

IN THE COURT OF QUEEN'S BENCH OF ALBERTA  
JUDICIAL DISTRICT OF CALGARY

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

AND IN THE MATTER OF  
**MAHALO ENERGY LTD.**

**AFFIDAVIT**

I, DAVID BURTON, of the City of Calgary, in the Province of Alberta, Businessman,  
MAKE OATH AND SAY AS FOLLOWS:

1. I am the President and Chief Executive Officer of Mahalo Energy Ltd. ("Mahalo") and as such I have personal knowledge of the matters hereinafter deposed to except where stated to be based upon information and belief, in which case I believe the same to be true.

**STATUS OF MAHALO'S CCAA PROCEEDINGS**

2. Mahalo entered into CCAA proceedings on May 22, 2009, pursuant to an Order of this Honourable Court (the "Initial Order"), and obtained its most recent stay extension order on January 13, 2010 (the "Stay Extension Order").
3. Since the granting of the Initial Order, Mahalo has acted in good faith and with diligence in respect of the restructuring of its affairs. In this regard, the following has been accomplished since the Stay Extension Order:
  - (a) Mahalo continues to carry on operations, including payment of accounts payable and collection of accounts receivable, in the ordinary course with no material adverse developments having occurred;
  - (b) Since closing the sale of Mahalo's assets, Mahalo has been liaising with provincial regulators and taking the necessary steps to ensure the transfer of the applicable

well, pipeline and facility licenses to the purchasers. All transfers have now been completed and the only remaining issue is for Mahalo to obtain a mineral lease to replace one that had previously expired. This will be done in April;

- (c) Mahalo has retained the accounting firm Ernst & Young Inc. to complete Mahalo's tax returns in order to allow Mahalo to assess the quantum of its tax pools and market itself as a tax reduction vehicle to prospective purchasers. Ernst & Young Inc. have completed the 2008 tax return and will complete the 2009 tax return during the budget period;
- (d) In January 2010, Mahalo asked the Monitor to conduct a Request for Proposal ("RFP") process to identify qualified organizations to oversee the sale of Mahalo and its remaining assets in a cost-effective manner. At the conclusion of this RFP process, Mahalo determined that Alger & Associates Inc. ("Alger") was the best qualified and most cost-effective candidate to act as its Corporate Transaction Advisor. Mahalo accordingly seeks the Court's approval to retain Alger in this capacity on the terms and conditions outlined in the engagement letter attached as Exhibit "C" to the Monitor's Sixth Report.
- (e) Alger has solicited RFP's from prospective purchasers for non-binding letters of intent and has received a number of letters of intent in response. Mahalo is currently considering the relative merits of these letters of intent. Proceeds from the sale of Mahalo, along with any recovery from Mahalo Energy USA Inc.'s (Mahalo USA) Chapter 11 proceedings (discussed below) will be used to fund Mahalo's Plan of Arrangement;
- (f) Mahalo continues to work with and communicate regularly with the Monitor to communicate with stakeholders and clarify financial information; and
- (g) Mahalo continues to meet its regulatory disclosure requirements in accordance with its statutory duties.

**STATUS OF MAHALO USA's CHAPTER 11 PROCEEDINGS**

4. I am advised by Mahalo USA's counsel in Oklahoma that the following has occurred in Mahalo USA's Chapter 11 proceedings since the Stay Extension Order:
- (a) The bankruptcy court conducted a non-evidentiary hearing on January 26, 2010, to consider confirmation of Mahalo USA's reorganization plan. The reorganization plan was to be confirmed at that time, provided the prerequisites to confirmation had been satisfied and there was no need for an evidentiary hearing. If an evidentiary hearing was necessary, the Court had previously set it for February 11, 2010. Given the objections to plan confirmation that remained pending as of January 26, 2010, the non-evidentiary hearing conducted at that time was effectively a pre-trial conference for the evidentiary confirmation hearing set on February 11, 2010.
  - (b) Between January 26 and February 11, 2010, the parties were able to resolve all objections to plan confirmation, except one filed by the unsecured creditors committee ("UCC"). The parties presented extensive factual stipulations and proffers of evidence in support of plan confirmation at the February 11 hearing, and made extensive argument on the unresolved legal issue involved in the one unresolved objection to plan confirmation. The Court was asked to rule on that unresolved issue, which was whether the lender's pre-petition security interests extended to any claims Mahalo USA might have against directors and officers for breach of their duties as such, and the parties agreed to amend the plan, if necessary, based on the Court's ruling. If the Court ruled that the security interests extended to claims of that sort, the remaining plan confirmation objection would be withdrawn and the plan would be confirmed as submitted; if the Court ruled to the contrary, the plan would be amended to provide that any claims against directors and officers for breach of their duties as such would be transferred to a liquidating trust formed under the trust to administer assets for the

benefit of Mahalo USA's unsecured creditors. Such an amendment would also resolve the lone plan objection remaining.

- (c) On March 3, 2010, the Court ruled that the lender's pre-petition security interests did not extend to any claims Mahalo USA might have against directors and officers for breach of their duties as such, and Mahalo USA is in the process of amending its reorganization plan to provide that the above-described claims will be transferred to the liquidating trust. Notice of that amendment has been provided to parties in interest to the case and they have been afforded an opportunity to object. Parties in interest have until March 18, 2010, within which to object to those amendments, and a hearing to consider any objections made is set on March 23, 2010. If no objections are timely made, it is anticipated that the plan of reorganization, as amended, will be confirmed shortly after the objection period runs, perhaps before the hearing date set or, in any event, within a short time thereafter.
5. Mahalo has filed a Proof of Claim in Mahalo USA's Chapter 11 proceedings in the amount of \$20,399,694.68 (USD). Under the Plan put forward in the Chapter 11 proceedings, Mahalo's claim has been classified in the unsecured creditor's pool and will share in any amounts that are paid into the liquidating trust. Initially, the US Plan provided for \$300,000 to be paid into the liquidating trust. The UCC rejected this amount, as well as a larger revised amount, in favour of \$50,000 in cash, plus certain unencumbered assets and the right to pursue designated avoidance actions. As a result, Mahalo's recovery will depend largely upon the resulting value these assets.
  6. Additionally, the UCC has filed an objection to Mahalo's claim arguing that the claim should be treated as equity as opposed to debt, and therefore should be equitably subordinated to the claims of unsecured creditors. Whether this argument will succeed or not is unknown at this time.
  7. In order to maintain its claim against Mahalo USA, Mahalo must file a response to this objection and participate in a hearing of the matter in the US Bankruptcy Court. Mahalo has now retained counsel in Tulsa, Oklahoma to represent it with respect to proving its

claim against Mahalo USA. It is estimated that the total cost of proving Mahalo's claim will be \$75,000 USD, \$25,000 of which has been provided for in Mahalo's projected cash flow statement, with the balance projected to be expended after the budget time frame.

## **FINANCIALS**

8. Attached hereto, and marked as Exhibit "A", is a summary of Mahalo's actual receipts and disbursements from the date of May 22, 2009 to March 12, 2010.
9. Attached hereto and marked as Exhibit "B" is Mahalo's revised projected cash flow statement to May 28, 2010, which cash flow statement has been approved by the Monitor. This revised cash flow statement is intended to replace the previous cash flow statement attached as Exhibit "B" to the Fifth Report of the Monitor, dated January 8, 2010, and to serve as the "Budget", as defined in Paragraph 23 of the Initial Order.

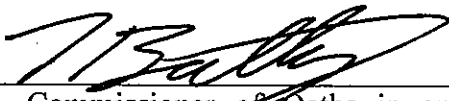
## **CLAIMS PROCEDURE**

10. Mahalo and the Monitor have received and reviewed approximately 85 proofs of claim from Mahalo's creditors and will begin issuing disallowances in relation to some of these claims shortly.

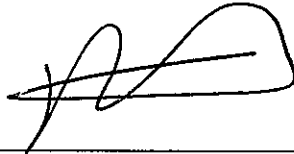
## **RELIEF SOUGHT**

11. I make this Affidavit in support of an application by Mahalo to have the Stay Period extended to May 28, 2010, to amend Paragraph 23 of the Initial Order in accordance with the form attached as Schedule "A" to the Notice of Motion filed herewith and for authorization to retain Alger & Associates Inc. as Corporate Transaction Advisor on the terms and conditions outlined in the engagement letter attached as Exhibit "C" to the Monitor's Sixth Report.

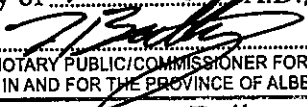
SWORN BEFORE ME at the City of Calgary, )  
in the Province of Alberta this 16<sup>th</sup> day of )  
March, 2010. )  
)  
)  
)  
)  
)

  
A Commissioner of Oaths in and for the  
Province of Alberta

**Trevor A. Batty**  
Barrister and Solicitor



**DAVID BURTON**


THIS IS EXHIBIT "A"  
referred to in the Affidavit of  
David Burton  
Sworn before me this 16th  
day of March A.D. 2010  
  
A NOTARY PUBLIC/COMMISSIONER FOR OATHS  
IN AND FOR THE PROVINCE OF ALBERTA

Trevor A. Batty  
Barrister and Solicitor

**Mahalo Energy Ltd. Cash Flow Budget vs. Actual,  
Canadian Operations during CCAA process  
Period From May 22, 2009 to March 12, 2010**

**EXHIBIT A**

<i>In Canadian \$</i>	<u>Cumulative</u>		<u>Variance</u>	
	<u>Budget</u>	<u>Actual</u>	<u>In \$'s</u>	<u>% of budget</u>
<b>Opening Cash on hand</b>	\$ 59,798	\$ 59,798	\$0	0.0%
<b>Canadian Revenue</b>				
GORR Revenue	9,000	28,698	\$19,698	218.9%
Anticipated cash receipt	705,335	768,971	\$63,636	9.0%
Repayment to Ableco	(256,080)	(256,080)	\$0	0.0%
	-	-		
Production Revenue	315,102	315,102	\$0	0.0%
US receipts	75,324	75,324	\$0	0.0%
	-	-		
<b>Operating Disbursements</b>				
Transaction Costs of Canadian Sale	(100,526)	(100,526)	\$0	0.0%
ERCB Issues	(41,693)	(41,693)	\$0	0.0%
Saskatchewan Environment	(47,299)	(47,299)	\$0	0.0%
Operating Expense	(194,473)	(194,473)	\$0	0.0%
Power prepayment	-	-	\$0	0.0%
	-	-		
	-	-		
<b>Net Revenue</b>	464,690	548,023	\$83,334	17.9%
	-	-		
<b>G&amp;A Disbursements</b>				
Canadian Rent	(162,461)	(162,461)	\$0	0.0%
Canadian Payroll and consultants	(1,089,688)	(1,082,555)	\$7,133	-0.7%
Canadian Benefits	(85,790)	(84,997)	\$793	-0.9%
Listing fee	(7,875)	(7,875)	\$0	0.0%
Travel	(120,637)	(109,375)	\$11,262	-9.3%
Meals and entertainment	(17,163)	(15,641)	\$1,522	-8.9%
Stationary	(8,567)	(8,035)	\$532	-6.2%
Communication	(50,236)	(43,751)	\$6,485	-12.9%
insurance (assumed paid in USA)	-	-	\$0	0.0%
Computer license rentals	(30,228)	(27,476)	\$2,752	-9.1%
Severance/Vacation Pay	(6,000)	(6,000)	\$0	0.0%
Bank Fees	(4,254)	(2,004)	\$2,250	-52.9%
Other G&A	(69,734)	(70,902)	(\$1,168)	1.7%
<b>Total Disbursements</b>	<b>\$ (1,652,634)</b>	<b>\$ (1,621,073)</b>	<b>\$31,561</b>	<b>-1.9%</b>
<b>Total Cashflow before Management Fee</b>	<b>\$ (1,187,945)</b>	<b>\$ (1,073,050)</b>	<b>\$114,895</b>	<b>-9.7%</b>
Management fee	1,590,188	1,805,582	\$215,394	13.5%
Professional Fees:				
BDP				
Retainer				
Fees (\$250,000 less Retainer of \$85,000)	(240,960)	(216,822)	\$24,138	-10.0%
Alger				
Retainer				
Fees (\$160,000 less retainer of 35,000)	(204,058)	(181,698)	\$22,360	-11.0%
Cash on Hand	\$ 17,023	\$ 393,810	\$ 376,787	2213.4%

THIS IS EXHIBIT " B "  
referred to in the Affidavit of  
David Burton  
Sworn before me this 16<sup>th</sup>  
day of March A.D. 2010  
  
A NOTARY PUBLIC / COMMISSIONER FOR OATHS  
IN AND FOR THE PROVINCE OF ALBERTA

Trevor A. Batty  
Barrister and Solicitor

**Mahalo Energy Cash Flow Budget**

**EXHIBIT B**

(CD \$'s except for unit data)	Week ending							Totals
	3/19/10	3/26/10	4/2/10	4/9/10	4/16/10	4/23/10	4/30/10	
Canadian revenue				10,000		10,000		20,000
Collection of receivables				35,000				35,000
<b>Operating Disbursements</b>								
Operating Expense								
Canadian Rent			(11,948)				(11,948)	(23,896)
Canadian Payroll & consultants		(33,050)			(33,050)		(33,050)	(169,252)
Canadian Benefits	(3,000)				(3,000)		(3,000)	(9,000)
Listing fee on Venture Exchange								-
Travel	(20,577)					(11,262)		(31,839)
Meals and entertainment	(2,125)					(2,125)		(4,250)
Stationary	(1,505)					(1,505)		(3,010)
Communication		(3,981)				(7,087)		(11,068)
Insurance							(10,000)	(10,000)
Computer license rentals		(3,520)				(3,520)		(7,040)
Severance/Vacation pay								-
Bank fees	(1,205)					(1,205)		(2,410)
Other G&A	(4,855)		(13,000)	(4,855)		(4,855)		(37,565)
Sub-total operating disbursements	(33,267)	(40,551)	(24,948)	(4,855)	(36,050)	(31,559)	(46,998)	(309,329)
Management fee	11,330	54,600	10,399	66,000				142,329
<b>Professional Fees:</b>								
Tax return preparation								(13,000)
US counsel retainer	(25,000)		(13,000)					(25,000)
Corporate Transaction costs/retainers					(75,000)			(75,000)
BDP	(29,000)				(20,000)		(20,000)	(69,000)
Alger & Counsel	(40,000)				(20,000)		(20,000)	(80,000)
Cash required	(115,937)	14,049	(27,549)	106,145	(151,050)	(31,559)	(46,998)	(374,000)
Cash on Hand - Opening	393,810	277,873	291,922	264,373	370,518	219,468	187,909	393,810
Cash on Hand - Closing	277,873	291,922	264,373	370,518	219,468	187,909	140,910	19,810

Action No. 0901-07221

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IN THE COURT OF QUEEN'S BENCH  
OF ALBERTA  
JUDICIAL DISTRICT OF CALGARY

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**Affidavit of David Burton**  
**Sworn March 16, 2010**

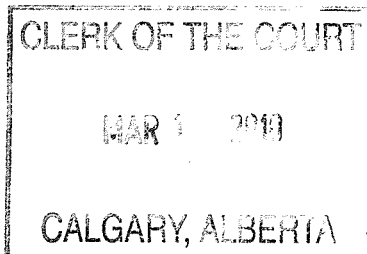
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**AFFIDAVIT**

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File No. 60470-42