Not Every Vote Matters: Non-Arm's Length Parties During Proposals Under the Bankruptcy and Insolvency Act

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FT ENE Canada Inc. (FECI) was in the nanofibre business, and was a wholly owned subsidiary of Finetex ENE Inc. (Finetex). As a result of insolvency difficulties separate and apart from the Canadian business, Finetex was engaged in bankruptcy proceedings in Korea (its home jurisdiction). There was animosity between Finetex and the director of FECI.

To avoid being caught in the Korean proceedings, FECI filed a Notice of Intention to Make a Proposal with the Ontario Superior Court of Justice. FECI's outstanding obligations were owed almost exclusively to Finetex. FECI owed $46,000 to trade creditors, and approximately $7.5 million to Finetex. The proposal was made on August 2, 2019.

The trade creditors, who would recover 100 cents on the dollar under the proposal, all voted in favour of the proposal. Finetex however voted against it. While Finetex's vote would have normally been determinative of the outcome of the proposal, the Chair of the meeting of the creditors concluded that Finetex was a non-arm's length party, and discounted Finetex's vote pursuant to sections 109(6) and 54(3) of the *Bankruptcy and Insolvency Act* (*BIA*). The proposal therefore passed despite Finetex's opposition.

The proposal trustee brought a motion for the Court to approve the proposal. Finetex opposed the motion, and argued that the Court should use its discretion under section 109(6) of the *BIA* to count its vote regardless of the Chair's decision.

One of the issues before the Court therefore, was whether or not the Court should exercise its discretion to include Finetex's vote on the proposal.

The Court began its analysis by reviewing whether Finetex was a non-arm's length party to FECI. The Court noted that the relationship between parties is a question of fact under section 4(4) of the *BIA*. The Court found that one of the concerns regarding non-arm's length transactions was that they do not reflect the ordinary commercial dealings between parties acting in their own self-interest.

In this instance, while the Court agreed that Finetex had been at odds with the director of FECI, the Court determined that Finetex owned 100% of the outstanding shares of FECI, and as such, it was a non-arm's length party.

Having found that Finetex was a non-arm's length party, the Court then reviewed the factors that guide the Court's exercise of discretion pursuant to section 109(6):

1. The rehabilitation of the debtor;
2. The rapid and orderly realization of the debtor's property;
3. The cancellation of preferential payments and revisable transactions;
4. The fair distribution of the debtor's assets;
5. The effective business reorganization of companies in financial difficulty;
6. The 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."

The Court found that under the circumstances, factors 1-6 weighed in favour of non-interference with the vote. While the Court found that Finetex had clean hands, it was insufficient on its own for the Court to exercise its discretion. Accordingly, the Court determined that it would not interfere with the Chair's decision to exclude Finetex's vote, and approved the proposal.

By

Scott Pollock

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BLG Offices

Calgary
Centennial Place, East Tower
520 3rd Avenue S.W.
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F 403.266.1395

Ottawa
World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver
1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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