District of Ontario
Division No. 09 -Toronto
Court File No. 31-2295766
Estate No. 31-2295766

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE PROPOSAL OF DIGITAL UNDERGROUND MEDIA INC., A COMPANY INCORPORATED PURSUANT TO THE LAWS OF THE PROVINCE OF ONTARIO, WITH A HEAD OFFICE IN THE CITY OF VANCOUVER, IN THE PROVINCE OF BRITISH COLUMBIA

FACTUM OF DIGITAL UNDERGROUND MEDIA INC.

(Motion returnable November 14, 2017)

Date: November 13, 2017

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FACTUM OF DIGITAL UNDERGROUND MEDIA INC.

PART I - NATURE OF THE MOTION

1. The proposal trustee of Digital Underground Media Inc. ("**DUM**" or the "**Company**") brings this motion seeking approval of a proposal to the Company's unsecured creditors.[1] The Proposal has been approved by the requisite majorities of unsecured creditors.

2. The Proposal provides for a reorganization of the Company's share capital in accordance with section 59(4) of the *Bankruptcy and Insolvency Act*[2] and section 186 of the *Business Corporations Act* (Ontario).[3] The outcome of the reorganization (the "**Reorganization**") is that all of the existing shares of the Company will be cancelled, an unlimited number of new common shares will be created, and new common shares will be issued to each of the DIP lender and the proposal sponsor[4], which have provided financial support to the Company through the proposal proceedings. The Reorganization recognizes the reality that the shares currently have no value, in light of the Company's insolvency.

[1] The proposal was filed on October 2, 2017, and was amended at the meeting of creditors held October 19, 2017 (as amended, the "**Proposal**").
[2] *Bankruptcy and Insolvency Act* (Canada), R.S.C. 1985, c. B-3 ("**BIA**"),
[3] *Business Corporations Act,* R.S.O. 1990, c. B.16 ("**OBCA**")
[4] The DIP lender is J.D. Craig Holdings Inc. The proposal sponsor is 7677189 Canada Ltd.

3. Forward Dimension Capital 1 LP ("**FDC**") is an existing shareholder of the Company, whose shares will be cancelled upon implementation of the Proposal. FDC purports to oppose the approval of the Proposal, despite shareholders having no right or standing to do so pursuant to the provisions of either the BIA or the OBCA. FDC is not a creditor of the Company.

4. FDC points to a number of bases upon which it suggests that the Proposal should not be approved. It asserts that the Company has mistakenly blamed FDC for the Company's insolvency; it asserts that Drew Craig, an officer and director of the Company who also controls the secured creditors, the DIP lender and the proposal sponsor, is acting out of self-interest and is conflicted; and it asserts that the proposal trustee should have put before the creditors a "counter-proposal" that it submitted. The Company disputes these assertions, and has set out its side of the story in an affidavit filed on this motion, and in an examination of Mr. Craig by FDC that the Company agreed to on a without prejudice basis.

5. However, the Company submits that the Court need not address these issues on this motion, because FDC's submissions are irrelevant to whether or not the Court ought to approve the Proposal. FDC's opposition is nothing more than noise designed to paint the Company in a negative light and distract from the real issue before this Court, which is the Proposal's treatment of the Company's creditors. The proposal trustee's motion for approval of the Proposal is not the proper forum for FDC to air its grievances with the Company and/or its secured creditors.

6. The Proposal meets the test for approval set out under section 59 of the BIA. That is the only relevant consideration on this motion. Accordingly, the Company supports the proposal trustee's request for approval of the Proposal, and requests that FDC's opposition be dismissed, with costs.

PART II - THE FACTS

Background

7. The Company was incorporated pursuant to the OBCA on January 19, 2010. The Company develops and, through its subsidiaries, operates subway in-tunnel advertising systems.[5] The Company's current officers and directors are Mr. Craig (executive chairman and secretary) and Ken Bicknell (president and CEO).[6]

8. Mr. Craig controls three other companies that are involved in this proceeding: J.D. Craig Holdings Inc. ("**Craig Holdings**"), which is the Company's senior secured creditor and the DIP lender; DUM Holdings Inc. ("**DUM Holdings**"), which is the Company's second secured creditor; and 7677189 Canada Ltd. ("**767**"), which is the proposal sponsor.[7]

The Company Becomes Insolvent

9. In or around July 2015, the Company entered into agreements with FDC, whereby FDC would advance $20 million in equity funding into the Company, in stages. This arrangement was memorialized by way of a Subscription and Investment Agreement dated July 27, 2015 (the "**SIA**") and a Unanimous Shareholders' Agreement dated July 27, 2015 (the "**USA**").[8]

10. As part of these agreements, FDC was entitled to appoint two directors to the Company's board, and appointed Gavin Owston and David Rigby.[9]

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[5] Trustee's Report on the Proposal dated November 2, 2017 (the "**Trustee's Report**") at Appendix H, Motion Record of the Proposal Trustee ("**Trustee's Record**"), Tab H, p. 169.
[6] Affidavit of Drew Craig, to be sworn ("**Craig Affidavit**") at para 2, Responding Motion Record of Digital Underground Media Inc. ("**DUM Record**") at Tab 1, p. 1.
[7] Craig Affidavit at paras. 3-5, DUM Record at Tab 1, p. 2.
[8] Affidavit of Laura Gilhespy sworn November 7, 2017 (the "**Gilhespy Affidavit**"), Exhibits A and B, Responding Application Record of Forward Dimension Capital 1 LP ("**FDC Record**") at Tabs A-B.
[9] Craig Affidavit at para. 15, DUM Record at Tab 1, p. 5.

11. The SIA contemplated that FDC would advance funding upon the Company achieving certain "milestones", which were set out at Article 3.2 of the SIA.[10] Shortly after the initial advance of $5 million, however, it became apparent to all involved that the Company would be unable to meet the funding milestones contemplated in the SIA. FDC nonetheless continued to support the Company, and continued to advance funds to the Company as follows (dates are approximate)[11]:

Date	Payment (CAD)
December 15, 2015	$3,000,000
July 16, 2016	$1,000,000
September 16, 2016	$1,000,000
December 16, 2016	$1,000,000
February 13, 2017	$500,000
March 31, 2017	$500,000

12. The Company does not dispute that it did not achieve the milestones prescribed by the SIA. However, the Company's board and FDC agreed to new funding milestones, on the basis of which FDC provided the foregoing funding.[12] Outside of FDC's funding, the Company did not have the cash flow to sustain its ongoing operations.[13]

[10] Gilhespy Affidavit at Tab A, Forward Record at Exhibit A, pp. 26-28.
[11] Craig Affidavit at para 14. Please note that dates are approximate.
[12] Craig Affidavit at paras. 14-16, Exhibits E, F, G, DUM Record at Tab 1, pp. 4-5;.Transcript of the Examination of Drew Craig held November 9, 2017 (the "**Craig Transcript**") at pp. 15-16. Q. 64-67, Forward Record at Tab 2, p. 522.
[13] Craig Affidavit at para. 35, DUM Record at Tab 1, p. 11.

13. The March 2017 advance was the last significant tranche of funding that the Company received from FDC. On June 15, 2017, FDC made its final contribution to the Company, by way of a wire transfer in the amount of CAD$54,693.66. This amount was intended to cover the Company's immediate cash needs, including payroll. FDC advanced this sum in response to Mr. Bicknell advising Mr. Owston that the Company needed cash immediately in order to avoid becoming insolvent.[14]

14. Since June 2017, the Company has been receiving funding from Craig Holdings. Craig Holdings initially advanced CAD$265,852.13 pursuant to a promissory note, and has advanced $114,900 (which amount is subordinate to the administration charge of $115,000) by way of DIP financing since the filing. Craig Holdings may advance up to $750,000 under the DIP charge.[15]

15. As an early-stage tech company, DUM was "loss-making".[16] The FDC investment was the only source of funding that the Company could rely upon, as its operations were still largely in their infancy, and its cash flow was not close to being able to sustain the ongoing operations.[17] As Mr. Craig put it on examination:

> 151. Q. Okay.
> A. It is very typical. You know, the company was relying on funding to meet its payroll, to pay expenses, to pay its suppliers, to pay its obligations, and when that funding stopped in March, the company became imperilled, and meaningfully so.[18]

16. There is no dispute that the Company is insolvent.

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[14] Crag Affidavit at para. 20, DUM Record at Tab 1, p. 6.
[15] Craig Affidavit at paras 30-31, Exhibit N, DUM Record at Tab 1, p. 10, Tab N, p. 152.
[16] Craig Transcript at p. 35-37, Q. 146-151, FDC Record at Tab 2, pp. 527-528.
[17] Craig Affidavit at para 35, DUM Record at Tab 1, p. 11.
[18] Craig Transcript at p. 37, Q. 151, FDC Record at Tab 2, p. 528.

The Company's Efforts to Work with FDC and Find Financing

17. On June 19, 2017, after FDC had ceased advancing funds to the Company, FDC presented to the Company a proposal for a revision to the Company's equity structure (the "**June 19 Proposal**"). The June 19 Proposal proposed to substantially alter the Company's capital structure, and provided for only $2 million in funding to the end of the year, which was substantially less than required by the Company's business plan. It also required the Company to relocate to London, England. This proposal was not acceptable to the secured creditors, the management team, or the Company's shareholders other than FDC.[19]

18. On July 10, 2017, Mr. Owston and Mr. Rigby resigned from their positions as directors of the Company.[20]

19. Between July 12, 2017, and August 31, 2017, the Company engaged in negotiations with FDC regarding revising the Company's capital structure in a manner that would be acceptable to both the Company and to FDC, to permit them to continue to work together. As part of these discussions, the Company advised FDC that the Company was insolvent, and that if they were unable to arrive at a mutually-acceptable plan to restructure the Company's capital structure, it would be forced to initiate insolvency proceedings.[21]

20. During this period, the Company also sought investors other than FDC for debt and/or equity financing to permit the Company to continue its operations. However, the investors that the Company approached were not interested in investing in the Company given the state of its

[19] Craig Affidavit at paras. 21-22, Exhibit J, DUM Record at Tab 1, pp. 6-8, Tab J, pp. 129-133.
[20] Craig Affidavit at para. 23, Exhibit K, DUM Record at Tab 1, p. 8, Tab K, pp. 135-136.
[21] Craig Affidavit at paras. 24-26, Exhibits L-M, DUM Record at Tab 1, p. 8-8, Tabs L-M, pp. 137-150.

capital structure. The Company's capital structure must be restructured in order to attract an investor.[22]

21. A major sticking point as between the Company and FDC is Craig Holdings' status as senior secured creditor of the Company. FDC has been aware of Craig Holdings' status as senior secured creditor since Craig Holdings assumed that role in October 2015. In fact, FDC and Craig Holdings originally intended to take on that role jointly, but FDC declined to participate, and offered the position to Craig Holdings alone. FDC asserts that Craig Holdings must convert its debt into equity if FDC is to continue to advance funds; this proposal is unacceptable to Craig Holdings. By contrast, Craig Holdings has proposed that FDC advance debt financing that will rank *pari passu* with Craig Holdings' secured position, to put them on equal footing. FDC has declined to do so.[23]

22. As a result of these divergent positions, the Company, FDC and Craig Holdings have been unable to agree on a restructuring plan. Without a restructuring plan in place, and therefore without the ability to raise additional financing, the Company continues to be insolvent.

The Company Initiates Insolvency Proceedings

23. On September 21, 2017, the Company filed a notice of intention to make a proposal pursuant to the BIA (the "**NOI**"), and MNP Ltd. was appointed as proposal trustee (the "**Proposal Trustee**").[24] On October 2, 2017, the Company filed a proposal with the Official

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[22] Craig Affidavit at para 27, DUM Record at Tab 1, p. 9.
[23] Craig Affidavit at Exhibits L-M, DUM Record at Tabs L-M, pp. 137-150.
[24] Craig Affidavit at para. 28, DUM Record at Tab 1, p. 9.

Receiver, which was subsequently amended at the meeting of creditors held October 19, 2017 (the "**Meeting of Creditors**").[25]

24. The basic features of the Proposal are as follows:

(a) 767 will advance $76,000 to the Company, which amount shall form the proposal fund to be distributed to unsecured creditors. This will result in recovery to the unsecured creditors of approximately 11 cents on the dollar; and

(b) the Reorganization shall be effected upon implementation of the Proposal.[26]

25. On October 19, 2017, the unsecured creditors voted in favour of the Proposal.[27] Secured creditors are unaffected by the Proposal.

26. The Proposal Trustee now seeks court approval of the Proposal pursuant to section 59 of the BIA.

PART III - THE LAW

THE PROPOSAL MEETS THE TEST FOR APPROVAL

27. The Proposal has been approved by the requisite majorities of unsecured creditors, by way of a vote held at the meeting of creditors on October 19, 2017.[28] Pursuant to section 58 of the BIA, the Proposal Trustee has applied to this Court for approval of the Proposal.

28. In considering whether to approve a proposal, the Court must be satisfied of the following:

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[25] Trustee's Report at paras. 3, 9, Trustee's Record at Tab 3, pp. 29-30.
[26] Trustee's Report at Appendix A to Draft Order, Trustee's Record at Tab 2, pp. 3-28.
[27] Trustee's Report at para 10, Exhibit J, Trustee's Record at Tab 3, p. 31, Tab J, p. 196-200.
[28] Trustee's Report at para 10, Exhibit J, Trustee's Record at Tab 3, p. 31, Tab J, p. 196-200; Section 54(2) of the BIA.

(a) the proposal is reasonable;

(b) the proposal is calculated to benefit the general body of creditors; and

(c) the proposal is made in good faith.[29]

29. In *Re Kitchener Fame Ltd.*, the Honourable Justice Morawetz articulated this test, and made the following comments:

> The first two factors are set out in s. 59(2) of the BIA while the last factor has been implied by the court as an exercise of its equitable jurisdiction. The courts have generally taken into account the interests of the debtor, the interests of the creditors and the interests of the public at large in the integrity of the bankruptcy system.[30]

30. When implementing this three-part test, courts have accorded substantial deference to the majority vote of creditors and to the recommendation of the proposal trustee.[31]

31. Applying the three-part test to the present case, the Proposal should be approved by this court because:

(a) the Proposal is reasonable: the payment terms of the Proposal and the distributions provided therein are commercially moral and adequate given the financial status of the Company, and are supported by the majority of creditors and by the Proposal Trustee. All voting creditors voted in favour of the Proposal,

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[29] *Kitchener Frame Ltd., Re,* 2012 ONSC 234, 212 A.C.W.S. (3d) 631 (Ont. S.C.J. [Comm. List]) ["*Kitchener*"] at paras. 18-20, Brief of Authorities of Digital Underground Media Inc. ("**DUM Brief of Authorities**"), Tab 5.
[30] *Kitchener* at para. 20, DUM Brief of Authorities, Tab 5; BIA, s. 59(2).
[31] *Kitchener* at para. 21, DUM Brief of Authorities, Tab 5.

with the exception of a former employee whose claim has not yet been admitted as a proven claim for distribution;[32]

(b) the Proposal is calculated to benefit the general body of creditors: the Proposal is intended to provide financial stability to the Company in order to permit the Company to continue its business operations following the implementation of the Proposal, and to provide a better platform from which to attract new external investor(s)[33]. The future value of the Company as a going concern is considerably greater under the Proposal, than it would be in a bankruptcy;[34] and

(c) the Proposal is made in good faith: the Company has and continues to act in good faith and has provided its creditors with full disclosure of its assets and encumbrances against such assets. Prior to the Meeting of Creditors, Mr. Craig and Mr. Bicknell spoke with all of the unsecured creditors regarding the Proposal (with the exception of the former employee who voted against the Proposal), and confirmed their support for same.[35]

32. Indeed, it does not appear that FDC takes particular issue with the Proposal, other than to the extent that it effects the Reorganization. As it is not a creditor, FDC is not affected by the Proposal, aside from the Reorganization.

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[32] Trustee's Report at para 10, Trustee's Record at Tab 3, p. 31.
[33] Craig Affidavit at para. 39, DUM Record at Tab 1, p. 12.
[34] Trustee's Report at para 18, Trustee's Record at Tab 3, p. 33.
[35] Craig Affidavit at para. 39, DUM Record at Tab 1, p. 12.

THE COURT SHOULD APPROVE THE REORGANIZATION

33. The Proposal contemplates the Reorganization, which provides for, among other things, the cancellation of all of the Company's issued and outstanding shares and the issuance of a new class of shares to Craig Holdings and 767, the entities funding the Proposal.[36]

(a) Authority to Effect the Reorganization

34. The Company is a corporation incorporated under the OBCA. Section 186 of the OBCA, provides, in part, as follows:

> 186 (1) In this section,
>
> "reorganization" means a court order made under section 248, an order made under the *Bankruptcy and Insolvency Act* (Canada) or an order made under the *Companies Creditors Arrangement Act* (Canada) approving a proposal.
>
> 186 (2) If a corporation is subject to a reorganization, its articles may be amended by the order to effect any change that might lawfully be made by an amendment under section 168.[37]

35. Section 168 of the OBCA provides, among other things, that a corporation may, subject to sections 170 and 171 of the OBCA, amend its articles to add, change or remove any provision that is permitted by the OBCA, including, without limitation, to create a new class of shares. Subsection 170(b) of the OBCA provides that the articles of a corporation may be amended to effect a cancellation of a class or series of shares.[38]

36. Subsection 59(4) of the BIA provides as follows:

> 59(4) Court may order amendment – If a court approves a proposal, it may order that the debtor's constating instrument be amended in accordance with the

[36] Appendix A to the Draft Order, Trustee's Record at Tab 2, pp. 13-14, 19.
[37] *OBCA*, s. 186
[38] *OBCA*, ss. 168, 170(b)

> proposal to reflect any change that may lawfully be made under federal or provincial law.[39]

37. Taken together, sections 186 of the OBCA and 59(4) of the BIA expressly permit the Company to effect the Reorganization. This Court has previously sanctioned reorganizations such as the one contemplated herein, in the 1999 decision *Re Royal Oak Mines*, and in an unreported decision in *Re. Telepanel Systems Inc.* made in 2009. [40]

38. There is little express judicial commentary on reorganizations effected pursuant to the BIA and the OBCA. The jurisprudence regarding the cancellation of shares is more robust in the context of a plan of arrangement or compromise under the *Companies' Creditors Arrangement Act*,[41] applying section 191 of the *Canada Business Corporations Act*,[42] which is functionally equivalent to section 186 of the OBCA:

> 191 (1) In this section, "reorganization" means a court order made under
>
> (a) section 241;
>
> (b) the *Bankruptcy and Insolvency Act* approving a proposal; or
>
> (c) any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors.
>
> 191 (2) If a corporation is subject to an order referred to in subsection (1), its articles may be amended by such order to effect any change that might lawfully be made by an amendment under section 173.

39. As functionally equivalent sections, the Company submits that the principles and authorities applicable under section 191 of the CBCA ought to apply equally to section 186 of the OBCA. Similarly, authorities applying these sections under the CCAA ought to apply

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[39] BIA, s. 59(4)

[40] *Royal Oak Mines Inc.*, Re, [1999] O.J. No. 4848, 14 C.B.R. (4th) 279 (Ont. S.C.J. [Comm. List]) ["***Royal Oak***"] at para. 3, DUM's Brief of Authorities, Tab 7; *Telepanel Systems Inc., Re* (2009), Ontario Endorsement 31-448752 (Ont. S.C.J. [Comm. List]) [unreported], DUM's Brief of Authorities, Tab 9.

[41] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "**CCAA**").

[42] *Canada Business Corporations Act*, RSC 1985, c C-44 (the "**CBCA**").

equally in the present case under the BIA, as both statutes are recognized in each of section 186 of the OBCA and section 191 of the CBCA.

(b) The Cancellation of the Company's Shares is Fair and Reasonable

40. Courts have interpreted section 191 of the CBCA as giving substantive, and not simply procedural, power to amend the articles of a corporation, which has included a cancellation of its shares.[43]

41. With respect to the cancellation of shares, the Honourable Justice Farley held in *Re Stelco Inc.*, that:

> [i]t is well established that a reorganization pursuant to s. 191 of the CBCA may be made in conjunction with a sanction order under the CCAA and that ***such a reorganization may result in the cancellation of existing shares of the reorganized corporation***... (emphasis added)[44]

42. Furthermore, in *Proposals for a New Business Corporations Law for Canada* (the "**Dickerson Report**"), which recommended the modifications to the various business corporations statutes across Canada that were ultimately enacted, the architects of the business corporation act model expressly contemplated reorganizations in which the insolvent corporation would eliminate the interest of common shareholders. The example of a reorganization given in the Dickerson Report is as follows:

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[43] *Beatrice Foods v. Merrill Lynch Capital Partners Inc.* (1996), 43 C.B.R. (4th) 10 (Ont. S.C.J. [Comm. List]) at para. 16, DUM's Brief of Authorities, Tab 1; *Laidlaw, Re* (2003), 39 C.B.R. (4th) 239 (Ont. S.C.J.) at para. 9, DUM's Brief of Authorities, Tab 6; *Stelco Inc, Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J. [Comm. List]) ["*Stelco Inc.*"] at para. 14, DUM's Brief of Authorities, Tab 8

[44] *Stelco Inc.* at para. 14, DUM Brief of Authorities, Tab 8.

> [f]or example, the reorganization of an insolvent corporation may require the following steps: first, ***reduction or even elimination of the interest of the common shareholders***... (emphasis added)[45]

43. Courts have exercised their jurisdiction to cancel shares where the proposed changes to the share-capital of the corporation are fair and reasonable to all stakeholders, including shareholders.[46]

44. In assessing whether the cancellation of shares is fair and reasonable, the Court must have regard for whether the shares have value or are likely to have value in the foreseeable future. In *Re Stelco Inc.*, the Honourable Justice Farley held that the cancellation of existing company shares can be effected:

> ...based on those shares/equity having no present value (in the sense of both value "now" and the likelihood of same having value in the foreseeable future, absent the reorganization including new debt and equity injections and permitted indulgences or other considerations and adjustments).[47]

45. Courts have held that the shares of an insolvent corporation have no value where its creditors are going to receive less than full recovery of their claims. In *Re Canadian Airlines Corp.*, the Honourable Justice Paperny stated that:

> [s]hareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full.[48]

46. In the present case, the Company is insolvent and, whether under the Proposal or in bankruptcy, the current value of the Company falls far short of being sufficient to pay the

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[45] Robert W.V. Dickerson et al., *Proposals for a New Business Corporations Law for Canada*, vol. 1 (Ottawa: Information Canada, 1971) at para. 374, DUM's Brief of Authorities, Tab 4.
[46] *Stelco Inc.*, DUM's Brief of Authorities, Tab 8.
[47] *Stelco Inc.* at para. 14, DUM's Brief of Authorities, Tab 8.
[48] *Canadian Airlines Corp., Re* (2000), 20 C.B.R. (4th) 1 (A.C.Q.B.) ["*Canadian Airlines*"] at para. 143, DUM's Brief of Authorities, Tab 2

aggregate claims owing to the Company's secured and unsecured creditors.[49] Absent a reorganization, the Company will be unable to raise additional funds. Consequently, there is no present value in the Company's share capital, and the cancellation of the Company's shares is both fair and reasonable.

(c) FDC Is Not Entitled to Oppose the Approval of the Proposal

47. A shareholder, such as FDC, has no standing to oppose the approval of a proposal made pursuant to the BIA.[50]

48. This principle applies even where the proposal effects a reorganization of the company's share capital. As stated by the Honourable Justice Paperny in *Re Canadian Airlines Corp.*:

> The rationale for allowing such a reorganization appears plain; the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances, as described further below under the heading "Fair and Reasonable", there is nothing unfair or unreasonable in the court effecting changes in such situations without shareholder approval. Indeed, it would be unfair to the creditors and other stakeholders to permit the shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.[51]

49. In addition, subsection 186(6) of the OBCA expressly provides that no shareholder of the Company is entitled to dissent under section 185 if an amendment to the Company's articles is granted by the court under section 186.[52]

50. On the basis of the foregoing, this Court should refuse to consider FDC's opposition to the within motion.

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[49] Trustee's Report at para 16, Trustee's Record at Tab 3, p. 32.
[50] *Can-Mar Precast Corp, Re.* 1994 CarswellOnt 313 (Ont. Gen. Div., in bankruptcy), DUM's Brief of Authorities, Tab 3.
[51] *Canadian Airlines* at para. 76, DUM's Brief of Authorities, Tab 2
[52] OBCA, s. 186(6).

(d) FDC's Opposition is Without Merit

51. In any event, FDC's opposition to the within motion has no merit.

(i) The Cause of the Company's Insolvency

52. FDC objects to the Company having characterized FDC's refusal to fund as the basis for its insolvency. It asserts that it had no obligation to advance funds because the Company did not meet the milestones contemplated in the SIA, and that it is therefore incorrect to point to FDC as the cause of the Company's insolvency.[53]

53. Whether or not FDC had an obligation to advance funds to the Company pursuant to the SIA, FDC was the source of funding upon which the Company relied. When that funding ceased, FDC became insolvent.[54] FDC's position in this regard cannot form the basis for an objection to the approval of the Proposal.

(ii) Mr. Craig is not in Conflict

54. FDC submits that Mr. Craig is in conflict, given that he controls the secured creditors and the companies that will receive shares in the Company upon implementation of the Proposal, as well as being a director and officer of the Company. FDC submits that the Proposal was designed to benefit Mr. Craig, to the exclusion of others, including FDC.[55]

55. Mr. Craig's various roles have been well-known to FDC throughout FDC's involvement with the Company.[56] In particular, FDC expressly authorized Craig Holdings to enter into the loan agreement with the Company pursuant to which it assumed the first secured creditor

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[53] Gilhespy Affidavit at paras. 16-19, FDC Record at Tab 1, pp. 8-10.
[54] Craig Affidavit at para. 34, DUM Record at Tab 1, p. 10.
[55] Gilhespy Affidavit at paras. 23-24, FDC Record at Tab 1, pp. 11-12.
[56] Craig Transcript at pp. 48-49, Q. 201, FDC Record at Tab 2, pp. 530-531.

position, and declined to participate in that loan.[57] There is no prohibition against an officer or director of a company lending funds to that company as a secured lender.

56. FDC has not presented any evidence to suggest that Mr. Craig is acting in a manner that is prioritizing his other interests over those of the Company. On examination, Mr. Craig stated as follows:

> 137. Q. And why did you decide to proceed by way of a proposal instead of putting in a receiver as a secured creditor?
>
> A. We were advised by MNP and our counsel this was the best route forward for the company, given the fact that we wanted to keep it alive and do the best we could for employees, suppliers, et cetera, and at the end of the day, have the ability to come out the other end and raise more capital.[58]

57. Mr. Craig and the Company have initiated this Proposal proceeding in order to find a way forward for the Company that will allow it to stay in business, restructure its capital structure, and provide a platform from which it can seek new financing. As part of this process, Mr. Craig's companies have loaned funds to the Company, and Mr. Craig expects that he may have to continue to fund the Company after implementation, until the Company secures an investor.[59] The Reorganization is compliant with all applicable statutes, and has been approved by those stakeholders who are entitled to vote on it. There is no basis upon which to find that the Proposal unfairly prefers Mr. Craig's interests over those of anyone else.

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[57] Craig Affidavit at paras. 10-13, Exhibit B, DUM Record at Tab 1, pp. 3-4, Tab B, pp. 30-32.
[58] Craig Transcript at p. 33, Q. 137, FDC Record at Tab 2, p. 527.
[59] Craig Affidavit at para. 39, DUM Record at Tab 1, p. 12; Craig Transcript at p. 37, Q. 152, FDC Record at Tab 3, p. 528.

(iii) The "Counter-Proposal" was Without Merit

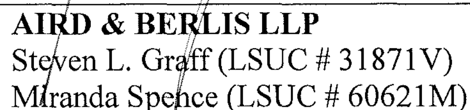
58. FDC submits that the Company ought to have considered the "counter-proposal" which it sought to have tabled at the Meeting of Creditors.[60]

59. As set out in the Trustee's Report, FDC's "counter-proposal" is mischaracterized; a proposal in an insolvency context is made by the Company to its creditors, and not by a shareholder to the Company and its creditors.[61] The "counter-proposal" was not a proposal that could have been put to a vote of the creditors. In any event, the "counter-proposal" effectively restated FDC's prior proposals to the Company, which proposals were unacceptable. In light of the DIP lender's position that it would not continue to fund the Company through an adjournment, it was appropriate for the Proposal Trustee to decline to adjourn the meeting for the purpose of considering the "counter-proposal".[62]

PART IV - ORDER REQUESTED

60. For the foregoing reasons, the Company respectfully requests an order approving the Proposal, and dismissing FDC's opposition thereto, with costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



Date: November 13, 2017

AIRD & BERLIS LLP
Steven L. Graff (LSUC # 31871V)
Miranda Spence (LSUC # 60621M)

Counsel for Digital Underground Media Inc.

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[60] Gilhespy Affidavit at paras. 28-30, FDC Record at Tab 1, pp. 12-13.
[61] Trustee's Report at para 11, Trustee's Record at Tab 3, p. 31.
[62] Craig Affidavit at para. 41, DUM Record at Tab 1, p. 13.

SCHEDULE A

List of Authorities

1. *Beatrice Foods v. Merrill Lynch Capital Partners Inc. (1996)*, 43 C.B.R. (4th) 10 (Ont. S.C.J. [Comm. List])

2. *Canadian Airlines Corp., Re (2000),* 20 C.B.R. (4th) 1 (A.C.Q.B.)

3. *Can-Mar Precast Corp, Re. 1994 CarswellOnt 313 (Ont. Gen. Div., in bankruptcy)*

4. Robert W.V. Dickerson et al., *Proposals for a New Business Corporations Law for Canada,* vol. 1 (Ottawa: Information Canada, 1971)

5. *Kitchener Frame Ltd., Re,* 2012 ONSC 234, 212 A.C.W.S. (3d) 631 (Ont. S.C.J. [Comm. List])

6. *Laidlaw, Re* (2003), 39 C.B.R. (4th) 239 (Ont. S.C.J.)

7. *Royal Oak Mines Inc., Re*, [1999] O.J. No. 4848, 14 C.B.R. (4th) 279 (Ont. S.C.J. [Comm. List])

8. *Stelco Inc, Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J. [Comm. List])

9. *Telepanel Systems Inc., Re (2009),* Ontario Endorsement 31-448752 (Ont. S.C.J. [Comm. List]) [unreported]

SCHEDULE B

Rules and Statutes

***Bankruptcy and Insolvency Act*, RSC 1985, c B-3**

Vote on proposal by creditors

- **54 (1)** The creditors may, in accordance with this section, resolve to accept or may refuse the proposal as made or as altered at the meeting or any adjournment thereof.

- **Voting system**

  (2) For the purpose of subsection (1),

  - **(a)** the following creditors with proven claims are entitled to vote:
    - **(i)** all unsecured creditors, and
    - **(ii)** those secured creditors in respect of whose secured claims the proposal was made;
  - **(b)** the creditors shall vote by class, according to the class of their respective claims, and for that purpose
    - **(i)** all unsecured claims constitute one class, unless the proposal provides for more than one class of unsecured claim, and
    - **(ii)** the classes of secured claims shall be determined as provided by subsection 50(1.4);
  - **(c)** the votes of the secured creditors do not count for the purpose of this section, but are relevant only for the purpose of subsection 62(2); and
  - **(d)** the proposal is deemed to be accepted by the creditors if, and only if, all classes of unsecured creditors — other than, unless the court orders otherwise, a class of creditors having equity claims — vote for the acceptance of the proposal by a majority in number and two thirds in value of the unsecured creditors of each class present, personally or by proxy, at the meeting and voting on the resolution.

- **Certain Crown claims**

  (2.1) For greater certainty, subsection 224(1.2) of the *Income Tax Act* shall not be construed as classifying as secured claims, for the purpose of subsection (2), claims of Her Majesty in right of Canada or a province for amounts that could be subject to a demand under

  - **(a)** subsection 224(1.2) of the *Income Tax Act*;

- (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, or a premium under Part VII.1 of that Act, and of any related interest, penalties or other amounts; or
- (c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum
  - (i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or
  - (ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

- **Where no quorum in a class**

  (2.2) Where there is no quorum of secured creditors in respect of a particular class of secured claims, the secured creditors having claims of that class shall be deemed to have voted for the refusal of the proposal.

- **Related creditor**

  (3) A creditor who is related to the debtor may vote against but not for the acceptance of the proposal.

- **Voting by trustee**

  (4) The trustee, as a creditor, may not vote on the proposal.

Class — creditors having equity claims

54.1 Despite paragraphs 54(2)(a) and (b), creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

...

Application for court approval

58 On acceptance of a proposal by the creditors, the trustee shall

- **(a)** within five days after the acceptance, apply to the court for an appointment for a hearing of the application for the court's approval of the proposal;
- **(b)** send a notice of the hearing of the application, in the prescribed manner and at least fifteen days before the date of the hearing, to the debtor, to every creditor who has proved a claim, whether secured or unsecured, to the person making the proposal and to the official receiver;
- **(c)** forward a copy of the report referred to in paragraph (d) to the official receiver at least ten days before the date of the hearing; and
- **(d)** at least two days before the date of the hearing, file with the court, in the prescribed form, a report on the proposal.

- R.S., 1985, c. B-3, s. 58;
- 1992, c. 1, s. 20, c. 27, s. 23;
- 1997, c. 12, s. 35.

Court to hear report of trustee, etc.

- **59 (1)** The court shall, before approving the proposal, hear a report of the trustee in the prescribed form respecting the terms thereof and the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, the person making the proposal, any opposing, objecting or dissenting creditor and such further evidence as the court may require.

- **Court may refuse to approve the proposal**

  (2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.

- **Reasonable security**

  (3) Where any of the facts mentioned in section 173 are proved against the debtor, the court shall refuse to approve the proposal unless it provides reasonable security for the payment of not less than fifty cents on the dollar on all the unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct.

- **Court may order amendment**

  (4) If a court approves a proposal, it may order that the debtor's constating instrument be amended in accordance with the proposal to reflect any change that may lawfully be made under federal or provincial law.

***Business Corporations Act*, R.S.O. 1990, c. B.16**

Amendments

168 (1) Subject to sections 170 and 171, a corporation may from time to time amend its articles to add, change or remove any provision that is permitted by this Act to be, or that is, set out in its articles, including without limiting the generality of the foregoing, to,

(a) change its name;

(b) Repealed: 1994, c. 27, s. 71 (20).

(c) add, change or remove any restriction upon the business or businesses that the corporation may carry on or upon the powers that the corporation may exercise;

(d) add, change or remove any maximum number of shares that the corporation is authorized to issue or any maximum consideration for which any shares of the corporation are authorized to be issued;

(e) create new classes of shares;

(f) Repealed: 1994, c. 27, s. 71 (20).

(g) change the designation of all or any of its shares, and add, change or remove any rights, privileges, restrictions and conditions, including rights to accrued dividends, in respect of all or any of its shares, whether issued or unissued;

(h) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series or into the same or a different number of shares of other classes or series;

(i) divide a class of shares, whether issued or unissued, into series and fix the number of shares in each series and the rights, privileges, restrictions and conditions thereof;

(j) authorize the directors to divide any class of unissued shares into series and fix the number of shares in each series and the rights, privileges, restrictions and conditions thereof;

(k) authorize the directors to change the rights, privileges, restrictions and conditions attached to unissued shares of any series;

(l) revoke, diminish or enlarge any authority conferred under clauses (j) and (k);

(m) subject to sections 120 and 125, increase or decrease the number, or minimum or maximum number, of directors; and

(n) add, change or remove restrictions on the issue, transfer or ownership of shares of any class or series. R.S.O. 1990, c. B.16, s. 168 (1); 1994, c. 27, s. 71 (20).

Idem

(2) Where the directors are authorized by the articles to divide any class of unissued shares into series and determine the designation, rights, privileges, restrictions and conditions thereof, they may authorize the amendment of the articles to so provide. R.S.O. 1990, c. B.16, s. 168 (2).

Revocation of resolution

(3) The directors of a corporation may, if so authorized by a special resolution effecting an amendment under this section, revoke the resolution without further approval of the shareholders at any time prior to the endorsement by the Director of a certificate of amendment of articles in respect of such amendment. R.S.O. 1990, c. B.16, s. 168 (3).

Change of number name

(4) Despite subsection (1), where a corporation has a number name, the directors may amend its articles to change that name to a name that is not a number name. R.S.O. 1990, c. B.16, s. 168 (4).

Authorization

(5) An amendment under subsection (1) shall be authorized by a special resolution and an amendment under subsection (2) or (4) may be authorized by a resolution of the directors. R.S.O. 1990, c. B.16, s. 168 (5).

Special Act corporations excepted

(6) This section does not apply to a corporation incorporated by special Act, except that a corporation incorporated by special Act, including a corporation to which *The Railways Act*, being chapter 331 of the Revised Statutes of Ontario, 1950, applies, may under this section amend its articles to change its name. R.S.O. 1990, c. B.16, s. 168 (6).

...

Authorization for variation of rights of special shareholders

170 (1) The holders of shares of a class or, subject to subsection (2), of a series are, unless the articles otherwise provide in the case of an amendment referred to in clause (a), (b) or (e), entitled to vote separately as a class or series upon a proposal to amend the articles to,

(a) increase or decrease any maximum number of authorized shares of such class or series, or increase any maximum number of authorized shares of a class or series having rights or privileges equal or superior to the shares of such class or series;

(b) effect an exchange, reclassification or cancellation of the shares of such class or series;

(c) add to, remove or change the rights, privileges, restrictions or conditions attached to the shares of such class or series and, without limiting the generality of the foregoing,

(i) remove or change prejudicially rights to accrued dividends or rights to cumulative dividends,

(ii) add, remove or change prejudicially redemption rights or sinking fund provisions,

(iii) reduce or remove a dividend preference or a liquidation preference, or

(iv) add, remove or change prejudicially conversion privileges, options, voting, transfer or pre-emptive rights, or rights to acquire securities of a corporation;

(d) add to the rights or privileges of any class or series of shares having rights or privileges equal or superior to the shares of such class or series;

(e) create a new class or series of shares equal or superior to the shares of such class or series, except in the case of a series under section 25;

(f) make a class or series of shares having rights or privileges inferior to the shares of such class or series equal or superior to the shares of such class or series;

(g) effect an exchange or create a right of exchange of the shares of another class or series into the shares of such class or series; or

(h) add, remove or change restrictions on the issue, transfer or ownership of the shares of such class or series. R.S.O. 1990, c. B.16, s. 170 (1).

Idem

(2) The holders of a series of shares of a class are entitled to vote separately as a series under subsection (1) only if such series is affected by an amendment in a manner different from other shares of the same class. R.S.O. 1990, c. B.16, s. 170 (2).

Idem

(3) Subsection (1) applies whether or not shares of a class or series otherwise carry the right to vote. R.S.O. 1990, c. B.16, s. 170 (3).

Idem

(4) A proposed amendment to the articles referred to in subsection (1) is adopted when the shareholders have approved the amendment by a special resolution of the holders of the shares of each class or series entitled to vote thereon. R.S.O. 1990, c. B.16, s. 170 (4).

Exception

(5) Subsection (1) does not apply in respect of a proposal to amend the articles to add a right or privilege for a holder to convert shares of a class or series into shares of another class or series that is subject to restrictions described in clause 42 (2) (d) but is otherwise equal to the class or series first mentioned. R.S.O. 1990, c. B.16, s. 170 (5).

Deeming provision

(6) For the purpose of clause (1) (e), a new class of shares, the issue, transfer or ownership of which is to be restricted by an amendment to the articles for the purpose of clause 42 (2) (d) that is otherwise equal to an existing class of shares shall be deemed not to be equal or superior to the existing class of shares. R.S.O. 1990, c. B.16, s. 170 (6).

Articles of amendment

171 (1) Articles of amendment in prescribed form shall be sent to the Director. R.S.O. 1990, c. B.16, s. 171 (1).

Application of s. 34 (4, 5)

(2) If an amendment effects or requires a reduction of stated capital, subsections 34 (4) and (5) apply. R.S.O. 1990, c. B.16, s. 171 (2).

Change of name

(3) No corporation shall change its name if,

(a) the corporation is unable to pay its liabilities as they become due; or

(b) the realizable value of the corporation's assets is less than the aggregate of its liabilities. R.S.O. 1990, c. B.16, s. 171 (3).

...

Reorganization

186 (1) In this section,

"reorganization" means a court order made under section 248, an order made under the *Bankruptcy and Insolvency Act* (Canada) or an order made under the *Companies Creditors Arrangement Act* (Canada) approving a proposal. 2000, c. 26, Sched. B, s. 3 (9).

Articles amended

(2) If a corporation is subject to a reorganization, its articles may be amended by the order to effect any change that might lawfully be made by an amendment under section 168. R.S.O. 1990, c. B.16, s. 186 (2).

Auxiliary powers of court

(3) Where a reorganization is made, the court making the order may also,

(a) authorize the issue of debt obligations of the corporation, whether or not convertible into shares of any class or having attached any rights or options to acquire shares of any class, and fix the terms thereof; and

(b) appoint directors in place of or in addition to all or any of the directors then in office. R.S.O. 1990, c. B.16, s. 186 (3).

Articles of reorganization

(4) After a reorganization has been made, articles of reorganization in prescribed form shall be sent to the Director. R.S.O. 1990, c. B.16, s. 186 (4).

Certificate

(5) Upon receipt of articles of reorganization, the Director shall endorse thereon in accordance with section 273 a certificate which shall constitute the certificate of amendment and the articles are amended accordingly. R.S.O. 1990, c. B.16, s. 186 (5).

No dissent

(6) A shareholder is not entitled to dissent under section 185 if an amendment to the articles is effected under this section. R.S.O. 1990, c. B.16, s. 186 (6).

Canada Business Corporations Act, **RSC 1985, c C-44**

Definition of *reorganization*

- **191** (1) In this section, ***reorganization*** means a court order made under
    - **(a)** section 241;
    - **(b)** the *Bankruptcy and Insolvency Act* approving a proposal; or
    - **(c)** any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors.

- **Powers of court**

  (2) If a corporation is subject to an order referred to in subsection (1), its articles may be amended by such order to effect any change that might lawfully be made by an amendment under section 173.

- **Further powers**

  (3) If a court makes an order referred to in subsection (1), the court may also
    - **(a)** authorize the issue of debt obligations of the corporation, whether or not convertible into shares of any class or having attached any rights or options to acquire shares of any class, and fix the terms thereof; and
    - **(b)** appoint directors in place of or in addition to all or any of the directors then in office.

- **Articles of reorganization**

  (4) After an order referred to in subsection (1) has been made, articles of reorganization in the form that the Director fixes shall be sent to the Director together with the documents required by sections 19 and 113, if applicable.

- **Certificate of reorganization**

  (5) On receipt of articles of reorganization, the Director shall issue a certificate of amendment in accordance with section 262.

- **Effect of certificate**

  (6) A reorganization becomes effective on the date shown in the certificate of amendment and the articles of incorporation are amended accordingly.

- **No dissent**

  (7) A shareholder is not entitled to dissent under section 190 if an amendment to the articles of incorporation is effected under this section.

30917212.1

IN THE MATTER OF THE PROPOSAL OF DIGITAL UNDERGROUND MEDIA INC., A COMPANY INCORPORATED PURSUANT TO THE LAWS OF THE PROVINCE OF ONTARIO, WITH A HEAD OFFICE IN THE CITY OF VANCOUVER, IN THE PROVINCE OF BRITISH COLUMBIA

District of Ontario
Division No. 09 -Toronto
Court File No. 31-2295766
Estate No. 31-2295766

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceedings commenced at Toronto

FACTUM OF DIGITAL UNDERGROUND MEDIA INC.
(Motion returnable November 14, 2017)

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