Court File No.: 31-2658047

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY
COMMERCIAL LIST

IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF MENDOCINO CLOTHING COMPANY LTD. OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO

BOOK OF AUTHORITIES OF THE PROPOSAL TRUSTEE
(returnable September 25, 2020)

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OF THE CITY OF TORONTO,
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BOOK OF AUTHORITIES

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TAB 1

CITATION: Elleway Acquisitions Limited v. 4358376 Canada Inc., 2013 ONSC 7009
COURT FILE NO.: CV-13-10320-00CL
DATE: 20131203

2013 ONSC 7009 (CanLII)

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c.B-3, AS AMENDED, AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c.C.43, AS AMENDED.

RE: **ELLEWAY ACQUISITIONS LIMITED, Applicant**

AND:

4358376 CANADA INC. (OPERATING AS ITRAVEL 2000.COM), THE CRUISE PROFESSIONALS LIMITED (OPERATING AS THE CRUISE PROFESSIONALS), AND 7500106 CANADA INC. (OPERATING AS TRAVELCASH), Respondents

BEFORE: **MORAWETZ J.**

COUNSEL: **Jay Swartz and Natalie Renner, for the Applicant**

John N. Birch, for the Respondents

David Bish and Lee Cassey, for Grant Thornton, Proposed Receiver

HEARD
&ENDORSED: NOVEMBER 4, 2013

REASONS: **DECEMBER 3, 2013**

ENDORSEMENT

[1] At the conclusion of argument on November 4, 2013, the motion was granted with reasons to follow. These are the reasons.

[2] On November 4, 2013, Grant Thornton Limited was appointed as Receiver (the "Receiver") of the assets, property and undertaking of each of 4358376 Canada Inc., (operating as itravel2000.com ("itravel")), 7500106 Canada Inc., (operating as Travelcash ("Travelcash")), and The Cruise Professionals Limited, operating as The Cruise Professionals ("Cruise" and, together with itravel2000 and Travelcash, "itravel Canada"). See reasons reported at 2013 ONSC 6866.

[3] The Receiver seeks the following:

(i) an order:

(a) approving the entry by the Receiver into an asset purchase agreement (the "itravel APA") between the Receiver and 8635919 Canada Inc. (the "itravel Purchaser") dated on or about the date of the order, and attached as Confidential Appendix I of the First Report of the Receiver dated on or about the date of the order (the "Report");

(b) approving the transactions contemplated by the itravel APA;

(c) vesting in the itravel Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the itravel APA) (collectively, the "itravel Assets"); and

(d) sealing the itravel APA until the completion of the sale transaction contemplated thereunder; and

(ii) an order:

(a) approving the entry by the Receiver into an asset purchase agreement (the "Cruise APA", and together with the itravel APA and the Travelcash APA, the "APAs") between the Receiver and 8635854 Canada Inc. (the "Cruise Purchaser"), and together with the itravel Purchaser and the Travelcash Purchaser, the "Purchasers") dated on or about the date of the order, and attached as Confidential Appendix 2 of the Report;

(b) approving the transactions contemplated by the Cruise APA; and

(c) vesting the Cruise Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the Cruise APA) (the "Cruise Assets", and together with the itravel Assets and the Travelcash Assets, the "Purchased Assets"); and

(d) sealing the Cruise APA until the completion of the sales transaction contemplated thereunder; and

(iii) an order:

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(a) approving the entry by the Receiver into an asset purchase agreement (the "Travelcash APA") between the Receiver and 1775305 Alberta Ltd. (the "Travelcash Purchaser") dated on or about the date of the order, and attached as Confidential Appendix 3 of the Report;

(b) approving the transactions contemplated by the Travelcash APA;

(c) vesting in the Travelcash Purchaser all of the Receiver's right, title and interest in and to the "Purchased Assets" (as defined in the Travelcash APA) (collectively, the "Travelcash Assets"); and

(d) sealing the Travelcash APA until the completion of the sale transaction contemplated thereunder.

[4] The Receiver further requests a sealing order: (i) permanently sealing the valuation reports prepared by Ernst & Young LLP and FTI Consulting LLP, attached as Confidential Appendices 4 and 5 of the Report, respectively; and (ii) sealing the Proposed Receiver's supplemental report to the court dated on or about the date of the order (the "Supplemental Report"), for the duration requested and reasons set forth therein.

[5] The motion was not opposed. It was specifically noted that Mr. Jonathan Carroll, former CEO of itravel, did not object to the relief sought.

[6] The Receiver recommends issuance of the Orders for the factual and legal bases set forth herein and in its motion record. The purchase and sale transactions contemplated under the APAs (collectively, the "Sale Transactions") are conditional upon the Orders being issued by this court.

General Background

[7] Much of the factual background to this motion is set out in the endorsement which resulted in the appointment of the Receiver (2013 ONSC 6866), and is not repeated.

[8] The Receiver has filed the Report to provide the court with the background, basis for, and its recommendation in respect of the relief requested. The Receiver has also filed the Supplemental Report (on a confidential basis) as further support for the relief requested herein.

[9] In the summer of 2010, Barclays Bank PLC ("Barclays") approached Travelzest and stated that it no longer wished to act as the primary lender of Travelzest and its subsidiaries, as a result of certain covenant breaches under the Credit Agreement. This prompted Travelzest to consider and implement where possible, strategic restructuring arrangements, including the divestiture of assets and refinancing initiatives.

[10] In September 2010, Travelzest publicly announced its intention to find a buyer for the Travelzest business.

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Travelzest's Further Sales and Marketing Processes

[11] In the fall of 2011, a competitor of itravel Canada contacted Travelzest and expressed an interest in acquiring the Travelzest portfolio. Negotiations ensued over a period of three months. However, the parties could not agree on a Purchase Price or terms, and negotiations ceased in December 2011.

[12] In early 2012, an informal restructuring plan was developed, which included the sale of international companies.

[13] The first management offer was received in April 2012. In addition, a sales process continued from May to October 2012, which involved 50 potential bidders within the industry. Counsel advised that 14 parties pursued the opportunity and four parties were provided with access to the data room. Four offers were ultimately made but none were deemed to be feasible, insofar as two were too low, one withdrew and the management offer was withdrawn after equity backers were lost.

[14] In September 2012, a second management offer was received, which was subsequently amended in November 2012. The second management offer did not proceed.

[15] In January 2013, discussions ended and the independent committee was disbanded.

[16] In March and April 2013, three Canadian financial institutions were approached about a refinancing. However, no acceptable term sheet was obtained.

[17] In May 2013, Travelzest entered into new discussions with a prior bidder from a previous sales process. Terms could not be reached.

[18] In May 2013, a third management offer was received which was followed by a fourth management offer in July, both of which were rejected.

[19] In July 2013, a press release confirmed that Barclays was not renewing its credit facilities with the result that the obligations became payable on July 12, 2013. However, Barclays agreed to support restructuring efforts until August 30, 2013.

[20] In August 2013, a fifth management offer was made for the assets of itravel Canada, which included limited funding for liabilities. This offer was apparently below the consideration offered in the previous management offers. The value of the offer was also significantly lower than the Barclays' indebtedness and lower than the aggregate amount of the current offer from the Purchasers.

Barclays' Assignment of the Indebtedness to Elleway

[21] On August 21, 2013, a consortium led by LDC Logistics Development Corporation ("LDC"), which included Elleway (collectively, the "Consortium") submitted an offer for

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Barclays debt and security, as opposed to the assets of Itravel Canada. On August 29, 2013, Elleway and Barclays finalized the assignment deal, which was concluded on September 1, 2013.

[22] The consideration paid by Elleway was less than the amount owing to Barclays. Barclays determined, with the advice of KPMG London, that the sale of its debt and security, albeit at a significant discount, was the best available option at the time.

[23] itravel Canada is insolvent. Elleway has agreed pursuant to the Working Capital Facility agreement to provide the necessary funding for itravel Canada up to and including the date for a court hearing to consider the within motion. However, if a sale is not approved, there is no funding commitment from Elleway.

Proposed Sale of Assets

[24] The Receiver and the Purchasers have negotiated the APAs which provide for the going-concern purchase of substantially all of the itravel Canada's assets, subject to the terms and conditions therein. The purchase prices under the APAs for the Purchased Assets will be comprised of a reduction of a portion of the indebtedness owed by Elleway under the Credit Agreement and entire amount owed under the Working Capital Facility Agreement and related guarantees, and the assumption by the Purchasers of the Assumed Liabilities (as defined in each of the Purchase Agreements and which includes all priority claims) and the assumption of any indebtedness issued under any receiver's certificates issued by the Receiver pursuant to a funding agreement between the Receiver and Elleway Properties Limited. The aggregate of the purchase prices under the APA is less the amount of the obligations owed by itravel Canada to Elleway under the Credit Agreement and Working Capital Facility Agreement and related guarantees.

[25] Pursuant to the APAs, the Purchasers are to make offers to 95% of the employees of itravel Canada on substantially similar terms of such employees current employment. The Purchasers will also be assuming all obligations owed to the customers of itravel Canada.

[26] In reviewing the valuation reports of FTI Consulting LLP and Ernst & Young LLP and considering the current financial position of itravel Canada, the Receiver came to the following conclusions:

(a) FTI Consulting LLP and Ernst & Young LLP concluded that under the circumstances, the itravel Canada companies' values are significantly less than the secured indebtedness owed under the Credit Agreement;

(b) Barclays, in consultation with its advisor, KPMG London, sold its debt and security for an amount lower than its par value;

(c) the book value of the itravel Canada's tangible assets are significantly less than the secured indebtedness; and

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(d) Elleway has the principal financial interest in the assets of itravel Canada, subject to priority claims.

[27] The Receiver is of the view that the Sale Transactions with the Purchasers are the best available option as it stabilizes itravel Canada's operations, provides for additional working capital, facilitates the employment of substantially all of the employees, continues the occupation of up to three leased premises, provides for new business to itravel Canada's existing suppliers and service providers, assumes the liability associated with pre-existing gift certificates and vouchers, allows for the uninterrupted service of customer's travel arrangements and preserves the goodwill and overall enterprise value of the Companies. In addition, the Receiver believes that the purchase prices under the APAs are fair and reasonable in the circumstances, and that any further marketing efforts to sell itravel Canada's assets may be unsuccessful and could further reduce their value and have a negative effect on operations.

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[28] The Receiver's request for approval of the Orders raises the following issues for this court.

A. What is the legal test for approval of the Orders?

B. Does the legal test for approval change in a so-called "quick flip" scenario?

C. Does partial payment of the purchase price through a reduction of the indebtedness owed to Elleway preclude approval of the Orders?

D. Does the Purchasers' relationship to itravel Canada preclude approval of the Orders?

E. Is a sealing of the APAs until the closing of the Sale Transactions contemplated thereunder and a permanent sealing of the FTI Consulting LLP and Ernst & Young LLP valuation and the Supplemental Report Warranted?

A. What is the Legal Test for Approval of the Orders?

[29] Receivers have the powers set out in the order appointing them. Receivers are consistently granted the power to sell property of a debtor, which is, indeed, the case under the Appointment Order.

[30] Under Section 100 of the *Courts of Justice Act (Ontario)*, this Court has the power to vest in any person an interest in real or personal property that the Court has authority to order be conveyed.

[31] It is settled law that where a Court is asked to approve a sales process and transaction in a receivership context, the Court is to consider the following principles (collectively, the "*Soundair* Principles"):

a. whether the party made a sufficient effort to obtain the best price and to not act improvidently;

b. the interests of all parties;

c. the efficacy and integrity of the process by which the party obtained offers; and

d. whether the working out of the process was unfair.

Royal Bank of Canada v. Soundair Corp. (1991), 4 O.R. (3d) 1 (C.A.); *Skyepharma PLC v. Hyal Pharmaceutical Corp*. (1999), 12 C.B.R. (4th) 87 (Ont. S.C.J., appeal quashed, (2000), 47 O.R. (3d) 234 (C.A.)).

[32] In this case, I am satisfied that evidence has been presented in the Report, the Jenkins Affidavit and the Howell Affidavit, to demonstrate that each of the *Soundair* Principles has been satisfied, and that the economic realities of the business vulnerability and financial position of itravel Canada (including that the result would be no different in a further extension of the already extensive sales process) militate in favour of approval of the issuance of the Orders.

B. Does the Legal Test for Approval Change in a So-called "Quick Flip" Scenario?

[33] Where court approval is being sought for a so-called "quick flip" or immediate sale (which involves, as is the case here, an already negotiated purchase agreement sought to be approved upon or immediately after the appointment of a receiver without any further marketing process), the court is still to consider the *Soundair* Principles but with specific consideration to the economic realities of the business and the specific transactions in question. In particular, courts have approved immediate sales where:

(a) an immediate sale is the only realistic way to provide maximum recovery for a creditor who stands in a clear priority of economic interest to all others; and

(b) delay of the transaction will erode the realization of the security of the creditor in sole economic interest.

Fund 321 Ltd. Partnership v. Samsys Technologies Inc. (2006), 21 C.B.R. (5th) 1 (Ont. S.C.J.); *Bank of Montreal v. Trent Rubber Corp*. (2005), 13 C.B.R. (5th) 31 (Ont. S.C.J.).

[34] In the case of *Re Tool-Plas,* I stated, in approving a "quick flip" sale that:

> A "quick flip" transaction is not the usual transaction. In certain circumstances, however, it may be the best, or the only, alternative. In considering whether to approve a "quick flip" transaction, the court should consider the impact on various parties and assess whether their respective positions and the proposed treatment that they will receive in the "quick flip" transaction would realistically be any different if an extended sales process were followed.

Tool-Plas Systems Inc., Re (2008), 48 C.B.R. (5th) 91 (Ont. S.C.J.).

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[35] Counsel submits that the parties would realistically be in no better position were an extended sales process undertaken, since the APAs are the culmination of an exhaustive marketing process that has already occurred, and there is no realistic indication that another such process (even if possible, which it is not, as itravel Canada lacks the resources to do so) would produce a more favourable outcome.

[36] Counsel further submits that a "quick flip" transaction will be approved pursuant to the *Soundair* Principles, where, as in this case, there is evidence that the debtor has insufficient cash to engage in a further, extended marketing process, and there is no basis to expect that such a process will result in a better realization on the assets. Delaying the process puts in jeopardy the continued operation of itravel Canada.

[37] I am satisfied that the approval of the Orders and the consummation of the Sale Transactions to the Purchasers pursuant to the APAs is warranted as the best way to provide recovery for Elleway, the senior secured lender of itravel Canada and with the sole economic interest in the assets. The sale process was fair and reasonable, and the Sale Transactions is the only means of providing the maximum realization of the Purchased Assets under the current circumstances.

C. Does Partial Payment of the Purchase Price Through a Reduction of the Indebtedness Owed to Elleway Preclude Approval of the Orders?

[38] Partial payment of the purchase price by Elleway reducing a portion of the debt owed to it under the Credit Agreement and the entire amount owned under the Working Capital Facility Agreement does not preclude approval of the Orders. This mechanism is analogous to a credit bid by a secured lender, but with the Purchasers, instead of the secured lender, taking title to the purchased assets. As noted, the Receiver understands that following closing of the transactions contemplated under the APAs, that Elleway (or an affiliate thereof) will hold an indirect equity interest in the Purchasers. It is well-established in Canada insolvency law that a secured creditor is permitted to credit bid its debt in lieu of providing cash consideration.

Re White Birch Paper Holding Co. (2010), 72 C.B.R. (5^{th}) 74 (Qc. C.A.); *Re Planet Organic Holding Corp*. (June 4, 2010), Toronto, Court File No. 10-86699-00CL, (S.C.J. [Commercial List]).

[39] This court has previously approved sales involving credit bids in the receivership context. See *CCM Master Qualified Fund, Ltd., v. Blutip Power Technologies Ltd.* (April 26, 2012), Toronto, Court File No. CV-12-9622-00CL, (S.C.J. [Commercial List]).

[40] It seems to me that, in these circumstances, no party is prejudiced by Elleway reducing a portion of the debt owed to it under the Credit Agreement and the entire amount owed under the Working Capital Facility Agreement as part of the Purchasers' payment of the purchase prices, as the Purchasers are assuming all claims secured by liens or encumbrances that rank in priority to Elleway's security. The reduction of the indebtedness owed to Elleway will be less than the total amount of indebtedness owed to Elleway under the Credit Agreement. As such, if cash was paid in lieu of a credit bid, such cash would all accrue to the benefit of Elleway.

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[41] Therefore, it seems to me the fact that a portion of the purchase price payable under the APAs is to be paid through a reduction in the indebtedness owed to Elleway does not preclude approval of the Orders.

D. Does the Purchasers' Relationship to itravel Canada preclude approval of the Orders?

[42] Even if the Purchasers and itravel Canada were to be considered, out of an abundance of caution, related parties, given that LDC is an existing shareholder of Travelzest and part of the Consortium or otherwise, this does not itself preclude approval of the Orders.

[43] Where a receiver seeks approval of a sale to a party related to the debtor, the receiver shall review and report on the activities of the debtor and the transparency of the process to provide sufficient detail to satisfy the court that the best result is being achieved. It is not sufficient for a receiver to accept information provided by the debtor where a related party is a purchaser; it must take steps to verify the information. See *Toronto Dominion Bank v. Canadian Starter Drives Inc.*, 2011 ONSC 8004 (Ont. S.C.J. [Commercial List]).

[44] In addition, the 2009 amendments to the BIA relating to sales to related persons in a proposal proceedings (similar amendments were also made to the *Companies' Creditors Arrangement Act* (Canada)) are instructive. Section 65.13(5) of the BIA provides:

> If the proposed sale or disposition is to a person who is related to the insolvent person, the court may, after considering the factors referred to in subsection (4), grant the authorization only if it is satisfied that:
>
> (a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the insolvent person; and
>
> (b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

[45] The above referenced jurisprudence and provisions of the BIA (Canada) demonstrate that a court will not preclude a sale to a party related to the debtor, but will subject the proposed sale to greater scrutiny to ensure a transparency and integrity in the marketing and sales process and require that the receiver verify information provided to it to ensure the process was performed in good faith. In this case, the Receiver is of the view that the market for the Purchased Assets was sufficiently canvassed through the sales and marketing processes and that the purchase prices under the APAs are fair and reasonable under the current circumstances. I agree with and accept these submissions.

[46] The Receiver requests that the APAs be sealed until the closing of the Sale Transactions contemplated thereunder. It is also requesting an order permanently sealing the valuation reports prepared by Ernst & Young LLP and FIT Consulting LLP and, attached as Confidential Appendices 4 and 5 of the Report, respectively.

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[47] The Supreme Court of Canada in *Sierra Club of Canada v. Canada (Minister of Finance)*, held that a sealing order should only be granted when:

> (a) an order is needed to prevent serious risk to an important interest because reasonable alternative measures will not prevent the risk; and
>
> (b) the salutary effects of the order outweigh its deleterious effects, including the effects on the right to free expression, which includes public interest in open and accessible court proceedings.

Sierra Club of Canada v. Canada (Minister of Finance), 2002 SCC 41, [2002] 2 S.C.R. 522, at para. 53; *Re Nortel Networks Corporation* (2009), 56 C.B.R. (5TH) 224, (Ont. S.C.J. [Commercial List]), at paras. 38-39.

[48] In my view, the APAs subject to the sealing request contain highly sensitive commercial information of itravel Canada and their related businesses and operations, including, without limitation, the purchase price, lists of assets, and contracts. Courts have recognized that disclosure of this type of information in the context of a sale process could be harmful to stakeholders by undermining the integrity of the sale process. I am satisfied that the disclosure of the APAs prior to the closing of the Sale Transactions could pose a serious risk to the sale process in the event that the Sale Transactions do not close as it could jeopardize dealings with any future prospective purchasers or liquidators of itravel Canada's assets. There is no other reasonable alternative to preventing this information from becoming publicly available and the sealing request, which has been tailored to the closing of the Sale Transactions and the material terms of the APAs until the closing of the Sale Transactions, greatly outweighs the deleterious effects. For these same reasons, plus the additional reason that the valuations were provided to Travelzest on a confidential basis and only made available to Travelzest and the Receiver on the express condition that they remain confidential, the Receiver submits that the FTI Consulting LLP and Ernst & Young LLP valuations be subject to a permanent sealing order. Further, the Receiver submits that the information contained in the Supplemental Report also meets the foregoing test for the factual basis set forth in detail in the Supplemental Report (which has been filed on a confidential basis). I accept the Receiver's submissions regarding the permanent sealing order for the valuation materials. For these reasons, (i) the APA is to be sealed pending closing, and (ii) only the valuation material is to be permanently sealed.

Disposition

[49] For the reasons set forth herein, the motion is granted. Orders have been signed to give effect to the foregoing.

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MORAWETZ J.

Date: December 3, 2013

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TAB 2

CITATION: Hypnotic Clubs. Inc. (Re), 2010 ONSC 2987
COURT FILE NO.: 31-1323465
DATE: 20100521

SUPERIOR COURT OF JUSTICE – ONTARIO

(COMMERCIAL LIST)

RE: IN THE MATTER OF THE PROPOSAL OF HYPNOTIC CLUBS INC., A COMPANY DULY INCORPORATED PURSUANT TO THE LAWS OF THE PROVINCE OF ONTARIO WITH A HEAD OFFICE IN THE CITY OF TORONTO IN THE PROVINCE OF ONTARIO, Applicant

BEFORE: CUMMING J.

COUNSEL: Domenico Magisano and Catherine DiMarco, for Hypnotic Clubs Inc.

Kenneth H. Page, for Jenny Telios

John Salmas, for Muzik Clubs Inc.

M. Solomon, for Generation of Dance, IncJohn Hendriks, for A. Farber & Partners Inc., Trustee

HEARD: MAY 18 and 21, 2010

2010 ONSC 2987 (CanLII)

ENDORSEMENT

The Motion

[1] A motion is made by the debtor corporation, Hypnotic Club Inc. ("Hypnotic" or the "debtor"), for a sale of its assets pursuant to s. 65.13 of the *Bankruptcy and Insolvency Act* ('*BIA*") R.S.C. 1985, c.B-3, as am.

Background

[2] The debtor is a private company, operating a nightclub management company at Exhibition Place in Toronto.

[3] The debtor filed a Notice of Intention to Make a Proposal (the "NOI") on February 17, 2010 under s. 50.4 of the *BIA*. A. Farber & Partners Inc. ("Farber" or "Proposal Trustee") was named Proposal Trustee. Court Orders have twice been made extending the time for the debtor to file its proposal. The last extension expires today, May 21, 2010.

[4] Hypnotic is a tenant under a sublease from Muzik Club's Inc. ("Muzik"). Muzik is a related person to Hypnotic.

[5] On May 5, 2010, the debtor entered into an Asset Purchase Agreement (the "APA") to sell its assets to Muzik (in trust for its nominee) subject to Court approval. On May 13, 2010, the APA was revised ("Revised APA") on the recommendation of the Proposal Trustee.

[6] Hence, the intended sale of assets is to a new corporation which will be a related person to Muzik.

[7] (If the Revised APA is approved, Hypnotic also requests a 32-day extension to June 22, 2010 pursuant to s. 50.4 (9) of the *BIA* to allow the Purchaser time to deal with various liquor licensing issues and to make a viable proposal upon the closing of the Revised APA.)

[8] Muzik is the tenant under an existing head lease from the Canadian National Exhibition ("CNE"). Muzik has some 12 years remaining on the 20-year term of the head lease. Muzik has a purported claim against Hypnotic of $1.5 million for unpaid rent. No proof of claim has been filed in respect of this alleged unpaid rent. Muzik also states that $210,000. in rent arrears is a preferred claim pursuant to s. 136 of the *BIA*.

[9] The Proposal Trustee is of the opinion that the process leading to the proposed sale and disposition to Muzik (in trust for its nominee) is reasonable in the circumstances because the sublease has expired and Hypnotic is now on a month-to-month tenancy. Muzik has the unfettered discretion as to who is acceptable as a new tenant. The clear intent of Muzik is to give a lease to the property to a related person tenant.

[10] It is also noted that s. 15.2 of the sublease to Hypnotic provides the tenant shall not effect any assignment or major sublease and there shall be no change of control of the tenant without the prior written consent of Muzik, which consent may be arbitrarily and unreasonably withheld.

[11] Mr. Starkovski, the principal of Muzik, also states that the head lease from the CNE only allows Muzik to sublet the premises to related parties without obtaining the prior written consent of the CNE; however, Muzik states that it will not entertain offers to lease from an unrelated party even if the CNE's consent were to be given.

[12] The Proposal Trustee's third report notes that two independent appraisals estimate the assets (equipment and inventory) of Hypnotic have a gross liquidation value of less than $282,000.

[13] The only secured creditor of Hypnotic, Generation of Dance Inc., is a related person to Muzik, owed some $325,000. A legal opinion has been provided that the security is valid and enforceable.

[14] Ms. Penny Telios, by far the largest arms-length unsecured creditor of Hypnotic, has a judgment against Hypnotic for $740,879.78 for monies loaned on or about May 27, 2005. Ms. Telios, in effect, has a veto over any proposal that Hypnotic makes to its creditors.

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[15] In his affidavit, Mr. John Telios (the brother of Ms. Penny Telios) alleges, amongst other things, that Mr. Zlatko Starkovski (the principal behind Muzik) made misrepresentations at the time of the loan to Hypnotic and specifically, misrepresented that Hypnotic was the tenant of the long-term lease from the CNE. Such allegation has no relevancy to the proceeding at hand.

[16] Ms. Telios has brought a cross motion seeking an order that Muzik produce the head lease from the CNE for the examination by Ms. Telios. Muzik refuses to produce the head lease. I have no jurisdiction (and the counsel for Ms. Telios does not suggest I have jurisdiction) to compel production of the head lease, being an agreement between two parties who are not the debtor. Accordingly, the cross motion is dismissed.

[17] Mr. Telios questions the validity of the Muzik purported claim against Hypnotic for unpaid rent of $1.5 million. The materials throw up suspicions as to the merits of this asserted claim.

[18] However, Muzik has agreed to waive the entirety of its purported claim of $1.5 million if the Revised APA is approved. Moreover, leaving aside the claim for $1.5 million by Muzik as landlord, it appears the appraised assets (inventory and equipment) of Hypnotic have a liquidation value that probably would not satisfy the secured creditor claim.

[19] The purchase price under the Revised APA is $450,000. In addition, as stated above, the landlord, Muzik, has agreed to not submit a claim against Hypnotic for asserted rent arrears of some $1.5 million. As well, subject to Court approval of the Revised APA, Muzik has agreed to fund 100% of any source deduction deemed trust and the directors' liabilities, including GST (some $130,874.83), and unremitted corporate taxes (some $110,199.72) and not file subrogated claims in the debtor's proposal if the Revised APA is accepted. Assuming the Revised APA is approved, Hypnotic intends to file a viable proposal after the closing of the sale under the Revised APA, with the $450,000. purchase price having replaced the sold assets of Hypnotic.

[20] Mr. Telios makes various allegations against Mr. Starkovski. I leave aside these various accusations. They are not relevant to this proceeding.

[21] Mr. Starkovski in his affidavit states that Ms. Telios will not agree to a compromise of her judgment and recognizes that she holds a veto power over any proposal. Ms. Telios's position is that the Revised APA should not be given Court approval and a formal proposal should be made by Hypnotic. The record suggests that Ms. Telios will not vote in favour of any proposal that does not satisfy her judgment.

[22] Mr. Starkovski is concerned that the Telioses have an ulterior motive of desiring to subvert the relationship of Muzik with the CNE for their own benefit.

[23] It is apparent that Mr. Telios and Mr. Starkovski have other business dealings and an acrimonious relationship. Whatever the merit, or lack of merit of their respective allegations about the other, those allegations are not relevant to this motion.

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[24] Realistically, Muzik is the only potential purchaser of Hypnotic's assets given Muzik's position that it will not agree to any subtenant who is not a related party to Muzik. Accordingly, there has not been any sales process undertaken by Hypnotic to offer the assets for sale to the public.

The Factors for Consideration in Considering the Motion

[25] The factors to be considered by the Court in respect of this Motion are set forth in s. 65.13 (4) and (5) of the *BIA*, which provide:

> 65.13(4) **Factors to be considered** – In deciding whether to grant the authorization, the court is to consider, among other things,
>
> (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
>
> (b) whether the trustee approved the process leading to the proposed sale or disposition;
>
> (c) whether the trustee filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
>
> (d) the extent to which the creditors were consulted;
>
> (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
>
> (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.
>
> (5) **Additional factors – related persons** – If the proposed sale or disposition is to a person who is related to the insolvent person, the court may, after considering the factors referred to in subsection (4), grant the authorization only if it is satisfied that
>
> (a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the insolvent person; and
>
> (b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

[26] Muzik has stated that it will only rent to a related party and no one else can enter the premises to run the business in the current location. Thus, there is no market for any third party to purchase the assets and operate from the current location.

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[27] The Proposal Trustee approves the process leading to the proposed sale. Farber has also stated that in its opinion the Revised APA "provides for a superior realization to the secured and arms-length unsecured creditors .... [and] permits the business to continue...[with] ongoing employment for 157 [7 full time and 150 part time] employees". In the Proposal Trustee's view, the consideration to be received for the sale of the assets is fair and reasonable, taking into account their market value as estimated by the two appraisals, attributing a value of about one-half the amount of the offer through the Revised APA.

[28] Muzik has advised that if the Revised APA is not approved it will withdraw its offer. Given the inability to find another purchaser, the resulting bankruptcy would quite probably result in a shortfall for the (related person) secured creditor and no recovery for the unsecured creditors, in particular, Ms. Telios.

[29] The opinion of the Proposal Trustee, reasonably founded upon the record as set forth above, is that the Revised APA provides for a better recovery to the secured creditor and the arms-length creditors than a bankruptcy.

[30] Thus, the factors to be considered as required by s. 65.13(4) of the *BIA* have been taken into account.

[31] The additional factor to be considered when the proposed sale is to a related person as required by s. 65.13 (5) (b) is also met. Given the impossibility of any real market for a sale of Hypnotic's assets to other than Muzik, a related person, and given the appraisals as to the liquidation value of those assets, the reasonable conclusion is that the consideration to be received by the Revised APA is superior to the consideration that would be received under any other conceivable offer.

[32] This brings me to the factor required to be met by s. 65.13(5) (a). Giving consideration to the entirety of the evidentiary record and the intent and policy underlying the *BIA*, I am not satisfied that good faith efforts have been made to sell or otherwise dispose of Hypnotic's assets to unrelated parties of Hypnotic within the intent and meaning of this provision.

[33] The intent and policy underlying the *BIA* is that creditors should consider and vote upon a proposal advanced pursuant to a NOI as they see fit in their own self interest. That objective is defeated in the instant situation if the Revised APA is approved.

[34] Section 65.13 (4) and (5) allow for exceptional situations to be considered by the Court provided the factors discussed are met.

[35] In the situation at hand, if the proposed sale is approved, Muzik ends up with the benefit of the nightclub establishment with a payment of approximately $150,000 to the unsecured creditors, their total claims being about $850,000. Muzik is in the position of effectively controlling who the subtenant replacing Hypnotic might be and insists that only a person related to Muzik can be the subtenant of Muzik. Thus, given the position of Muzik, there is no real market for the nightclub business. It is clear that the nightclub business of Hypnotic has considerable value to Muzik. In the course of submissions counsel for Muzik stated that Muzik

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had expended more than $1 million in improvements to the business property of Hypnotic. However, given its control of the granting of the sublease, Muzik in effect removes itself from having to bid a competitive price for the business of Hypnotic. Moreover, Muzik could agree to sublet to a non-related party, subject to the CNE consenting to the sublet, however, Muzik wants to capture the economic benefit of the ongoing nightclub business for itself.

[36] Given these circumstances, and taking into account the underlying policy of the *BIA* of letting creditors vote as they choose in respect of accepting or rejecting a proposal, in my view, the factor of required good faith efforts stipulated by s. 65.13(5)(a) has not been met.

[37] It is obvious that a deemed assignment into bankruptcy by s. 50.1 (8), consequential to no proposal having being made, will quite probably result in Ms. Telios and the other unsecured creditors not recovering anything at all. However, that is a consequence that should be determined by the unsecured creditors through a vote upon a proposal without a prior disposition of Hypnotic's assets through the proposed Revised APA.

Disposition

[38] For the reasons given, the motion is dismissed.

[39] I have advised all parties in court this morning as to my intended disposition of this motion, with these written reasons to follow. The debtor requested under s. 50.4 (9) of the *BIA* a further brief extension for the possible filing of a proposal. All parties present consent to the request. In my view, the request is reasonable in the circumstances and accordingly, an extension is given to June 7, 2010, and an Order shall issue to that effect.

CUMMING J.

Date: May 21, 2010

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TAB 3

In the Matter of the Proposal of Komtech Inc.

[Indexed as: Komtech Inc. (Re)]

106 O.R. (3d) 654

2011 ONSC 3230

Ontario Superior Court of Justice,
Kane J.
July 8, 2011

Bankruptcy and insolvency -- Sale of assets -- Court approval -- Presentation by debtor of proposal to its creditors or ability to present proposal not prerequisite for court approval of sale of debtor's assets under s. 65.13 of Bankruptcy and Insolvency Act -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 65.13.

K Inc. filed a Notice of Intention to make a proposal under s. 50.4 of the Bankruptcy and Insolvency Act ("BIA"), and a proposal trustee was appointed. K Inc. subsequently brought a motion for approval of a bidding process for the auction of its assets and the preliminary approval of an asset purchase agreement. The trustee recommended that the motion be granted. It was unlikely that K Inc. would be able to present a proposal for approval by its creditors.

Held, the motion should be granted.

Presentation of, or the ability to present, a proposal is not a condition to the exercise of the court's jurisdiction under

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s. 65.13 of the BIA to authorize a sale of assets.

The position of K Inc.'s secured and unsecured creditors would not improve if the motion was dismissed, given the past unsuccessful attempts to sell the business and the estimate of the realizable value of the company's assets. The requirements under s. 65.13 of the BIA were met.

Cases referred to

Brainhunter Inc. (Re), [2009] O.J. No. 5578, 62 C.B.R. (5th) 41 (S.C.J.); Hypnotic Clubs Inc. (Re), [2010] O.J. No. 2176, 2010 ONSC 2987, 68 C.B.R. (5th) 267; Nortel Networks Corp. (Re) [Bidding Procedures], [2009] O.J. No. 3169, 55 C.B.R. (5th) 229 (S.C.J.) [page655]

Statutes referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 14.06(7) [as am.], 50.4, (1) [as am.], 64.1 [as am.], 64.2 [as am.], 65.13 [as am.], (1), (3), (4), 81.4(4), 81.6(2)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 36 [as am.]

MOTION by the debtor for the approval of the sale of assets.

Keith A. MacLaren, for Komtech Inc.

John O'Toole and Andr Ducasse, for Business Development Bank of Canada.

Karen Perron, for Hubbell Canada LP.

[1] KANE J.: -- The applicant, Komtech Inc. ("Komtech"), designs and manufactures plastic injection products at two facilities in Ontario and employs approximately 150 employees. Faced with serious financial difficulties, Komtech filed a Notice of Intention ("NOI") to make a proposal ("Proposal") under s. 50.4(1) of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ("BIA") on March 2, 2011. A. Farber & Partners Inc. was appointed Proposal Trustee ("Trustee").

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[2] This court, on March 31, 2011, granted an extension to file the Proposal until May 16, 2011.

[3] On April 20, 2011, Komtech by motion sought approval of a bidding process ("Bid Process") for the auction of its assets and the preliminary approval of the Stalking Horse Asset Purchase Agreement (the "APA") between itself as vendor and 2279591 Ontario Inc. as purchaser. Pursuant to the APA, most of the assets of the vendor, including accounts receivable, inventory equipment, assigned contracts, intellectual property, products and prepaid expenses, are to be sold subject to the bid process, for a purchase price of $2,800,000 (the "Purchase Price", or the "MBA").

[4] All secured creditors of Komtech were served with this motion pursuant to s. 65.13(3) of the BIA. Section 65.13(3) of the Act does not require service on unsecured creditors.

[5] The two primary secured lenders support this motion, namely, the Business Development Bank of Canada ("BDB") and HSBC Canada ("HSBC"). Demand for payment by each of these secured lenders has been made of Komtech. Komtech has been unsuccessful in obtaining alternative credit facilities. Combined, these two secured lenders are presently owed approximately $6 million. The NOI dated February 26, 2011 lists approximately $3,600,000 additional debt owing to other creditors of Komtech in addition to BDB and HSBC. [page656]

[6] The Purchase Price may be increased in an auction under the Bid Process. The Trustee recommends that the motion be granted and, in support thereof, filed a second report dated April 19, 2011 and a supplement to the second report dated April 27, 2011. The Trustee expresses the opinion that the greatest chance of return to creditors of Komtech is proceeding with the APA coupled with an auction using the APA and the Purchase Price as the floor.

[7] The Trustee in the second report confirms that the purchaser under the APA will carry on the business now being operated by Komtech and continue the employment of most of the 150 unionized and non-unionized employees of Komtech.

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Evaluation of the APA and Bid Process

[8] I have reviewed the asset realization value estimate of Komtech's assets, the analysis prepared by the Trustee as well as an independent manufacturing equipment evaluation dated April 8, 2011. This estimate of liquidation value strongly supports the recommendation of the Trustee that Komtech be authorized to execute the APA as it represents consideration materially in excess of the liquidation value likely obtainable on a forced sale of assets.

[9] I am satisfied on the material filed that Komtech has made reasonable efforts in search of alternate financing, equity partnership or a purchaser of the business. I am further satisfied that Komtech has co-operated with the Trustee to identify and engage prospective purchasers of the company and its assets.

[10] In the event this motion is granted, the Trustee has undertaken to conduct further marketing in the hope of obtaining higher bids from prospective purchasers above that contained in the APA. That potential may increase consideration and payment to secured and unsecured creditors.

[11] It is my understanding that 2279591, as purchaser in the APA, is not a related party to Komtech.

[12] The position of Komtech's secured and unsecured creditors will not improve if this motion is dismissed given the past unsuccessful attempts to sell the business and the estimate of the realizable value of the company's assets. The use of the Stalking Horse APA in the marketing and Bid Process represents the only remaining potential recovery for creditors beyond BDB and HSBC.

[13] The Trustee in his reports has satisfied the requirements under s. 65.13(4). Alternative sources of financing were sought and are unavailable. A process was undertaken to identify and seek interest from potential purchasers under the direction of [page657] the Proposal Trustee. Negotiations took place with the knowledge of BDB and

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HSBC which led to the presentation for approval of the APA.

[14] Involvement by the BDB since April 20, 2011 has increased the level of consideration payable under the APA by $100,000.

[15] The APA represents continued employment to a large majority of the existing employees of Komtech. The APA represents a lower level of financial disruption to the existing customer base and suppliers of Komtech.

[16] Given the realization value estimate, it appears that the consideration to be paid under the APA is reasonable and fair considering the book value, the market value and the estimate of liquidation value of such assets.

[17] It is contemplated that a motion seeking a vesting order will be brought in the next several weeks. The Trustee has undertaken to provide all secured creditors and a representative group of the largest unsecured creditors with notice of that motion. That motion will provide creditors with an opportunity to express concerns regarding this initial approval of the APA, the auction bid process and amounts.

[18] There is also value to suppliers and the greater community if this business is continued by a purchaser under the APA or the Bid Process.

[19] Subject to the issue stated below, the moving party has satisfied me as to the requisite elements under s. 65.13 of the BIA.

Remaining Issue

[20] On the facts in this case, it is unlikely that Komtech will be able to present a Proposal for approval by its creditors. The issue is whether court approval of the sale of assets is available under s. 65.13 of the BIA when the debtor is unable to present a Proposal to its creditors.

[21] Parliament enacted s. 65.13 of the BIA at the same time as enacting s. 36 of the Companies' Creditors Arrangement Act,

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R.S.C. 1985, c. C-36 ("CCAA"). Both amendments were enacted in 2005.

[22] The wording of s. 65.13 under the BIA and s. 36 under the CCAA are remarkably similar.

[23] Section 65.13(1) of the BIA prohibits the sale and disposition of assets outside the ordinary course of business in respect of an insolvent person which has filed an NOI under s. 50.4, unless authorized by the court to do so. [page658]

[24] Hypnotic Clubs Inc. (Re), [2010] O.J. No. 2176, 68 C.B.R. (5th) 267 (S.C.J.) involved an NOI by the debtor under the BIA and a motion for approval of a sale of assets to a related third party under s. 65.13. The trustee was this Proposal Trustee. The court refused to approve that asset purchase agreement as it was not satisfied that good faith efforts had been made to sell the debtor's assets to unrelated parties. In coming to that conclusion, the court, at paras. 36 and 37, states:

> Given these circumstances, and taking into account the underlying policy of the BIA of letting creditors vote as they choose in respect of accepting or rejecting a proposal, in my view, the factor of required good faith efforts stipulated by s. 65.13(5)(a) has not been met.
>
> It is obvious that a deemed assignment into bankruptcy by s. 50.1(8), consequential to no proposal having being made, will quite probably result in Ms. Telios and the other unsecured creditors not recovering anything at all. However, that is a consequence that should be determined by the unsecured creditors through a vote upon a proposal without a prior disposition of Hypnotic's assets through the proposed Revised APA.

[25] Under s. 65.13, the court's jurisdiction to authorize the sale of assets outside of the ordinary course of business is not expressed as limited to cases where the debtor is capable of presenting a Proposal to its creditors. The ability to present a Proposal is not one of the listed factors to be

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considered on a motion under s. 65.13(4). Parliament could have, but did not include language in s. 65.13 requiring the presentation of or the ability to present a Proposal and the vote thereon by creditors, as a condition to the exercise of the court's jurisdiction to authorize a sale of assets.

[26] A comparable issue under the CCAA with wording remarkably similar to s. 65.13 of the BIA has concluded that the court has jurisdiction to authorize the sale of business assets absent a formal plan of compromising arrangement under s. 36 of the CCAA.

[27] Section 36 of the CCAA reads as follows:

Restriction on disposition of business assets

36(1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

Notice to creditors

(2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition. [page659]

Factors to be considered

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or

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disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Additional factors -- related persons

(4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that

(a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and

(b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

Related persons

(5) For the purpose of subsection (4), a person who is related to the company includes

(a) a director or officer of the company;

(b) a person who has or has had, directly or indirectly, control in fact of the company; and

(c) a person who is related to a person described in paragraph (a) or (b).

Assets may be disposed of free and clear

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the

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creditor whose security, charge or other restriction is to be affected by the order.

Restriction -- employers

(7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(a) and (5)(a) if the court had sanctioned the compromise or arrangement. [page660]

[28] In Nortel Networks Corp. (Re) [Bidding Procedures], [2009] O.J. No. 3169, 55 C.B.R. (5th) 229 (S.C.J.), the court found jurisdiction under the CCAA absent a plan of an arrangement which was described as "skeletal in nature". That court held that an important consideration, in addition to whether the business continues under the debtor stewardship or under a new equity structure, is whether the business can be continued as a going concern in the form of a sale by the debtor.

[29] Following the amendments creating s. 36 of the CCAA, the court in Brainhunter Inc. (Re), [2009] O.J. No. 5578, 62 C.B.R. (5th) 41 (S.C.J.) determined that s. 36 of the CCAA expressly permits the sale of substantially all of the debtor's assets even in the absence of the presentation and vote upon a plan of arrangement.

[30] Section 65.13 of the BIA and s. 36 of the CCAA were introduced in 2005 in An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts (Bill C-55).

[31] There were two Senate Committee meetings. At one of those, the Honourable Jerry Pickard, Parliamentary Secretary to the Minister of Industry, stated:

It is widely accepted that inadequate provisions exist for workers whose employers becomes bankrupt. Previous attempts to bring about better protection for workers have failed, as

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the Minister of Labour has pointed out[.]

Experience has shown that restructuring provides much greater protection than liquidations through bankruptcy. Jobs are saved, creditors obtain better recovery and more competition is stimulated. Therefore, it is a cornerstone of Bill C-55 to promote restructuring. Bill C-55 encourages a culture of restructuring by increasing transparency in the proceedings, providing better opportunities for affected parties to participate, and improving the system of checks and balances to create greater fairness and efficiency.

To achieve its aims, the bill provides the courts with legislative guidance to ensure greater certainty and predictability with reference to such items as interim financing, the disclaimer and assignment of agreements, the sale of assets out of the ordinary course of business, governance arrangements of the debtor company, and the application of regulatory measures during the restructuring process. These issues were addressed in recommendations contained in your 2003 committee report and are largely reflected in the provisions of this bill.
(Emphasis added)

[32] The resulting Senate Committee Report discusses how a sale of assets, at times, is necessary to effect a successful restructuring, resulting in added protection for both creditors and employees. [page661]

[33] Although different legislation, the similarity of language of s. 65.13 of the BIA and s. 36 of the CCAA, including the listed factors for court consideration as to a sale of assets outside the ordinary course of business notwithstanding (a) the filing of an NOI or (b) an order under the CCAA, together with the factors listed above, leads me to conclude that the presentation of a Proposal to creditors is not a condition to this court's authority to approve, if appropriate, a sale of assets under s. 65.13 of the BIA.
Interim Charges

[34] The Stalking Horse Bidders Charge as security for the

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breakup fee and expense reimbursement under the APA, the director's and officer's charge to indemnify against statutory liability and the administration charge related to the fees of the Proposal Trustee and the debtor as presented are authorized under s. 64.1 and s. 64.2 of the BIA. They are appropriate priorities and charges in this case subject to ss. 14.06(7), 81.4(4) and 81.6(2) of the BIA.

[35] For the above reasons, the relief sought in this motion is granted.

Motion granted.

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TAB 4

CITATION: Karrys Bros. Ltd. (Re), 2014 ONSC7465
COURT FILE NO.: 32-1942339/1942340/1942341
DATE: 20141224

SUPERIOR COURT OF JUSTICE - ONTARIO

IN THE MATTER OF AN INTENTION TO MAKE A PROPOSAL OF KARRYS BROS., LIMITED, KARRYS SOFTWARE LIMITED AND KARBRO TRANSPORT INC.,

COUNSEL: *E. Pillon and K. Esaw* for the Applicants

L. Rogers for PWC

S. Graft for BMO

C. Armstrong for Core-Mark

HEARD: December 23, 2014

ENDORSEMENT

Overview

[1] On December 23, 2014 I granted orders approving a sale of substantially all of the applicants' assets together with various related administrative orders, with reasons to follow. These are those reasons.

[2] This motion seeks approval of a sale of the applicants' assets out of the ordinary course, authorization to distribute funds to the senior secured lender, a sealing order of certain confidential information and various administrative orders, including:

(i) extending the time for filing a proposal;

(ii) approving a key employee retention agreement;

(iii) approving an administrative charge;

(iv) approving the consolidation of the applicants' proposal proceedings; and

(v) approving the report of the proposal trustee.

Background

[3] Karrys is a wholesale distributor of tobacco, confectionery, snacks, beverages, automotive supplies and other products to retail, gas and convenience stores across Canada. As of November 1, 2014, Karrys' assets were exceeded by its liabilities by over $1 million. Karrys experienced net losses of over $3 million in each of the last two years.

[4] As a result of its financial difficulties, Karrys committed defaults under its loan agreement with the Bank of Montréal in 2013. BMO is Karrys' senior secured lender. BMO agreed to a number of forbearance agreements to enable the sales process which is at the heart of this motion.

[5] Karrys commenced a sales process in December 2013. It retained a financial advisor, Capitalink. Karrys had initial, exclusive negotiations with Core-Mark, itself a wholesale distributor of similar goods, in May through July 2014. Those negotiations did not result in an agreement.

[6] Karrys retained Price Waterhouse Coopers to assist Karrys and Capitalink in undertaking a more expansive sale process. In the fall of 2014, Karrys developed a process in which Core-Mark agreed to make a stalking horse bid for substantially all of Karrys' assets.

[7] Over 53 potential strategic and financial buyers were also invited to bid on the assets. Thirteen of these potential buyers entered into confidentiality agreements and received a confidential information memorandum and access to Karrys' data room. PWC and Capitalink responded to all reasonable requests for information.

[8] By the bidding deadline of noon on December 10, 2014, however, no other bids were received. Core-Mark was, accordingly, declared the successful bidder.

[9] Karrys now asks for the court's approval of the asset purchase agreement with Core-Mark and for a vesting order, together with approval of distribution, from the proceeds, of the amount owed to BMO and other related relief.

The Sale and Vesting Order

[10] Jurisdiction to make orders approving the sale derives from s. 65.13 of the BIA. Factors for the court to consider when asked to approve a sale out of the ordinary course are also listed in s. 65.13.

[11] It is not necessary for the debtor to present its proposal under the BIA before an order approving a sale, *Re Komtech*, 2011 ONSC 3230.

[12] In this case, the sale was the result of a broad and comprehensive marketing process. Two financial advisors were engaged. When initial negotiations with Core-Mark did not produce an amount the applicants originally thought acceptable, another process was initiated with the assistance of PWC. Efforts to lever the Core-Mark offer were, however, although widely promoted, ultimately unsuccessful. The "market" has, in that sense, spoken.

[13] The proposal trustee, PWC, has reviewed the sale process and is supportive of the process and the result. The proposal trustee has, as well, conducted a detailed analysis of the Core-Mark bid measured against a "liquidation in bankruptcy" scenario. Even under a "best case" liquidation scenario, the unsecured creditors would be expected to recover significantly less than under the Core-Mark sale transaction. Under the proposed sale, there is the possibility of surplus for distribution to unsecured creditors. There would be no such possibility under a liquidation scenario. BMO, the senior secured lender, is also supportive of the process and the result.

[14] Because the purchase price represents, through an extensive sales process, the highest price realizable and an amount which is greater than what could be realized under a liquidation, the consideration to be received for the assets is reasonable and fair. Further, the sale will enable Karrys to make the payments contemplated under s. 65.13(8) of the BIA.

[15] The fact that the sales process was not pre-approved by the court is not a bar to the court's approval in this case. Is clear on the evidence that the Core-Mark transaction is the best available option in the circumstances. No one has come forward to argue otherwise. The test is the same whether approval is sought before or after the process – the principles in *Soundair* govern. The *Soundair* test has been met. A judgment call had to be made whether to further extend the process in hopes of perhaps finding a better bid. Further delay would just as likely have resulted in a greater erosion of value. An immediate sale was, on the evidence, the only way to maximize recovery.

[16] In addition, the process actually followed is indistinguishable from what the court might reasonably have approved had prior authorization been sought. There is no evidence, or likelihood, that Karrys or its creditors would be in a better position if some further, or other, sales process had been followed.

[17] The sale is approved and the vesting order shall issue.

The Key Supplier Issue

[18] On the very day Karrys filed its notice of intention to make a proposal, Karrys' principal tobacco supplier delivered a substantial quantity of tobacco. A dispute arose over payment. The supplier took the position it was under no legal obligation to continue to supply and that it would not supply unless payment was received. Karrys' supply agreement had expired and the parties were operating on the basis of an informal supply arrangement.

[19] Ensuring ongoing tobacco supply from this supplier was critical to Karrys in terms of the ongoing operations of the business pending the closing of the sale to Core-Mark, the satisfaction of conditions precedent to the closing with Core-Mark, including the loss of potential customers should their tobacco requirements not be satisfied, and the resulting risk that the Core-Mark transaction would be lost as a result.

[20] Karrys and its legal advisers considered there was significant litigation risk relating to the ability to enforce a stay of proceedings against the supplier in any event and, accordingly, entered into negotiations with the tobacco supplier.

[21] These negotiations resulted in a substantial payment to the supplier which, arguably, involved post-filing payment for a pre-filing obligation. Given the importance of this supplier to ongoing operations and to the success of the Core-Mark sale, however, Karrys, along with its advisors, had little option but to reach a settlement.

[22] Unlike the CCAA, the concept of "critical suppliers" is not found in the proposal provisions of the BIA. Nevertheless, in my view, similar considerations can and should be taken into account in appropriate circumstances. In this case, Karrys and its advisors reasonably believed that the ongoing viability of the business and the Core-Mark sale (which, as found

above, represents the highest realizable price for Karrys' assets available in the circumstances) required the ongoing availability of this critical source of supply. There is also a significant net benefit to Karrys arising from sales of the product supplied. The supply contract negotiated, in the context of both the importance of the supply and significant litigation risk, was, I find, reasonable in the circumstances.

BMO Distribution

[23] BMO delivered notices of intention to enforce its security. The unchallenged evidence before the court is that BMO holds a valid, perfected security interest over each of the applicants' assets. BMO is entitled to a distribution of proceeds from the sale in satisfaction of its claim.

Sealing Order

[24] I am satisfied that the confidential appendices should be sealed until the deal is closed. There is an important public interest in maximizing returns in proceedings of this kind. It is important, therefore, that until the deal is concluded, commercially sensitive information about the deal not be publicly disclosed. Failure to grant the order would impair the integrity of any subsequent process. In addition, in the context of the key employee retention agreement, there is sensitive personal information which ought not to be disclosed.

[25] The *Sierra Club* test has been met on the facts of this case, *Elleway Acquisitions Ltd.*, 2013 ONSC 7009. The salutary effects of granting the sealing order outweigh the limited deleterious effect of restricting access to these limited pieces of evidence.

Extension

[26] Section 50.4(9) of the BIA grants the jurisdiction to grant the extension. The initial proposal period expires on January 12, 2015. The Core-Mark transaction will not close until February 2015.

[27] The applicants are acting in good faith. There is some prospect of surplus funds for distribution to unsecured creditors, given time to close the Core-Mark sale and assess the remaining priorities and claims. The cash flow statements indicate that Karrys has sufficient cash to fund operations through to the end of February 2015. There is no evidence any creditor will be prejudiced by the extension.

[28] Accordingly, the time for filing a proposal is extended to February 23, 2015.

Key Employee

[29] It is often recognized in restructuring proceedings that retention of key employees is vital. Securing payment is, in turn, a vital incentive for the employee to remain.

[30] In this case, there is one employee whose assistance has been, and will remain, key to ongoing operations to the date of sale. The retention bonus in issue is relatively modest. It is supported by the proposal trustee and BMO. Without securing the retention payment, there is a

significant risk the employee would leave. In addition, given the abbreviated timeframe for closing the Core-Mark sale, it would be almost impossible to find a timely replacement.

[31] For these reasons, the retention agreement and charge, as requested, is approved.

Administrative Charge

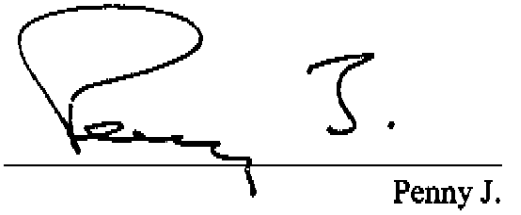
[32] Section 64.2 of the BIA provides for a super-priority to secure the fees for needed professional services during the restructuring. Secured creditors have received notice of this request. The proposal trustee supports the granting of the charge. The amount sought is, in my view, appropriate. The administrative charge requested is approved.

Consolidation

[33] It is clear that the operations of the three applicants are closely intertwined such that it would be difficult to disentangle their affairs. In order to secure the just, most expeditious and least expensive resolution, it is necessary to consolidate these closely related bankruptcy proceedings. This will avoid duplication and reduce cost. The requested order is therefore granted.

Proposal Trustee Report

[34] Given my approval of the elements above, it follows that the first report and activities of the proposal trustee should also be approved.



Penny J.

Date: December 24, 2014

IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF MENDOCINO CLOTHING COMPANY LTD. OF THE CITY OF TORONTO, IN THE PROVINCE OF ONTARIO

Estate/Court File No.: 31-2658047

ONTARIO
SUPERIOR COURT OF JUSTICE –
IN BANKRUPTCY AND INSOLVENCY
(COMMERCIAL LIST)

BOOK OF AUTHORITIES OF THE PROPOSAL TRUSTEE (returnable September 25, 2020)

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