar in scope to Chapter 11 of the United States *Bankruptcy Code*. So that you will better understand the scope of the protection extended to Hydroxyl, we attach a copy of an Order of the Supreme Court of British Columbia dated December 5, 2008, which sets out in some detail the scope of the stay of proceedings that applies to Hydroxyl. We draw your attention, specifically, to paragraph 12 of the Order,

which permits Hydroxyl to proceed with an orderly downsizing of its business including, without limitation, the right to terminate or repudiate such of its arrangements or agreements as Hydroxyl deems appropriate (Clause 12(B)(vi)).

Hydroxyl has determined that it would be in Hydroxyl's best interest to terminate the above described Agreements with RCCL. We have reviewed this decision with the Court-appointed Monitor (Steve Lum of Campbell Saunders Limited), who has consented to the terminations. Accordingly, please take this letter as our formal, written notice on behalf of Hydroxyl that, effective as of the date of this letter, Hydroxyl terminates the Agreements, and repudiates any and all of its obligations or liabilities under those Agreements, including without limitation any obligation to complete any work now under way, commission systems that have been installed or are being installed, or to honour any contractual warranties.

To the extent that RCCL may take the position that it has claims against Hydroxyl as a result of the termination of the Agreements, RCCL should so advise the Monitor (whose address for delivery is: Campbell Saunders, Ltd., 1000 - 570 Granville Street, Vancouver, British Columbia V6C 3P1, Canada, Attention: Steve Lum). In due course, Hydroxyl will be presenting a Plan of Arrangement to its creditors, each of whom will be given an opportunity to submit Proofs of Claim and vote on the Plan. If RCCL wishes to be considered as a creditor, you should write to the Monitor as indicated and, in due course, he will send you a Proof of Claim form and other materials. You can also obtain information regarding the CCAA proceedings by going to the Monitor's website at <http://www.csvan.com/corporate/index.html>. You may also contact the undersigned directly.

Notwithstanding the termination of the Agreements, we understand that Hydroxyl continues to be of the view that it would be in RCCL's best interests to have Hydroxyl complete the installations contemplated by the Agreements. Hydroxyl has the knowledge and expertise to complete the projects and make these systems operational, and is willing to enter into a new agreement or agreements to complete the work that it has begun. Any such arrangement would have to provide for payment of Hydroxyl on a cost-plus (time and materials) basis. If RCCL is interested in such an arrangement, we invite you to contact Thomas Major at your earliest convenience to discuss the terms upon which RCCL might be prepared to proceed.

Very truly yours,

**BURNS, FITZPATRICK, ROGERS & SCHWARTZ LLP**

Per:



Scott A. Turner

SAT/kr  
Encl.

cc: Thomas Major  
Charles E. Croft  
Steve Lum

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No. S-088488  
Vancouver Registry

**IN THE SUPREME COURT OF BRITISH COLUMBIA**

**IN THE MATTER OF THE COMPANIES' CREDITORS  
ARRANGEMENT ACT**

R.S.C. 1985, c. C-36, as amended

AND

**IN THE MATTER OF THE *Canada Business Corporations Act***  
R.S.C., 1985 c. C-44

AND

**IN THE MATTER OF HYDROXYL SYSTEMS INC.**

PETITIONER

---

**AFFIDAVIT #4  
OF DAVID GRAY**

---

**Burns, Fitzpatrick, Rogers & Schwartz LLP**

Barristers & Solicitors

#1400 - 510 Burrard Street

Vancouver, BC V6C 3A8

Telephone: 604-685-0121; Fax: 604-685-2104

Attention: Scott A. Turner

Ref: 16071

Filing Agents: Dye & Durham