

**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**

**FACTUM OF THE PROPOSAL TRUSTEE
(returnable September 25, 2020)**

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TO: **THE SERVICE LIST**

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PART I - INTRODUCTION

1. This factum is filed in support of a motion made by KSV Restructuring Inc., in its capacity as proposal trustee (**Proposal Trustee**), in connection with a Notice of Intention to Make a Proposal (**NOI**) filed on July 14, 2020 (**Filing Date**) by Mendocino Clothing Company Ltd. (**Mendocino** or the **Company**), for, among other things, an order:
 - (a) authorizing the Company to complete a transaction (the **Transaction**) for the sale of certain assets (the **Purchased Assets**) pursuant to an agreement of purchase and sale dated as of August 4, 2020 (the **Sale Agreement**) between the Company and Shop Mboutique Ecomm Ltd. (the **Purchaser**);
 - (b) vesting in the Purchaser all of the Company's right, title and interest in and to the Purchased Assets;
 - (c) authorizing and directing the Proposal Trustee, following completion of the Transaction, to pay the net proceeds of distribution to the Toronto-Dominion Bank (**TD Bank**), net of (i) any reserves considered necessary by the Proposal Trustee to pay the outstanding fees, costs and other obligations related to these proceedings or payable in respect of such proceeds; and (ii) amounts to be held back to fund the bankruptcy of the Company including for the administration of claims under the Wage Earner Protection Program;
 - (d) extending the time required by the Company to file a proposal to October 28, 2020; and
 - (e) such other relief as the Proposal Trustee may request and the Court may deem appropriate.

PART II - THE FACTS

2. The facts supporting this motion are set out in full detail in the Second Report to Court of the Proposal Trustee (the **Second Report**).¹ Capitalized terms used herein and not otherwise defined have the meaning given to them in the Second Report.
3. The Company is incorporated under the *Business Corporations Act* (Ontario) and has been operating since 1987. The Company is privately owned and its head office is located at 496 Gilbert Avenue, Toronto.²
4. The Company is a retailer of women's clothing. Prior to the government-mandated shutdown due to the COVID-19 pandemic, the Company operated 27 stores from leased locations in the Greater Toronto and surrounding areas operating under the "Mendocino" (5 stores) and "M Boutique" (22 stores) names.³
5. The Company has conducted a liquidation sale from certain of its locations that were permitted to re-open after the province-wide shutdown. The Company liquidated substantially all of its inventory and has disclaimed all of its retail store leases.⁴
6. Employees working in stores have been terminated as stores were closed. The Company continues to retain employees who may be hired by the Purchaser.⁵

¹ Second Report to Court of KSV Restructuring Inc., as Proposal Trustee of the Company, dated September 17, 2020 (**Second Report**), Motion Record of the Court-Appointed Proposal Trustee returnable September 25, 2020 (**MR**), Tab 2.

² Second Report, MR, Tab 2, paras 2.0(1) and (2).

³ Second Report, MR, Tab 2, para 2.0(2).

⁴ Second Report, MR, Tab 2, para 2.0(5).

⁵ Second Report, MR, Tab 2, para 2.0(5).

Stalking Horse Agreement

7. In August, the Company and the Purchaser entered into the Sale Agreement as a “stalking horse agreement” (in such capacity, the **Stalking Horse Agreement**) for the sale of the Purchased Assets, which consisted of those assets that were remaining after the liquidation, mainly intellectual property and unsold inventory.⁶ The purchase price for the Purchased Assets is \$400,000 plus the assumption of the cost of inventory ordered subsequent to the NOI filing but not received as at the closing date.⁷
8. The Purchaser is a company related to the Company.⁸
9. The Company sought approval of a sale process (the **Sale Process**) to test the market for other interest in the Purchased Assets.⁹ The Sale Process was conducted by the Proposal Trustee.

Sale Process

10. On August 10, 2020, the Ontario Superior Court of Justice issued an order approving the terms of the Sale Process.¹⁰
11. The Sale Process commenced immediately following its approval by the Court. An overview of the Sale Process is as follows:¹¹

⁶ Second Report, MR, Tab 2, para 3.0(2).

⁷ Second Report, MR, Tab 2, para 3.2(2).

⁸ Second Report, MR, Tab 2, para 3.2(2).

⁹ First Report to Court of KSV Restructuring Inc., as Proposal Trustee of the Company, dated August 4, 2020 (**First Report**), MR, Tab 2, Appendix “B”, para 3.3(1).

¹⁰ Second Report, MR, Tab 2, para 1.0(3).

¹¹ Second Report, MR, Tab 2, para 3.0(4).

(a) the Proposal Trustee prepared an interest solicitation letter (the **Teaser**), which was sent to 34 target buyers;

(b) a confidentiality agreement (the **CA**) was attached to the Teaser. Interested parties were required to sign the CA in order to obtain access to an online data room set up by the Proposal Trustee;

(c) following execution of a CA, interested parties were provided an opportunity to perform due diligence, including the opportunity to review information in a data room set up by the Proposal Trustee;

(d) the data room included historical financial information, a location listing, an inventory listing, trademark details, anonymized high-level employee information and other information;

(e) prospective purchasers were required to submit offers in the form of the Stalking Horse Agreement and to blackline any changes to the agreement;

(f) offers were required to be submitted to the Proposal Trustee by 5:00 pm (Toronto time) on September 1, 2020; and

(g) bids were required to be submitted with a cash deposit of not less than 10% of the base purchase price.

12. Two parties expressed an interest in the opportunity, one of whom executed the CA and performed due diligence. However, no offers were received at the Bid Deadline and as such, the Proposal Trustee determined that the Purchaser was the successful bidder.¹²

¹² Second Report, MR, Tab 2, para 3.1(2).

PART III - ISSUES AND THE LAW

13. The issues addressed in this factum are:
- (a) whether this Court should authorize the Company to complete the Transaction and grant the vesting order; and
 - (b) whether this Court should grant an extension of time to file a proposal.

A. The Transaction Should be Completed and the Vesting Order Should be Granted

14. This Court has the authority and jurisdiction pursuant to subsections 65.13(1) and (7) of the *Bankruptcy and Insolvency Act* (**BIA**) to grant approval and vesting orders.¹³
15. Section 65.13(4) of the BIA provides a non-exhaustive list of criteria for the Court to consider. These include:¹⁴
- (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 its 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;

¹³ *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (**BIA**), sections 65.13(1) and (7).

¹⁴ BIA, section 65.13(4).

- (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.
16. In *Royal Bank of Canada v Soundair Corp.*,¹⁵ before BIA s. 65.13 was enacted, the Ontario Court of Appeal set the following criteria for approving a sale of an insolvent person or entity's assets generally:
- (a) whether a sufficient effort was made to get the best price and whether the parties acted improvidently,
 - (b) the interests of all parties,
 - (c) the efficacy and integrity of the process by which offers are obtained, and
 - (d) whether there has been unfairness in the process.
17. It is clear based on the case law that the Court has the jurisdiction to approve a sale transaction within a BIA proposal proceeding in the absence of a proposal.¹⁶ Such orders may be made if the Court is satisfied that the criteria set out in Section 65.13(4) have been satisfied.

¹⁵ *Royal Bank of Canada v Soundair Corp.* [1991] O.J. No. 1137 (ONCA), Commercial List Authorities Book, page 8 and 9.

¹⁶ *Komtech Inc. (Re)*, [2011 ONSC 3230](#) (CanLII), Book of Authorities of the Proposal Trustee (**BOA**), Tab 3, para 33; *Karrys Bros. Ltd. (Re)*, 2014 ONSC 7465, BOA, Tab 4, para. 11.

18. In addition, Section 65.13(5) provides that 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:¹⁷
- (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.
19. Courts have been reluctant to approve sales to related persons where there is not sufficient evidence that “good faith” efforts to sell the assets exist and where the policy reasons behind the proposal provisions of the BIA are being defeated.¹⁸ However, the Court has acknowledged that where evidence of sufficient good faith efforts are shown, it may approve a sale to a related person.¹⁹
20. In this instance, the Proposal Trustee is of the view that the Transaction between the Company and the Purchaser satisfies the criteria set out in ss. 65.13(4) and (5) for the following reasons:²⁰
- (a) good faith efforts were made to sell the Purchased Assets to third parties pursuant to the Sale Process, which was approved by the Court and run exclusively by the Proposal Trustee;

¹⁷ BIA, section 65.13(5).

¹⁸ *Hypnotic Clubs Inc. (Re)*, [2010 ONSC 2987](#) (CanLII) (*Hypnotic*), BOA, Tab 2.

¹⁹ *Hypnotic*, BOA, Tab 2; *Elleway Acquisitions Limited v 4358376 Canada Inc.*, [2013 ONSC 7009](#) (CanLII), BOA, Tab 1, para. 45.

²⁰ Second Report, MR, Tab 2, para 3.3(1).

- (b) no offers were received from third parties as a result of the Sale Process;
- (c) the duration of the Sale Process was sufficient to allow interested parties to perform diligence and submit offers. Additionally, the duration of the Sale Process was approved by the Court;
- (d) the Transaction will allow the business of the Company to continue on a scaled basis focused on an e-commerce platform and potentially a few stores;
- (e) the restructured business will provide the opportunity for employment for certain of the Company's employees;
- (f) the Proposal Trustee does not believe that further time spent marketing the Company's business and assets will result in a superior transaction; and
- (g) completing the Transaction will allow these proceedings to be completed.

21. Accordingly, it is the Proposal Trustee's view that the Court should approve the Sale Agreement, authorize the Company to complete the Transaction and approve the vesting order.

B. The Extension Should be Granted

22. The Company is seeking an extension of the time in which it must file a proposal from September 28, 2020 to October 28, 2020.

23. Extensions may be granted for a period of up to 45 days for a total period of not more than 6 months. An extension need not be for the full 45 day period.²¹

²¹ BIA, section 50.4(9).

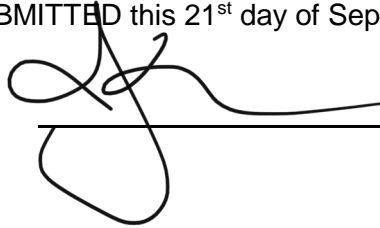
24. Section 50.4(9) of the BIA provides that the Court may extend the time in which the Company can file a proposal if the Court is satisfied of the following:
- (a) the insolvent person has acted, and is acting, in good faith and with due diligence;
 - (b) the insolvent person would likely be able to make a viable proposal if the extension being applied for were granted; and
 - (c) no creditor would be materially prejudiced if the extension being applied for were granted.
25. In this case, the Proposal Trustee is of the view that the extension request should be granted for the following reasons:²²
- (a) the Company is acting in good faith and with due diligence;
 - (b) it will provide the Company with the additional time it requires for the Transaction to close and for all outstanding matters in these proceedings to be completed;
 - (c) it will provide the Company the opportunity to consider whether it can make a viable proposal to creditors; and
 - (d) the extension will not materially prejudice any creditors as the Company is projected to have sufficient funding for the extension period.

²² Second Report, MR, Tab 2, para 5.0(3) and (4).

PART IV - ORDER REQUESTED

26. For the reasons set out above, the Proposal Trustee requests that this Court grant an order for the relief sought in its Notice of Motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 21st day of September, 2020.



SCHEDULE "A"
LIST OF AUTHORITIES

1. *Elleway Acquisitions Limited v 4358376 Canada Inc.*, [2013 ONSC 7009](#) (CanLII)
2. *Hypnotic Clubs. Inc. (Re)*, [2010 ONSC 2987](#) (CanLII)
3. *Komtech Inc. (Re)*, [2011 ONSC 3230](#) (CanLII)
4. *Karrys Bros. Ltd. (Re)*, 2014 ONSC 7465
5. *Royal Bank of Canada v Soundair Corp.* [1991] O.J. No. 1137 (ONCA)

SCHEDULE "B"
RELEVANT STATUTES

Bankruptcy and Insolvency Act, R.S.C. 1985, c B-3

Extension of time for filing proposal

50.4 (9) The insolvent person may, before the expiry of the 30-day period referred to in subsection (8) or of any extension granted under this subsection, apply to the court for an extension, or further extension, as the case may be, of that period, and the court, on notice to any interested persons that the court may direct, may grant the extensions, not exceeding 45 days for any individual extension and not exceeding in the aggregate five months after the expiry of the 30-day period referred to in subsection (8), if satisfied on each application that

- (a) the insolvent person has acted, and is acting, in good faith and with due diligence;
- (b) the insolvent person would likely be able to make a viable proposal if the extension being applied for were granted; and
- (c) no creditor would be materially prejudiced if the extension being applied for were granted.

[...]

Restriction on disposition of assets

65.13 (1) An insolvent person in respect of whom a notice of intention is filed under section 50.4 or a proposal is filed under subsection 62(1) 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 secured creditors

(3) An insolvent person who applies to the court for an authorization shall give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.

Factors to be considered

- (4)** 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.

Additional factors — related persons

(5) 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.

Related persons

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

- (a) a director or officer of the insolvent person;
- (b) a person who has or has had, directly or indirectly, control in fact of the insolvent person; and
- (c) a person who is related to a person described in paragraph (a) or (b).

Assets may be disposed of free and clear

(7) 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 insolvent person or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

Restriction — employers

(8) The court may grant the authorization only if the court is satisfied that the insolvent person can and will make the payments that would have been required under paragraphs 60(1.3)(a) and (1.5)(a) if the court had approved the proposal.

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
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