CITATION: FT ENE Canada Inc. (Re), 2019 ONSC 5793
COURT FILE NO.: 31-OR-208344-T and CV-18-61369
DATE: 20191007

SUPERIOR COURT OF JUSTICE – ONTARIO

(COMMERCIAL LIST) – Bankruptcy and Insolvency

IN THE MATTER OF THE PROPOSAL OF FT ENE CANADA INC.,

of the City of Brantford, in the Province of Ontario

BEFORE: Penny J.

COUNSEL: *Alexander Ilchenko* for Proposal Trustee

Mervyn Abramowitz and Alexandra Teodorescu for FT ENE Canada Inc.

Michael Nowina for Finetex ENE Inc.

Timothy R. Dunn for JC Park

Patrick Shea for Yoonjun Park

HEARD: September 26, 2019

ENDORSEMENT

Overview

[1] This is a motion by the proposal trustee of FTE Canada, MNP Ltd., for an order approving FTE Canada's proposal. The proposal was approved by100% of the creditors permitted to vote.

[2] Finetex is the parent of FTE Canada. It has by far the largest monetary claim of FT Canada's creditors. Its vote against the proposal was disregarded by the chair of the creditors' meeting by virtue of ss. 54(3) and 109(6) of the BIA.

[3] Finetex opposes the motion, as is its right under s. 109(6) of the BIA. Its principal objection is the scope of the release being granted to JC Park under the proposal. JC Park is the sole director of FTE Canada.

[4] For the reasons that follow, the motion is granted.

Background

[5] Finetex ENE Inc. (Finetex) and FT ENE Canada Inc. ("FTE Canada") are in the nanofibre business. FTE Canada is a wholly-owned subsidiary of Finetex, which is a Korean company. FTE Canada operates a manufacturing facility in Brantford which employs 13 people.

[6] JC Park is the founder of this business. He has had a falling out with Finetex. Park has been removed from office as a "representative director" of the parent Finetex.

[7] Park is the owner of the principal technology/IP necessary to this business. He granted a license to Finetex to use that technology. Finetex is itself embroiled in insolvency proceedings in Korea under the *Debtor Rehabilitation and Bankruptcy Act*.

[8] As a result of his falling out with Finetex and Finetex's insolvency proceedings, Park has purported to terminate the licence agreement with Finetex. He has an agreement with FTE Canada, however, which enables FTE Canada to continue to use the technology. Finetex has taken the position that the termination is ineffective.

[9] Finetex has also made serious allegations of wrongdoing against Park, which include fraud, breach of fiduciary duty and various forms of self-dealing.

[10] FTE Canada filed an NOI to avoid being drawn into and controlled by Finetex's Korean insolvency proceedings. The proposal trustee is MNP. The NOI was filed in February 2019.

[11] As is apparent from this summary, FTE Canada's NOI proceedings are taking place in the context of a larger corporate commercial/shareholder dispute between the shareholders of the Korean parent, Finetex. This circumstance has had profound implications for the conduct of the NOI proceedings and the positions taken by FTE Canada, Park and Finetex in these proceedings.

[12] In June 2019 I dismissed a motion by Finetex to remove Park as the director of FTE Canada. I did so in part because Finetex had not attempted to avail itself of its prerogative, as 100% shareholder of FTE Canada, to remove Park by shareholder resolution at a properly constituted meeting of FTE Canada's shareholders.

[13] In August 2019 (that is, shortly after the release of my decision dismissing the Finetex motion), Finetex called a special meeting of shareholders of FTE Canada and, as 100% shareholder, passed a resolution which, among other things, removed Park as a director of FTE Canada.

[14] FTE Canada and Park have taken the position that the shareholder meeting was improperly held and that the resolution is of no force or effect. That issue remains outstanding as Finetex has taken no further steps to enforce its purported resolution and removal of Park.

[15] A proposal was made to the proposal trustee by FTE Canada on August 2, 2019. Notice was given to all creditors of a meeting to consider the proposal. The proposal trustee ultimately concluded that Finetex, being the 100% shareholder of FTE Canada, was "related" to FTE Canada. Finetex claimed to be owed about $7.5 million by FTE Canada. Its claim vastly overwhelms all other debts, which are essentially trade creditors owed about $46,000. Finetex's claim was accepted for voting purposes at $3.5 million. However, at the meeting, the chair concluded, under section 109(6) of the BIA, that the outcome of the vote was determined by the Finetex vote against the proposal and, as a non-arm's-length party, its vote should be disregarded. The remaining creditors, all trade creditors who, under the proposal, would recover 100 cents on the dollar, voted in favour of the proposal and the proposal was accepted.

[16] A significant aspect of the proposal involves Park's removal as a director immediately upon the proposal being approved. Another significant aspect of the proposal is the grant of a release to FTE Canada's officers and directors. Significant attempts were made to negotiate the form of release before the creditor vote but, although significant progress was made, the parties were unable to achieve comprehensive agreement on this issue.

[17] The proposal trustee brings this motion for an order:

(a) approving FTE Canada's proposal and the associated release of the officers and directors; and

(b) approving the activities of the proposal trustee and the payment of its fees and disbursements as well as those of its counsel.

[18] Having had its vote disregarded, such that its otherwise deciding vote against the proposal was ineffective, Finetex has asserted its rights under s. 109(6) of the BIA to ask the *court* to include Finetex's vote and to determine another outcome, i.e., that the proposal has been rejected, triggering a bankruptcy of FTE Canada. Finetex also argues that the proposal should not be approved on other grounds.

[19] Although Finetex made a number of arguments, the essential issue in dispute is the scope of the release that should be made available to the officers and the director of FTE Canada. Specifically, the issue is whether possible claims under ss. 95 to 101.1 of the BIA should be included in the release (the "95 – 101.1 release" issue).

The Exclusion of the Finetex Vote

[20] The two issues, exclusion of the Finetex vote and the 95 – 101.1 release, are intertwined. This is because the importance to Finetex of its vote to reject the proposal was not really to assert its monetary claim in a bankruptcy. The liquidation value of FTE Canada is around $1.8 million. The consequence of the proposal, if approved, apart from costs, is a payment of $46,000 to trade creditors. Another important consequence of the proposal, if approved, is the resignation of Park as a director. Thus, although in a bankruptcy Finetex would receive the lion's share of available funds from a liquidation (while trade creditors would get a fraction of their claims), under the proposal Finetex regains control of FTE Canada without further litigation and, therefore, obtains indirect control of all FTE Canada's assets. Finetex wanted its vote to count because of the leverage it would gain in extracting a more limited release for Park, i.e., no 95 – 101.1 release.

[21] Nevertheless, the Finetex vote having been excluded, Finetex maintains its position that its vote against the proposal should be counted, therefore triggering a bankruptcy.

[22] The only authority on the issue of the Court's review of the chair's decision to disregard a vote is the decision of the Québec Superior Court in *Re Saargummi Quebec Inc.* (2006), EYB 2006-106495. As noted, the BIA provides that the vote as counted by the chair excluding a related party vote stands unless the court "considers it appropriate to include the creditor's vote and determines another outcome." In *Saargummi* the Québec Superior Court found that there was no established test for the exercise of this discretion. Dumas J., therefore, found that the exercise of the Court's discretion under s. 109(6) should be based on "the objectives sought by the legislator when drafting" the BIA. This involves a consideration of six factors:

(1) the rehabilitation of the debtor;

(2) rapid and orderly realization of the debtor's property;

(3) cancellation of preferential payments and revisable transactions;

(4) fair distribution of the debtor's assets;

(5) effective business reorganization of companies in financial difficulty;

(6) protection of the public interest; and

(7) the person asking for the exercise of judicial discretion must be acting in good faith and have "clean hands."

No one factor is determinative. Not all factors must be met but they all inform the exercise of judicial discretion.

[23] This is a very unusual case. As noted in my June 2019 decision, the bankruptcy issues have been influenced by the strategic considerations of both parties in the larger corporate/shareholder dispute between Park and Finetex.

[24] Finetex's main argument is that the chair of the creditors' meeting was wrong to conclude that just because Finetex was "related" to FTE Canada, it was not dealing "with the debtor at arm's length" within the prior year.

[25] The term "arm's-length" is not defined in the BIA. Whether the parties were at arm's-length is a question of fact, BIA, s. 4(4).

[26] The leading case on the meaning of arm's length in the BIA is *Piikani Nation v. Piikani Energy Corp.*, 2003 ABCA 293. In *Piikani*, the Alberta Court of Appeal held that jurisprudence under the *Income Tax Act* provides the most appropriate guidance for determining whether two parties deal at arm's-length in connection with the BIA. The court came to this conclusion for essentially four reasons: 1) the terms 'related persons' and 'arm's-length' are similar in both statutes; 2) when these terms were incorporated into the BIA, they had already existed in the ITA for some time; 3) cases defining arm's-length in the BIA had already drawn on ITA jurisprudence for interpretive guidance; and 4) the "statute book" approach to interpretation seeks to minimize conflict or incoherence between similar language used in different enactments of the same legislative entity.

[27] The general concern in non-arm's-length transactions is that there is no assurance that such a transaction "will reflect ordinary commercial dealing between parties acting in their separate interests." Provisions dealing with non-arm's-length parties are "intended to preclude artificial transactions from conferring" benefits on one or more of the parties, *McLarty v. R.*, 2008 SCC 26 at 43, citing *Swiss Bank Corp. v. Minister of National Revenue,* [1972] SCR 1144 at p 1152.

[28] Thus, the concept of a non-arm's length relationship is one in which there is no incentive for the transferor to maximize the consideration for the property being transferred in negotiations with the transferee. It is intended to address situations in which the economic self-interest of the

transferor is, or is likely to be, displaced by other non-economic factors that result in the consideration for the transfer failing to reflect the value of the transferred property, *Juhasz (Trustee of) v. Cordeiro*, 2015 ONSC 1781.

[29] Finetex maintains that it has been in opposition to Park (and FTE Canada by virtue of Park's control and direction) for some time. Park has caused FTE Canada to "shut out" Finetex from both information about and control of FTE Canada. Thus, Finetex argues, the outcome of the vote (before Finetex's vote was disregarded) was not determined by the vote of someone who was not dealing at arm's length with the debtor.

[30] There is some evidence to support the proposition that Finetex and Park have been in opposition since October 2018. I am not satisfied, however, that this necessarily leads to the conclusion that Finetex and FTE Canada were not "at arm's length." This is in part because Finetex owns 100% of FTE Canada's shares and has been seeking to remove Park for many months. It will, if the proposal is approved, immediately regain control of FTE Canada because Park must resign.

[31] As the proposal trustee argues at para. 36 of its factum, if the vote of Finetex is counted, triggering a bankruptcy, Finetex would be achieving a result which is precisely what s. 109(6) of the BIA was designed to prevent – a result where the insider determines the acceptance (or rejection) of a proposal to the detriment of ordinary, unrelated creditors. If the vote of Finetex remains excluded and the proposal is approved, all the unrelated, ordinary creditors are paid in full (and will presumably be willing to continue to do business with the post-proposal FTE Canada). By contrast, counting the vote of Finetex results in "another outcome;" the proposal is rejected, triggering a bankruptcy, and the related party is paid the vast majority of the net proceeds of the liquidation of FTE Canada's assets while the unrelated trade creditors receive but a small fraction of their entitlements.

[32] I am not prepared to say that the chair was demonstrably wrong in deciding to disregard Finetex's vote.

[33] Finetex's second argument focuses on the discretion available to the Court under s. 109(6) of the BIA. However, I assess the *Saargummi* factors as follows:

(1) the proposal advances the rehabilitation of the debtor;

(2) the proposal involves a rapid and orderly realization of the debtor's property;

(3) there is no evidence of any preferential payments or revisable transactions (this is discussed in more detail below);

(4) there is nothing unfair about the distribution of the debtor's assets under the proposal because, once the proposal is approved, Park resigns and Finetex can take control of FTE Canada and its assets;

(5) there is no evidence the proposal does not entail an effective business reorganization in light of FTE Canada's financial difficulty;

(6) under the proposal the FTE Canada business survives and continues to employ a dozen or more people in the Brantford area, all in the public interest; and

(7) there is no evidence of bad faith or that Finetex does not come to the Court with clean hands.

[34] Factors one through six all support non-interference with the vote under s. 109(6). Since factor seven is a threshold issue (a necessary but not sufficient condition for the exercise of the Court's discretion), it cannot, standing alone, carry the day.

[35] For these reasons, I find it is not appropriate to exercise my discretion under s. 109(6) of the BIA to overturn the chair's determination of the appropriate vote at the meeting of creditors.

The 95 – 101.1 Release

[36] Sections 95 to 101.1 of the BIA deal with preferences (transfers of property which give one creditor preference over another) and transfers at undervalue (dispositions of property for no consideration or consideration which is conspicuously less than the fair market value).

The Proposal Provisions

[37] The following sections of the proposal are relevant to the proper analysis of this issue.

[38] As noted, s. 1.1(g) of the proposal defines "Claim" to include "any claims which might be made by a trustee in bankruptcy or creditor or any other party pursuant to sections 95 to 101.1 of the *BIA* or under a statute or common law rule similar to these sections."

[39] Section 3.5 of the proposal "Claims Against Directors or Deemed Director" provides:

> Any Claims (other than those set out in section 50(14) of the *BIA*, which for greater certainty includes a claim for oppression, breach of fiduciary duty or that falls within section 178 of the *BIA*, including without limitation allegations of fraud, embezzlement, misappropriation and/or defalcation) against any Director, including any deemed director, that relate to obligations of such persons to the Company or actions taken by such person on behalf of or to support the interests of the Company or where the directors are under any law liable in their capacity as directors for the payment or performance of such obligations which occurred prior to the filing date (a "**Director Claim**") shall, on the Implementation Date be and are hereby, compromised and released and forever discharged as against the directors of the Company.

[40] Section 7.3, "Consents, Waivers and Agreements" provides that each creditor, including related parties, "will be deemed":

(c) to have released the Company, the Proposal Trustee and all of their respective affiliates, employees, agents, officers, shareholders, advisors (including without limitation counsel for the directors), consultants and solicitors from any and all demands, claims, actions, causes of action, counter claims, suits, debts, sums of money, accounts, covenants, damages, judgements, expenses, executions, liens, set

> off rights and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any Person may be entitled to assert, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Implementation Date, relating to or arising out of or in connection with the matters herein, including, without limitation, those claims which could have been advanced or pursued pursuant to sections 95 to 101.1 of the *BIA*.

"Directors" are conspicuously absent from this list.

[41] Subsection (e) of this section goes on to provide that:

> Notwithstanding s. 7.3(d), nothing in this Proposal or in 7.3(d) constitutes a release of the Company and/or its employees, affiliates, officers and directors in respect of a claim for oppression, breach of fiduciary duty or that falls within section 178 of the *BIA*, including without limitation allegations of fraud, embezzlement, misappropriation and/or defalcation.

"Directors" are included in this list.

[42] Finally, s. 7.4, "Conditions Precedent to Proposal Implementation" provides that the implementation of the Proposal is conditional upon fulfilment or satisfaction of certain conditions, which include:

> Finetex will be provided with an opportunity to conduct a site visit and orientation at the Company's leased premises prior to September 17, 2019;
>
> Finetex shall be provided with all available current operational information relating to the Company as well as all operational information in the three months preceding the date of the Proposal including but not limited to lease information, details on capital assets and government remittances, accounts receivables and account payable information and customer and sales information;
>
> JC Park shall resign from all positions with the Company effective one day after the Approval Date; and
>
> Finetex will be provided with keys to the Company's leased premises, passwords to access the Company's premises and data and access to the Company's books and records.

The Finetex Position

[43] Finetex represents that it and FTE Canada have possible claims against Park and his son-in-law Yoonjun Park. The evidence of Yongwon Kim, Finetex's "representative director," is that he filed a "statement of claim" with a Korean district prosecutor's office on behalf of Finetex. The "claim" is said to allege that Park "(a)…manipulated the accounting of Finetex and FT Philippines by creating false sales in order to publish the profit and loss of Finetex being in the black in the quarterly reports of 2017, and (b) had FT Philippines deal with the company under their control

for their own good." No translated copy of this "claim" has been put in evidence before the Court nor is there any evidence of civil proceedings in any other jurisdiction.

[44] There is also a report, described in my June 2019 endorsement, which alleges that Park and others, among other things, fraudulently created a "middle man" corporation which bought products from one FTE entity and sold them to another FTE entity at a markup, thereby secretly diverting profits that would otherwise have accrued to the FTE business, to himself.

[45] Finetex objects to Park receiving a release of any kind. In particular, Finetex objects to the inclusion, in the definition of "Claim" in the proposal, of "any claims which might be made by a trustee in bankruptcy or creditor or any other party pursuant to sections 95 to 101.1 of the *BIA* or under a statute or common law rule similar to these sections."

[46] Finetex argues that, even if I approve the proposal, I should only do so conditional upon the release of sections 95 to 101.1 claims being excised from the proposal, relying on the decision of Garson J. in *Innovative Coating Systems Inc., Re* 2017 ONSC 3070 at paras 30 and 31.

The Law

[47] In *Re Kitchener Frame Ltd.*, 2012 ONSC 234 Morawetz J. (as he then was) confirmed the three-part test for the approval of a proposal under s. 59(2) of the BIA; that is, the proposal must be:

(1) reasonable;

(2) calculated to benefit the general body of creditors; and

(3) made in good faith.

[48] The nature and scope of releases under a proposal are an important consideration in evaluating the reasonableness of that proposal. In *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, the Court of Appeal for Ontario set out the criteria for assessing a release in the context of a Plan under the CCAA. I am aware of no reason why these criteria are not equally applicable to a proposal. They include:

(a) the parties to be released are necessary and essential to the debtor's proposal;

(b) the claims to be released are rationally related to the purpose of the proposal and necessary for it;

(c) the proposal cannot succeed without the releases;

(d) the parties who are to have claims against them released are contributing in a tangible and realistic way to the proposal;

(e) the proposal will benefit not only the debtor company but creditors generally;

(f) the voting creditors who have approved the proposal did so with knowledge of the nature and effect of the releases; and that

(g) the releases are fair and reasonable and not overly broad or offensive to public policy.

Analysis

[49] It is common ground that the parties to this disagreement about the 95 – 101.1 release were consulted and had input into the terms and the language of the amended proposal. The report of the proposal trustee documents a process by which the original creditors' meeting was adjourned to consider proposed amendments to the proposal and allow time for Finetex and its counsel to review the proposed amendments and obtain instructions from Mr. Kim. During the adjournment period, there were discussions and negotiations, following which FTE Canada amended its proposal to reflect some of the things Finetex had demanded. There was no agreement, however, about excising the 95 – 101.1 release from the proposal.

[50] In light of the controversy over this issue, the proposal trustee undertook a limited review of the FTE Canada's banking records over the past five years to identify potential preferences and transactions at undervalue and, in particular, with respect to related parties. Based on the proposal trustee's review, two issues were identified:

(i) there were a number of transactions, including some with related parties (including Finetex), which the proposal trustee did not have the time to review in detail or obtain explanations or supporting documents which might have enabled the proposal trustee to comment on the propriety of the transaction; and

(ii) there were a few months of missing bank statements that could not be located which impaired the proposal trustee's ability to complete its review.

Accordingly, the proposal trustee concluded that it would neither support nor oppose the inclusion in the amended proposal of the 95 – 101.1 release.

[51] It is also relevant to my analysis of this issue that no one, other than the proposal trustee (as outlined above) filed any evidence to support their position for or against the inclusion of the 95 – 101.1 release in the proposal.

[52] Examining the factors set out in *Metcalfe, supra,* I find as follows.

(a) Necessary and Essential

[53] Park was necessary and essential to FTE Canada's proposal. It was at his direction that the proposal was initiated and brought forward.

(b) Rationally Related

[54] Lack of evidence on this issue makes the analysis more difficult. In effect, Park and FTE Canada argue that the 95 – 101.1 release is rationally related to the proposal because that is what it took for the amended proposal to be approved by the directing mind of FTE Canada. I do not find this approach particularly helpful, although I acknowledge that in the ebb and flow of insolvency litigation, what a party is prepared to accept on one issue may in some circumstances be evidence that it is rationally related to the proposal as a whole.

[55] I view the issue differently, however. Finetex's allegation is that it has claims against Park for, among other things, the secret diversion of profits from FTE entities to himself and the intentional misrepresentation of revenues to improve the "look" of FTE entities' financial statements.

[56] The release language which forms part of the proposal excludes from the release claims under s. 50(14) and s. 178 of the BIA. Thus, excluded from the release in the proposal are claims against directors that relate to contractual rights of creditors arising out of contracts with one or more directors or are based on allegations of misrepresentation made by directors to creditors or of wrongful or oppressive conduct by directors. The proposal also excludes from the release claims arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity or any debt or liability resulting from obtaining property or services by false pretenses or fraudulent misrepresentation.

[57] In light of these exclusions, any conduct of Park which fell into one of these categories, even if it related to a ss. 95 to 101.1 preference or undervalue transaction, would not be released.

[58] During argument, I asked counsel for Finetex what his client would be getting by excising the 95 – 101.1 release that it would not already be getting by virtue of the limitations on the release in the existing proposal. Mr. Nowina could not articulate a specific, or a general category of, claim that, having regard to Finetex's pending allegations and concerns, would not be excluded from the release under the existing terms of the proposal. The concern, he said, is "we do not know what we do not know."

[59] Given that the release defined in the proposal excludes every category of claim which Finetex has, to date, described and that Finetex cannot describe a potential claim it might have against Park that would not be caught by the existing exclusions from the release, I find the release is rationally related to the proposal in the circumstances.

(c) Cannot Succeed Without

[60] Again, given the limited nature of the evidence, what I have to go on is the representations of counsel for Park and FTE Canada to the effect that the existing proposal, as amended through negotiation as described above, is what the company, through Park, is willing to accept. The lack of evidence makes it difficult to say this criterion has been fulfilled.

(d) Contribution By Releasee

[61] As described in sub-heading (a) above, Park has contributed to the proposal in a material way although it is clear he has made no financial contribution.

(e) Benefit Creditors Generally

[62] I have no hesitation in concluding that the proposal benefits creditors generally because, in the absence of the proposal being approved, FTE Canada will be liquidated and the trade creditors will receive only a fraction of what they are owed. The employees will also all lose their jobs.

(f) Knowledge of Voting Creditors

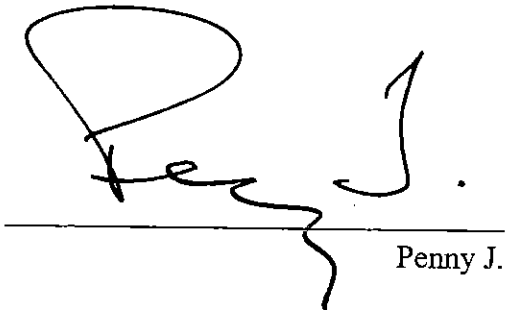
[63] The amended proposal was put before the creditors at the continued creditors' meeting. It is clear the terms of the release were known to the creditors. It was common ground among counsel at the hearing, however, that the trade creditors were entirely indifferent to the terms of the release one way or the other.

(g) Fair and Reasonable

[64] The proposal, if approved, results in the unrelated, ordinary creditors being paid in full, the business continuing and the empoyees' jobs being preserved. The scope of the exclusions from the release under the proposal appears to cover any claim articulated by Finetex. I find the release to be fair and reasonable.

Approval of the Proposal

[65] For reasons outlined in this decision, I find the proposal is reasonable. I also find that the proposal is calculated to benefit the general body of creditors. Finally, there is no evidence that the proposal has been made in bad faith. Accordingly, the proposal, as approved by the voting creditors, is approved. The activities of the proposal trustee and the payment of its fees and disbursements as well as those of its counsel are also approved.



Penny J.

Date: October 7, 2019