

**ONTARIO
SUPERIOR COURT OF JUSTICE
(IN BANKRUPTCY AND INSOLVENCY)**

**IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C., 1985, c. B-3, AS AMENDED**

**AND IN THE MATTER OF THE BANKRUPTCY 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 FORWARD DIMENSION CAPITAL 1 LLP
(Application returnable November 14, 2017)**

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FACTUM OF FORWARD DIMENSION CAPITAL 1 LLP

PART I - INTRODUCTION

1. Forward Dimension Capital 1 LLP (“**FDC**”) opposes the proposal (the “**Proposal**”) of Digital Underground Media Inc. (“**DUMI**” or the “**Company**”) made pursuant to the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, as amended (the “**BIA**”), as the Proposal is unreasonable, has been calculated to benefit the principal secured creditor over the general body of creditors, and has not been brought in good faith.

2. Drew Craig (“**Craig**”) who, among other things, is the chairman of DUMI and, through companies he controls, is also its principal pre-filing secured creditor, debtor-in-possession lender (“**DIP Lender**”), the Proposal sponsor and a significant shareholder, is using the Proposal as a means to take 100% control of DUMI while leaving his secured debt unaffected and only providing unsecured creditors with a *total recovery of \$76,000, or approximately 11.5 cents on the dollar*. The evidence is clear that Craig, acting in a conflict of interest, initiated the Proposal “*for the number one reason*” of protecting his own personal position as DUMI’s principal secured creditor, a fact which has been made clear by Craig’s refusal to show DUMI’s creditors

the alternative proposal from FDC that would have tripled recovery for DUMI's unsecured creditors.

3. Not only has the Proposal been calculated to benefit Craig at the expense of other stakeholders, it has also not been brought in good faith. Craig has allowed incorrect information to be provided to this Court and to the creditors. In particular, DUMI has sought to lay the blame for its financial difficulties at the feet of FDC by falsely alleging FDC failed to meet its funding obligations to the Company. As the record makes clear, at no point did FDC fail to meet its funding obligations to DUMI. To the contrary, notwithstanding the fact that DUMI failed to meet any of the financial milestones that were conditions precedent to FDC providing additional funding, FDC in fact provided in excess of \$7 million of further funding to DUMI from late 2015 through mid-2017. DUMI's failure to advise this Court and the creditors of the true cause of its insolvency and to instead seek to blame FDC is not consistent with the candid, good faith disclosure that is required of a debtor seeking authority to implement a proposal.

4. Ultimately, the Proposal for which approval is sought is not the type of good faith restructuring contemplated by the BIA's commercial proposal regime. Rather, it is effectively secured creditor enforcement by other means, but without any of the protections that creditor enforcement would typically provide to other stakeholders, such as the appointment of a Court officer to administer the assets and some form of sales process to appropriately value the assets. This is made clear from the fact that even if the Proposal were to be approved, the Company would still be insolvent. Thus, it is clear that the attempt to wipe out FDC's shareholdings – which is not necessary to effect a proposal with the unsecured creditors – was not done in a good faith attempt to make the company solvent again, but rather is an attempt by Craig to eliminate FDC from the Company despite the fact that FDC has provided approximately 75% of the funding for the Company since 2015.

5. Further, by proceeding via proposal rather than enforcement, Craig and DUMI's other director, Kenneth Bicknell ("**Bicknell**") (who also has an interest in one of the secured creditors), have sought to obtain the benefit of a release of personal liability that would not be available to them were this case to have proceeded via an enforcement process. Such relief should not be

granted in the circumstances and, in any event, the release sought is beyond the scope permitted by the BIA.

6. For these and the other reasons set forth herein, FDC respectfully requests that the Court reject the Proposal such that DUMI is deemed bankrupt and a trustee is appointed to administer DUMI's assets for the benefit of all stakeholders.

PART II - THE FACTS

(1) FDC and DUMI

7. FDC is a private equity firm headquartered in London, England. FDC invests primarily in small to medium sized businesses, particularly in the digital consumer and internet industries.

Affidavit of Laura Gilhespy sworn November 7, 2017 (the "**Gilhespy Affidavit**"), at para. 3; Responding Application Record of FDC (the "**FDC Application Record**"), Tab 1, p. 4.

8. DUMI is a company incorporated under the *Business Corporations Act* (Ontario), R.S.O. 1990, c. B.16, that directly and through its subsidiaries develops and operates subway in-tunnel advertising systems.

Gilhespy Affidavit, at para. 4; FDC Application Record, Tab 1, p. 4.

9. FDC is the majority shareholder of DUMI. In June of 2015, FDC subscribed for and received 541,813 Class A Common Shares of DUMI at a purchase price of \$5 million. FDC's shareholding represents approximately 50% of the issued and outstanding shares of DUMI. As described in further detail below, FDC funded in excess of an additional \$7 million to DUMI from late 2015 through mid-2017 notwithstanding it had no obligation to do so.

Gilhespy Affidavit, at paras. 4 and 18; FDC Application Record, Tab 1, p. 4.

10. DUMI's other principal shareholder, through companies under his control, is Craig. Craig holds DUMI shares through J.D. Craig Holdings Inc. ("**Craig Holdings**") and DUM Holdings Inc. ("**DUM Holdings**"), two companies he controls. Craig is also the chairman of the board of DUMI.

Gilhespy Affidavit, at para. 5; FDC Application Record, Tab 1, p. 5.

11. In addition to being DUMI's second largest shareholder and its chairman, Craig, through the companies under his control, is also DUMI's principal secured creditor and its DIP Lender. Furthermore, Craig is also the sole director and 100% shareholder of 7677189 Canada Ltd., the entity who, along with the DIP Lender, is sponsoring the Proposal (the "**Proposal Sponsor**"). No disclosure as to Craig's relationship with the Proposal Sponsor was made in the Proposal or in any related disclosure. DUMI's other director, Bicknell, also has a financial interest in DUM Holdings.

Transcript of the Examination of Drew Craig taken November 9, 2017 (the "**Craig Transcript**"), 7:14 – 11:20; FDC Application Record, Tab 2, pp. 520-521.

12. Attached as Schedule "C" is a chart that summarizes the various roles and interests of each of Craig and Bicknell with respect to DUMI, Craig Holdings, DUM Holdings and the Proposal Sponsor.

(2) Events leading to the Application to Approve the Proposal

13. DUMI filed a Notice of Intention to Make a Proposal pursuant to the BIA on September 21, 2017. MNP Ltd. was appointed to act as the proposal trustee (the "**Trustee**").

Gilhespy Affidavit, at para. 22; FDC Application Record, Tab 1, p. 11.

14. On October 2, 2017, DUMI filed the Proposal with the Trustee and the Official Receiver. Notice of the Proposal was sent to DUMI's creditors along with the Report of the Trustee on the Proposal (the "**Trustee's Report on the Proposal**").

Gilhespy Affidavit, at para. 22; FDC Application Record, Tab 1, p. 11.

15. The Proposal, among other things, cancels all existing equity of DUMI and proposes to provide only approximately \$76,000 to DUMI's unsecured creditors (resulting in a recovery of approximately 11.5 cents on the dollar based on the Trustee's estimated creditor pool) in

exchange for transferring 100% control of DUMI to the DIP Lender and the Proposal Sponsor, each of which is controlled by Craig. DUMI's secured creditors are unaffected by the Proposal.

Gilhespy Affidavit, at para. 23; FDC Application Record, Tab 1, pp. 11-12.

16. The Proposal was approved by Craig and Bicknell in their capacity as DUMI's directors without any disclosure of the conflict of interest arising from their interest in DUMI's secured creditors.

Resolutions of the Directors of Digital Underground Media Inc. dated September 22, 2017; FDC Application Record, Tab 3-C, pp. 560-561.

17. Craig admitted under oath that the "number one reason" he elected to proceed via a proposal was to structure the Company to give him the best chance possible to recoup his secured debt.

Craig Transcript, 34:9 – 34:20; FDC Application Record, Tab 2, p. 527.

18. In making the Proposal, DUMI blamed FDC as being the cause of its financial difficulties. DUMI advised the Trustee that the need to undertake the Proposal was due primarily to FDC's "failure" to fulfill its funding obligations to DUMI. This information was then repeated in two reports of the Trustee that were provided to this Court on the motion to approve the DIP financing and to the creditors in connection with the creditors' meeting. In its most recent report, the Trustee changed its description of the cause of DUMI's insolvency and now states that DUMI "...has been unable to achieve its business and strategic plan as a result of being undercapitalized." DUMI allowed this false information to be provided to the Court and the creditors despite the fact FDC had previously objected to Craig taking this position.

Gilhespy Affidavit, at paras. 9-10; FDC Application Record, Tab 1, p. 6.

Report of the Trustee on the Proposal dated November 2, 2017, at para. 17(a); Motion Record of the Proposal Trustee re: Approval of Proposal returnable November 14, 2017 (the "**Trustee's Application Record**"), Tab 3, p. 33.

Email exchange between Graham Coxell and Drew Craig dated July 12, 2017; Responding Motion Record of Digital Underground Media Inc. ("**DUMI's Responding Motion Record**"), Tab 1-L, p. 139.

Craig Transcript, 30:7 – 32:11; FDC Application Record, Tab 2.

19. FDC, upon learning of the Proposal, attempted to engage with DUMI and the Trustee. FDC took issue with the Proposal, including, among other things, its proposed treatment of DUMI's stakeholders and the representation that the cause of DUMI's financial difficulties was FDC failing to meet its alleged obligations. As a result of its concerns, FDC requested that the creditors' meeting be delayed to allow FDC to consider its position and take action as appropriate, which request was denied.

Gilhespy Affidavit, at para. 25; FDC Application Record, Tab 1, p. 13.

20. FDC submitted an alternative proposal (the "**FDC Proposal**") for consideration at the creditors' meeting, which proposal provided a significantly greater return to DUMI's unsecured creditors (approximately 30 cents on the dollar) relative to the Proposal. Although the Trustee recommended the creditors' meeting be adjourned to consider the FDC Proposal, DUMI rejected the Trustee's advice as well as the FDC proposal out of hand on the basis that it was not acceptable to Craig in his personal capacity as secured creditor.

Gilhespy Affidavit, at para. 26; FDC Application Record, Tab 1, pp. 13-14.

Craig Transcript, 41:8 – 42:5; FDC Application Record, Tab 2, p. 529.

21. Notwithstanding the Trustee's recommendation and request to adjourn the creditors' meeting, the creditors' meeting continued at Craig's insistence and the Proposal (in a slightly amended form) was narrowly approved by the requisite majorities.

Report of the Trustee on the Proposal dated November 2, 2017 at para. 10;
Trustee's Application Record, Tab 3, p. 31.

Craig Transcript, 41:3 – 42:5; FDC Application Record, Tab 2, p. 529.

PART III - ISSUES AND THE LAW

22. The only issue to be decided on this motion is whether DUMI has satisfied the conditions that must be met for the Court to approve the Proposal, namely whether the Proposal (i) is reasonable, (ii) calculated to benefit the general body of creditors, and (iii) made in good faith.

(1) The Test for Approval of a Proposal

23. In order to approve the Proposal, the Court must be satisfied that:

- (a) the Proposal is reasonable;
- (b) the Proposal is calculated for the benefit of the general body of creditors;
- (c) the Proposal is made in good faith; and
- (d) the Proposal complies with the formalities of the BIA.

24. Where the Court is of the opinion that the terms of a proposal are not reasonable or are not calculated to benefit the general body of creditors, the Court shall refuse to approve the proposal. The requirement that the Court be satisfied that a proposal be made in good faith has been implied as an exercise of a bankruptcy court's equitable jurisdiction.

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, s. 59(2).

Re Kitchener Frame Ltd., 2012 ONSC 234 at para. 20; Book of Authorities, Tab 1.

25. Approval of a proposal at a meeting of the creditors is not determinative of the appropriateness of the proposal and courts must look beyond the vote of creditors and the trustee's recommendation when considering whether to approve a proposal, including whether the proposal is adequate to meet the requirements of commercial morality and considering the integrity of the bankruptcy system.

Re Milan, 2012 ONSC 2899 at para. 27; Book of Authorities, Tab 2.

Re Sumner Co. (1984), 64 C.B.R. (N.S.) 218 (N.B.Q.B.) at para. 37; Book of Authorities, Tab 3.

Re Kitchener Frame Ltd., 2012 ONSC 234 at para. 22; Book of Authorities, Tab 1.

(2) The Proposal is Not Reasonable

26. There is no compelling evidence before the Court that the Proposal is reasonable. Indeed, the evidence before the Court is that the FDC Proposal provided the unsecured creditors with

substantially more recovery. While the FDC Proposal also proposed that the secured debt be compromised to a certain extent, such a compromise was reasonable given that, according to the financial information signed by Craig, most of the “secured debt” is in fact unsecured as a result of the estimated value of DUMI’s assets.

27. There is also no other basis to consider whether or not the Proposal is reasonable given that no independent valuation has been undertaken to determine the actual value of the Company’s technology assets, including its patents. In the Trustee’s Report on the Proposal, the estimated realizable value of DUMI’s assets has been greatly marked-down with no explanation provided. As Craig admitted under examination, although DUMI, like many other technology companies, is currently making losses, this does not mean that DUMI does not have material intrinsic value or that the market value of the Company is not worth much more than such value of its assets. In the absence of a proper business valuation or a properly conducted sales process, there is no basis or evidence on which the Court can conclude that the Proposal is, in fact, reasonable, particularly where the sum proposed to be distributed to creditors is a mere \$76,000 that results in an estimated recovery of only 11.5 cents on the dollar. Accordingly, the Proposal must be rejected.

Re Milan, 2012 ONSC 2899 at paras. 28 and 40; Book of Authorities, Tab 2.

(3) The Proposal is Crafted to Benefit Craig as Secured Creditor to the Detriment of DUMI and its Other Stakeholders

28. Courts have refused to approve proposals (i) where the proposal has been found to be crafted in such a way that it effectively serves the interests of parties other than the unsecured creditors, and (ii) where certain creditors stand to benefit more than others, including where a preferred creditor is a related party to the debtor and this fact has not been sufficiently disclosed to the other creditors.

Re Sumner Co. (1984), 64 C.B.R. (N.S.) 218 (N.B.Q.B.) at para. 35; Book of Authorities, Tab 3.

Re Mister C’s Ltd. (1995), 32 C.B.R. (3d) 242 (Ont. S.C.J.) at paras. 7 and 9; Book of Authorities, Tab 4.

29. Here, it is clear that the Proposal has been developed and advanced by Craig to serve his interests as DUMI's principal secured creditor. Indeed, Craig has confirmed that the "number one reason" for advancing the Proposal was to protect his secured debt:

Q: And Mr. Craig, you mentioned you wanted to try to keep the company alive. Can you explain for me why you wanted to keep the company alive?

A: Well, the number one reason, I suppose, was to make sure that I recovered my capital which was sitting in the loan, I guess, and you know, I felt that the company [i.e. DUMI] was technically insolvent, and in order to recapture...having any hope of recapturing the secured debt, we felt the Proposal was the best way to go to try to attract outside capital and keep it alive. [emphasis added]

Craig Transcript, 34:9 – 34:20; FDC Application Record, Tab 2, p. 527.

30. The extent to which the Proposal has been structured to protect Craig's personal interest *qua* secured creditor is also evidenced by the terms of the Proposal itself, which leaves secured creditors completely unaffected notwithstanding that DUMI's statement of affairs filed in connection with the Proposal and executed by Craig shows only \$305,001 in total assets, meaning the Company's secured debt of approximately \$3 million is significantly under-secured on its own assessment.

Statement of Affairs dated September 29, 2017; Trustee's Application Record, Tab 3-I, p. 187.

31. Rather than compromising this debt and providing DUMI with a clean balance sheet moving forward, the Proposal instead leaves secured creditors unaffected such that DUMI will still be insolvent if the Proposal is approved as the Company's secured debt has not been amended, there is no exit financing in place, and according to Craig's own affidavit there is not sufficient funds to carry DUMI to the end of the year. That DUMI would fail to take steps to address the most problematic aspect of its capital structure through the Proposal – being the secured financing – highlights the extent to which the Proposal has been structured to benefit DUMI's secured creditors and Craig personally to the detriment of the Company and its other stakeholders.

Affidavit of Drew Craig sworn November 13, 2017 (the "**Craig Affidavit**"), at para. 22; DUMI's Responding Motion Record, Tab 1, p. 7.

32. Nor is there any indication that DUMI has or can obtain financing to operate its business on a go-forward basis. Indeed, the Proposal does not contemplate any such financing. Rather, after having been examined, Craig belatedly provides a convenient and unsupported statement that he intends to provide necessary funding (while also stating he has no express obligation to do so).

Craig Affidavit, at para. 39; DUMI's Responding Motion Record, Tab 1, p. 12.

33. Considered as a whole, the Proposal is clearly structured to benefit Craig by leaving his secured debt unaffected and transferring 100% control of DUMI to him in exchange for a token payment to unsecured creditors, which payment falls well short of the 50 cents on the dollar threshold contemplated by Section 173(1)(a) of the BIA, which is a ground for refusing a proposal in the absence of security being provided. In contrast, there is no evidence in the record that FDC's equity holdings were an impediment to finding appropriate financing for the Company, or that a proposal to the unsecured creditors, if needed, was contingent upon wiping out the existing equity positions. This is particularly problematic given that the equity holders were not given a vote despite the fact, as noted above, there has been no formal valuation of the Company or its assets or a proper sales process conducted to determine if, in fact, there is no value for equity holders.

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, ss. 59(3) and 173(1)(a).

34. Upon implementation of the Proposal, DUMI will emerge still insolvent, still in default under its secured debt and without any apparent ability to fund itself on a go forward basis, thus setting the stage for this process to repeat itself to the detriment of DUMI's future creditors. The Court should not approve a Proposal that is so blatantly tilted towards the interests of a related party to the debtor, particularly one that so obviously fails to address the causes of the debtor's insolvency or provide a platform for future success.

(4) DUMI Failed to Consider Alternatives in Good Faith

35. That Craig has advanced the Proposal to benefit himself as secured creditor is also evidenced by DUMI's refusal to put the FDC Proposal to creditors or to even explore whether negotiations with FDC could have yielded a better result for creditors.

36. The FDC Proposal provided a substantially greater recovery to unsecured creditors (approximately three times that provided by the Proposal) and proposed to restructure DUMI's capital structure for the long-term benefit of the Company.

37. Although the Trustee recommended that the creditors' meeting be adjourned so that DUMI could consider the FDC Proposal, Craig rejected the Trustee's adjournment recommendation and request. The minutes of the creditors' meeting suggest that the FDC Proposal was rejected because it "had no plan to fund [DUMI] going forward" – which is an obviously specious rationale given that the Proposal itself does not provide DUMI with any such funding. The minutes also confirm that the "secured creditor" was unwilling to accept any arrangement that affected DUMI's secured debt and advised that as the DIP Lender, it would not continue to fund DUMI through any adjournment period.

Gilhespy Affidavit, at paras. 27-30; FDC Application Record, Tab 1, pp. 14-15.

Minutes of Meeting of Creditors held October 19, 2017; Trustee's Application Record, Tab 3-J, pp. 196-199.

38. Craig subsequently confirmed at his examination under oath that the core reason for the directors rejecting both the Trustee's adjournment recommendation and ultimately the FDC Proposal was again his interest as DUMI's principal secured creditor:

Q: Can you explain for me why [DUMI's] directors rejected the Trustee's recommendation to adjourn the creditors' meeting and decided just to proceed with the creditors' meeting?

A: It was based on the fact that FDC was not recognizing J.D. Craig Holdings' position as secured creditor, and the fact that they wanted to give J.D. Craig Holdings effectively a 50% haircut on its secured position. [Emphasis Added]

Craig Transcript, 41:8 – 41:16; FDC Application Record, Tab 2, p. 529.

39. In considering the totality of the record, including both the terms of the Proposal itself and the candid admissions of Craig on his examination, it is clear that DUMI, under the control of Craig and Bicknell (each of whom is hopelessly conflicted with respect to the Proposal), has advanced the Proposal primarily with a view to protecting their personal interests rather than pursuing a good faith proposal for the benefit of the Company and all its stakeholders.¹ In circumstances where the Proposal has been calculated to serve certain creditors who are related to the Company's directors to the detriment of the general body of creditors (including future creditors), the Court should decline to approve the Proposal.

Re Mister C's Ltd. (1995), 32 C.B.R. (3d) 242 (Ont. S.C.J.); Book of Authorities, Tab 4.

Re Liquid Nutrition Franchising Corp., 2017 QCCS 1928 at para. 79; Book of Authorities, Tab 5.

(5) The Proposal Has Not Been Made in Good Faith

40. The requirement that the Proposal be made in good faith, like the requirement that the Court find the Proposal to be reasonable, necessitates a consideration of the public interest and the integrity of the bankruptcy process. The integrity of the bankruptcy process demands that there be "...full and complete disclosure by the proponent to enable the creditors and the court to determine whether the proposal is reasonable and in the best interests of all interested parties."

Re Milan, 2012 ONSC 2899 at para. 40; Book of Authorities, Tab 2.

Re Mister C's Ltd. (1995), 32 C.B.R. (3d) 242 (Ont. S.C.J.); Book of Authorities, Tab 4.

¹ In this regard, it is notable that the directors' resolution executed by each of Craig and Bicknell approving the Proposal does not even disclose (let alone suggest that any steps were taken to address) the fact that each of Craig and Bicknell were in a conflict of interest position in proposing and approving the Proposal given their personal interest as DUMI's secured creditors. That Craig was aware of the conflict that existed between his role as a director of DUMI and his status as a secured creditor of DUMI is made clear by an earlier directors' resolution approving the loan, which plainly discloses Craig's conflict and indicates he is abstaining from voting on the matter. See Resolutions of the Directors of DUMI (undated), FDC Application Record, Tab 3-B, pp. 555-559 and the Director's Resolution of DUMI dated September 22, 2017, FDC Application Record, Tab 3-C, pp. 560-561.

(a) *DUMI Has Misrepresented the Cause of its Financial Difficulties by Blaming FDC*

41. The Trustee's Report on the Proposal states that DUMI advised the Trustee that the cause of its financial difficulties and the need to undertake the Proposal was due primarily to FDC's "failure" to fulfill its funding obligations to DUMI. As stated in the Trustee's Report on the Proposal:

The Company advises that the causes of its financial difficulties are due primarily to agreements that the Company entered into in mid-2015 with a U.K. based private equity fund [i.e. FDC], whereby the fund would act as an institutional investor (the "**Agreements**"). The institutional investor committed to support the Company's business plan to establish the global in-tunnel media industry as a niche market of the Transit Out of Home media industry. *The Agreements provided that the institutional investor would provide funding to the Company in accordance with the business plan.* In Q2 of 2017, the institutional investor provided notice to the Company *that it would not fulfill its funding obligations* under the Agreements [emphasis added].

Report of the Trustee on the Proposal dated October 6, 2017, Exhibit "C", at p. 2; Trustee's Application Record, Tab 3-H, p. 169.

42. A similar statement is repeated in the Trustee's Report on the Proposal which reads: "[T]he Company's current financial difficulty is attributable *to the failure of an institutional investor to provide funding per its agreement with DUMI* resulting in insufficient working capital to grow DUMI's business to a scale where it becomes viable" [emphasis added].²

Report of the Trustee on the Proposal dated October 6, 2017, Exhibit "C", at p. 10; Trustee's Application Record, Tab 3-H, p. 177.

43. However, FDC did not, in fact, have any obligation to provide further funding to DUMI as the financial milestones upon which further funding was conditioned were never met. On examination, Craig admitted as much, agreeing that "[t]he original funding milestones were not met".

Craig Transcript, 13:21 – 15:12; FDC Application Record, Tab 2, p. 522.

Gilhespy Affidavit, at para. 17; FDC Application Record, Tab 1, pp. 8-9.

² Of note, the Trustee's latest report now recasts the reasons for DUMI's insolvency as an inability "...to achieve its business and strategic plan as a result of being undercapitalized" (See Report of the Trustee on the Proposal dated November 2, 2017 at para. 17(a); Trustee's Application Record, Tab 3, p. 33).

44. On his examination and in his affidavit, Craig has suggested that DUMI and FDC agreed to amend the Subscription & Investment Agreement dated July 27, 2015 (the “**Subscription Agreement**”) to provide for amended milestones. While FDC acknowledges that discussions occurred regarding amending the milestones, even on DUMI’s evidence the record is clear that no amendments were ever agreed to.

45. The principal evidence DUMI has tendered in support of its contention that FDC agreed to amend the milestones are draft, unexecuted documents and board minutes, including a document titled “First Amendment to the Subscription & Investment Agreement”.³ That these documents cannot have served to amend the terms of the Subscription Agreement is made plain by the clear language of Section 1.5 of the Subscription Agreement which provides that it “...cannot be altered, amended or modified *except in writing executed by the parties...*”, and further by Section 8.7 which provides that “[a]ny waiver of, or consent to depart from, the requirements of any provision of [the Subscription] Agreement shall be effective *only if it is in writing and signed* by the party giving it...” As such, the Subscription Agreement and the milestones contained therein stand as the parties’ binding agreement, and it is clear that FDC was under no obligation to advance further funding to DUMI.

Subscription & Investment Agreement dated July 27, 2015, ss. 1.5 and 8.7; FDC Application Record, Tab 1-A, p. 24 and 47.

46. Notwithstanding DUMI’s failure to meet the financial milestones, FDC continued to fund DUMI in good faith – a further approximately \$7 million over the course of the past 22 months – until it became apparent that Craig was going to favour his interest as secured creditor rather than make a bona fide attempt at restructuring DUMI.

Gilhespy Affidavit, at paras. 9-12 and 14-18; FDC Application Record, Tab 1, pp. 6-9.

³ Craig has admitted that the draft agreements relating to amending the milestones “were never signed” and that the related board resolutions were only “notionally approved” (See Craig Transcript, 14:15 – 15:12; FDC Application Record, Tab 2, p. 522).

(b) *No Disclosure Regarding Craig's Connection to Proposal Sponsor*

47. As stated above, the integrity of the bankruptcy process requires that full disclosure be made of any conflict of interest. If there is any suggestion of “collusion or *secret advantage*, the matter should be particularly scrutinized” [emphasis added].

Re Magi, 2006 QCCS 5129 at para. 19; Book of Authorities, Tab 6.

48. A corporate search in respect of the Proposal Sponsor discloses that Craig is its sole director, and on his examination Craig confirmed that he is also its sole shareholder.

Craig Transcript, 10:20 – 11:8; FDC Application Record, Tab 2, p. 521.

Corporate Profile Search of 7677189 Canada Ltd.; FDC Application Record, Tab 1-F, pp. 507-509.

49. Neither the Proposal nor any of the disclosure related thereto advised that the Proposal Sponsor (who, along with the DIP Lender, will acquire 100% of the new equity of DUMI) is a company controlled by Craig. The failure to disclose that Craig, through his interest in both the DIP Lender and the Proposal Sponsor, will acquire 100% control of DUMI is a fatal flaw that taints the entire approval process. DUMI's creditors voted without knowledge that Craig was effectively acquiring 100% control of the Company (or that a superior proposal had been made by FDC but rejected by Craig). Had creditors been made aware of the full extent of Craig's conflict with respect to the Proposal, they may have made different decisions when voting.

Re Mister C's Ltd. (1995), 32 C.B.R. (3d) 242 (Ont. S.C.J.) at para. 7; Book of Authorities, Tab 4.

(6) The Proposed Director Release is Inequitable and Overly Broad

50. The Proposal provides the following release in favour of DUMI's current and former directors:

Release of Directors

36. Upon the Implementation Date, the Company, *each and every present and former director of the Company (collectively, the “Released Parties”)* shall be released and discharged from any and all demands, claims, actions, causes of action, counter claims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, options, liens and other

recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any Creditor or Person may be entitled to assert, in the case of the Released Parties as of the Filing Date, including, without limitation, any and all Claims in respect of the potential statutory liabilities of the present or former directors of the Company, and any and all Claims relating to any obligations of the Company where the present or former directors are or may be by law liable in their capacity as directors for the payment of such obligations, and provided that nothing herein shall release or discharge any of the present or former directors of the Company from the exceptions set out in Section 50(14) of the Act. [emphasis added]

Amended Proposal dated October 16, 2017 (the “**Proposal**”), at para. 36;
Trustee’s Application Record, Tab 2-A, p. 21.

51. FDC objects to the inclusion of any release in the Proposal for the benefit of DUMI’s directors, particularly any release that would seek to impair any claims FDC may hold against DUMI’s directors. As outlined above, the Proposal has not been advanced with a view to promoting the best interests of either DUMI or its stakeholders, but rather to protect and advance the interests of DUMI’s secured creditors (principally Craig, who is also a beneficiary of the director release). In the circumstances, it is not apparent what, if any, consideration has been provided by the directors in exchange for the releases sought, nor does the Proposal purport to provide any consideration for the compromise of director claims. To the contrary, the directors (in particular, Craig) appear to be seeking a release of claims against them in exchange for having advanced a proposal under which they are also the principal (and nearly the exclusive) economic beneficiaries. It is neither just nor equitable to permit the compromise of any claims against the directors where the Proposal has been calculated to their benefit (both in their capacities as directors and secured creditors), and the court should also refuse to approve the Proposal on this basis.

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, s. 50(15).

Re Liquid Nutrition Franchising Corp., 2017 QCCS 1928 at paras. 27-31 and 79-80; Book of Authorities, Tab 5.

52. Further and in any event, the director release is also impermissibly broad. Section 50(13) of the BIA provides that:

Claims against directors — compromise

50 (13) A proposal made in respect of a corporation may include in its terms provision for the compromise of claims against directors of the corporation that arose before the commencement of proceedings under this Act and that relate to the obligations of the corporation where the directors are by law liable in their capacity as directors for the payment of such obligations. [emphasis added]

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, s. 50(13).

53. Accordingly, the scope of a director release that is permissible under a proposal is limited to claims that relate to obligations of the debtor corporation where the directors are liable in their capacity as directors for the payment of such obligations (such as, for instance, director liability under various corporate law statutes for debts owed to employees for services performed for the corporation). The release potentially available to directors under a proposal does not extend to liabilities they may incur in their capacity as a director independent of a liability of the corporation (e.g. independent claims for oppression or breach of duties), or liabilities they may incur in other capacities (e.g. as a shareholder).

Re Maple Homes Canada Ltd., 2000 BCSC 1443 at paras. 40-41 and 43; Book of Authorities, Tab 7.

54. Contrary to the limited potential director release contemplated by the BIA, the director release under the Proposal appears to contemplate a comprehensive release of all claims by any Creditor or Person⁴ against the current and former directors of DUMI, subject only to the express carve outs contemplated by Section 50(14) of the BIA. That the proposed release is broader than what is permissible under the BIA is made plain by its structure inasmuch as the release that is expressly permissible under Section 50(13) of the BIA is provided for following the words “including, without limitation” in the drafting of the release.⁵

Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, s. 50(14).

55. Further, as drafted, it is possible the directors could take the position that the Proposal releases claims against them independent of their capacity as directors,⁶ such as contractual

⁴ Each as defined in the Proposal. “Person” means any individual, partnership, joint venture, trust, corporation, unincorporated organization, government or any agency or instrumentality thereof, or any other entity howsoever designated or constituted.

⁵ In addition to the general release of all claims (etc.) by any Creditor or Person against the directors, the release also purports to release “...any and all Claims in respect of the potential statutory liabilities of the present or former directors of the Company”, which is also beyond the scope of what is permitted under Section 50(13) of the BIA.

⁶ The release does not make explicit that the directors are being released from claims solely in their capacity as directors, and not in any other capacity.

rights against them, and even in respect of claims unrelated to DUMI.⁷ Such a broad and ill-defined release should not be authorized or approved by the Court.

PART IV - RELIEF REQUESTED

56. For the reason set out above, FDC respectfully requests that this Court reject the Proposal such that a trustee in bankruptcy can be appointed to administer DUMI's assets for the benefit of all creditors.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

November 13, 2017


Goodmans LLP

⁷ The release is in the nature of an "all claims" release without any language that would scope the release to a particular subject matter, such as, for instance, "claims related to DUMI".

A

SCHEDULE A - LIST OF AUTHORITIES

1. *Re Kitchener Frame Ltd.*, 2012 ONSC 234.
2. *Re Milan*, 2012 ONSC 2899.
3. *Re Sumner Co.* (1984), 64 C.B.R. (N.S.) 218 (N.B.Q.B.).
4. *Re Mister C's Ltd.* (1995), 32 C.B.R. (3d) 242 (Ont. S.C.J.)
5. *Re Liquid Nutrition Franchising Corp.*, 2017 QCCS 1928.
6. *Re Magi*, 2006 QCCS 5129.
7. *Re Maple Homes Canada Ltd.*, 2000 BCSC 1443.

B

SCHEDULE B – STATUTORY REFERENCES

***BANKRUPTCY AND INSOLVENCY ACT* R.S.C., 1985, c. B-3, as amended**

s. 50(13)

Claims against directors – compromise – A proposal made in respect of a corporation may include in its terms provision for the compromise of claims against directors of the corporation that arose before the commencement of proceedings under this Act and that relate to the obligations of the corporation where the directors are by law liable in their capacity as directors for the payment of such obligations.

s. 50(14)

Exception – A provision for the compromise of claims against directors may not include claims that

(a) relate to contractual rights of one or more creditors arising from contracts with one or more directors; or

(b) are based on allegations of misrepresentation made by directors to creditors or of wrongful or oppressive conduct by directors.

s. 50(15)

Powers of court – The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be just and equitable in the circumstances.

s. 59(1)

Court to hear report of trustee, etc. – 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.

s. 59(2)

Court may refuse to approve the proposal – 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.

s. 59(3)

Reasonable security – 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.

s. 173(1)

Facts for which discharge may be refused, suspended or granted conditionally – The facts referred to in section 172 are:

(a) the assets of the bankrupt are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities, unless the bankrupt satisfies the court that the fact that the assets are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities has arisen from circumstances for which the bankrupt cannot justly be held responsible;

b) the bankrupt has omitted to keep such books of account as are usual and proper in the business carried on by the bankrupt and as sufficiently disclose the business transactions and financial position of the bankrupt within the period beginning on the day that is three years before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included;

(c) the bankrupt has continued to trade after becoming aware of being insolvent;

(d) the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet the bankrupt's liabilities;

(e) the bankrupt has brought on, or contributed to, the bankruptcy by rash and hazardous speculations, by unjustifiable extravagance in living, by gambling or by culpable neglect of the bankrupt's business affairs;

(f) the bankrupt has put any of the bankrupt's creditors to unnecessary expense by a frivolous or vexatious defence to any action properly brought against the bankrupt;

(g) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, incurred unjustifiable expense by bringing a frivolous or vexatious action;

(h) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, when unable to pay debts as they became due, given an undue preference to any of the bankrupt's creditors;

(i) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, incurred liabilities in order to make the bankrupt's assets equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities;

(j) the bankrupt has on any previous occasion been bankrupt or made a proposal to creditors;

- (k) the bankrupt has been guilty of any fraud or fraudulent breach of trust;
- (l) the bankrupt has committed any offence under this Act or any other statute in connection with the bankrupt's property, the bankruptcy or the proceedings thereunder;
- (m) the bankrupt has failed to comply with a requirement to pay imposed under section 68;
- (n) the bankrupt, if the bankrupt could have made a viable proposal, chose bankruptcy rather than a proposal to creditors as the means to resolve the indebtedness; and
- (o) the bankrupt has failed to perform the duties imposed on the bankrupt under this Act or to comply with any order of the court.

SCHEDULE C
VARIOUS ROLES OF DREW CRAIG AND
KENNETH BICKNELL AND THEIR RELATED COMPANIES IN RESPECT
OF THE PROPOSAL OF DIGITAL UNDERGROUND MEDIA INC.

[See Attached]

**Various Roles of Drew Craig (“Craig”) and Kenneth Bicknell (“Bicknell”)
and their Related Companies in Respect of the Proposal of Digital Underground Media Inc. (“DUMI”)**

**J.D. Craig Holdings Inc.
(DUMI’s Principal Secured Creditor, DIP Lender
and Second Largest Shareholder)**

Craig: 50% shareholder (the other 50% being held by parties related to Craig).

Notes:

- J.D. Craig Holdings Inc. is listed as having a \$2,511,030.78 secured claim and as at July 27, 2015, held 414,697 Class B Common Shares of DUMI.
- Together, J.D. Craig Holdings Inc. and DUM Holdings Inc. hold all of DUMI’s secured debt.
- With 7677189 Canada Ltd. (the Proposal Sponsor), will hold all of DUMI’s share capital if the Proposal is approved.

**DUM Holdings Inc.
(Secured Creditor of DUMI and Shareholder)**

Craig: (1) Officer, (2) Director and (3) principal shareholder (approximately 75%).

Bicknell: (1) Director and (2) minority shareholder.

Notes:

- DUM Holdings Inc. is listed as having a \$528,291.47 secured claim and as at July 27, 2015 held 10,000 Class B Common Shares of DUMI.
- Together, J.D. Craig Holdings Inc. and DUM Holdings Inc. hold all of DUMI’s secured debt.

**Digital Underground Media Inc.
(Debtor in the Proposal Proceedings)**

Craig: (1) Chairman, (2) one of the two members of the Board of Directors; and (3) the second largest shareholder (through J.D. Craig Holdings Inc. and DUM Holdings Inc.).

Bicknell: President and Chief Executive Officer, (2) one of the two members of the Board of Directors, and (3) shareholder (Bicknell, personally and through the Bicknell Trust held 65,494 Class B Common Shares as at July 27, 2015).

**7677189 Canada Ltd.
(Proposal Sponsor)**

Craig: Sole director and 100% shareholder.

Notes:

- Under the Proposal, the Proposal Sponsor will provide \$76,000 to form the Proposal Fund to be distributed to unsecured creditors (providing a recovery of approximately 11.5 cents on the dollar).
- With J.D. Craig Holdings Inc. (the DIP Lender), will hold all of DUMI’s share capital if the Proposal is approved.

**IN THE MATTER OF THE *BANKRUPTCY AND INSOLVENCY ACT*,
R.S.C., 1985, c. B-3, AS AMENDED**

Court File No. CV-17-00582960-00CL

**AND 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**

**ONTARIO
SUPERIOR COURT OF JUSTICE
(IN BANKRUPTCY AND INSOLVENCY)**
Proceeding commenced at Toronto

**FACTUM OF
FORWARD DIMENSION CAPITAL 1 LLP
(Application returnable November 14, 2017)**

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