

District of ONTARIO
Division No. 09 - Toronto
Estate No. 31-2504280
Court No. 31-2504280

ONTARIO
SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE PROPOSAL OF
TOONBOX ENTERTAINMENT LTD.
OF THE CITY OF TORONTO,
IN THE MUNICIPALITY OF METROPOLITAN TORONTO,
IN THE PROVINCE OF ONTARIO.

AND

District of ONTARIO
Division No. 09 - Toronto
Estate No. 31-2504276
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SUPERIOR COURT OF JUSTICE
IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE PROPOSAL OF
THE NUT JOB 2 PRODUCTIONS INC.
OF THE CITY OF TORONTO,
IN THE MUNICIPALITY OF METROPOLITAN TORONTO,
IN THE PROVINCE OF ONTARIO.

AND

Court File No. CV-19-618364-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N:

PACIFIC MERCANTILE BANK

Applicant

- and -

THE NUT JOB 2 PRODUCTIONS and TOONBOX ENTERTAINMENT LTD.

Respondent

FIRST REPORT OF THE PROPOSAL TRUSTEE AND INTERIM RECEIVER

MAY 27, 2019

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INTRODUCTION

1. On April 10, 2019 Pacific Mercantile Bank (“PMB”) brought Applications for Bankruptcy Orders against Toonbox Entertainment Ltd. (“Toonbox”) and The Nut Job 2 Productions Inc. (“Nut Job”, and collectively, the “Companies”), returnable May 7, 2019.
2. PMB brought a further application for the appointment of an Interim Receiver to preserve the assets of the Companies, until such time as Bankruptcy Orders were issued. On April 18, 2019, by Order of the Honourable Mr. Justice Hailey of the Ontario Superior Court of Justice, BDO Canada Limited (“BDO”) was appointed as Interim Receiver of all assets, undertakings and properties of the Companies (the “Interim Receiver”). The Order is attached hereto as Appendix “I”.
3. The Companies and PMB subsequently agreed that an orderly sale of assets “*en bloc*” would maximize realization and, accordingly, the Applications for Bankruptcy Orders were adjourned to June 4, 2019 to allow the Companies to file Proposals under the *Bankruptcy and Insolvency Act* (“BIA”).
4. On April 28, 2019, the Companies each filed a Proposal, naming BDO as the proposal trustee (the “Proposal Trustee”). A copy of each respective Proposal, together with each Certificate of Filing dated April 29, 2019, is attached hereto as Appendix “II” and Appendix “III”. Lipman Zener Waxman PC (“LZW”) is counsel to the Proposal Trustee/Interim Receiver.
5. On May 21, 2019 separate First Meetings of Creditors were held for each of Toonbox and Nut Job. Both meetings were adjourned *sine-die* pending the outcome of the proposed sale process of the assets of the Companies. Copies of the Reports of Trustee on Proposal and Supplementary Report of Trustee on the Companies’ proposals are attached hereto as Appendix “IV”.

PURPOSE OF REPORT

6. This is the first Report of the Proposal Trustee/Interim Receiver (the “Report”) for both Companies’ estates. The purpose of the Report is to:
 - a) provide this Court with information regarding:
 - (i) the activities of the Proposal Trustee/Interim Receiver to date; and
 - (ii) the proposed sales process (as described elsewhere in this Report); and

- b) respectfully request that this Court grant an order that:
- (i) approves the proposed sales process;
 - (ii) authorizes the Proposal Trustee/Interim Receiver to carry out the sales process and take such incidental steps as it considers necessary or desirable in the circumstances to complete the sales process;
 - (iii) permits the consolidation of the proposal proceedings of each of Toonbox and Nut Job for administrative purposes, including, without limitation, the preparation and filing of motions and reports to creditors, the Official Receiver, and this Court, all as may be required by the BIA;
 - (iv) approves a \$200,000 first-ranking priority charge over all of the Companies' assets, undertakings, and property (the "Administration Charge") in favour of the Proposal Trustee/Interim Receiver and LZW to secure payment of their professional fees and disbursements. The Administration Charge is to rank in priority to all other charges; and
 - (v) approves this Report and the conduct and activities of the Proposal Trustee/Interim Receiver described herein.

DISCLAIMER

7. In preparing this Report, the Proposal Trustee/Interim Receiver has relied upon unaudited financial information prepared by the Companies' representatives, the Companies' books and records and discussions with the Companies' representatives. The Proposal Trustee/Interim Receiver has not performed an audit or other verification of such information.

BACKGROUND

8. Toonbox was incorporated on June 19, 2008 and operated as an animation studio, producing various computer-animated films. Mr. Hong Kim is Toonbox's controlling shareholder and director. Toonbox is a holding company which owns various production companies, including Nut Job.

9. Nut Job was incorporated on April 5, 2013 and is a wholly owned subsidiary of Toonbox. Nut Job was an animation studio and produced the film “The Nut Job 2: Nutty by Nature” (the “Film”).
10. On December 19, 2017 Nut Job entered into a loan agreement with PMB in the amount of US\$8,170,705, secured by a general security agreement in favour of PMB (the “Loan”). Toonbox guaranteed the payment of the loan to PMB.
11. Nut Job was eligible to claim various provincial and federal refundable tax credits for the production of the film (the “Tax Credits”).
12. Nut Job was to use the Tax Credits to repay PMB in full. Pursuant to the Loan agreement with PMB (the “PMB Loan Agreement”) the funds generated from the Tax Credits were to be kept in a separate trust account in favour of PMB, and paid over as soon as possible. Nut Job did not comply with the terms of the PMB Loan Agreement. Instead, the refunded Tax Credits were co-mingled with Toonbox’s funds and allegedly used by Toonbox to fund other ongoing film productions and operations.
13. The Loan matured on March 19, 2019 and Nut Job failed to repay it.
14. On March 20, 2019, having no funds to finance the continuation of business, the Companies ceased operations and Toonbox’s employees were terminated. At the time of the cessation of operations, Toonbox had approximately 40 active and 10 non-active employees.

ACTIVITIES OF PROPOSAL TRUSTEE/INTERIM RECEIVER TO DATE

Redrover Co. Ltd.

15. In 2013, Toonbox entered into a co-production agreement with Redrover Co. Ltd. (“Redrover”) pursuant to which Redrover financed various co-productions being produced by the two parties. Toonbox in turn produced the films. Pursuant to the agreement, the net receipts from the exploitation of the films were to be shared on a 50/50 basis between Toonbox and Redrover. Toonbox advises that it has been unable to obtain an accounting relating to the gross and net receipts from the films and that Redrover has not made any payments to Toonbox.
16. Management of Toonbox has advised the Proposal Trustee/Interim Receiver that in 2017 Redrover suspended its funding to Toonbox on all ongoing projects. Toonbox and its solicitors have advised the Proposal Trustee/Interim Receiver that Toonbox made

numerous attempts to contact Redrover to obtain an accounting, and clarity with respect to Redrover's reasons for the suspension of funding.

17. The Proposal Trustee/Interim Receiver was recently contacted by Lerner's LLP ("Lerner's"), solicitors for Redrover. Lerner's advised the Proposal Trustee/Interim Receiver that Redrover is a significant creditor of Toonbox. Accordingly, the Proposal Trustee/Interim Receiver and LZW are reviewing the various agreements between Toonbox and Redrover and have agreed to work co-operatively with Lerner's to exchange information to determine the rights and duties of the parties pursuant to the various productions, and amounts that may be owed by either company to the other.

Nut Job co-mingled funds with Toonbox

18. After Redrover stopped funding the projects, Toonbox arranged for financing by way of a loan from PMB to Nut Job in the amount of US\$8.17 million, secured by certain Tax Credits expected by Nut Job, related to the production of the film for which it had been incorporated, being "The Nut Job 2: Nutty by Nature".
19. Nut Job received Tax Credits in October of 2018 in the amount of approximately CDN\$9.1 million. The Tax Credits received were to be used to repay PMB; however, only CDN\$3.249 million was paid to PMB. The balance of funds received was transferred by Nut Job to Toonbox to allegedly fund its operations, and repay shareholder loans from Mr. Kim in the amount of \$980,000.
20. The Proposal Trustee/Interim Receiver and LZW are considering the effect of the breach of the PMB Loan Agreement on the assets of Toonbox and Nut Job.
21. This issue represents the major reason for the creditors' decision to defer voting on the Proposals pending a realization process that will result in a definitive realization from the assets of the Companies.

Other Issues- Toonbox

22. The Proposal Trustee/Interim Receiver conducted a search under the *Personal Property Security Act* and determined that the following creditors have registered security interests against Toonbox:
 - ACTRA Performer's Rights Society;
 - Royal Bank of Canada; and
 - Screen Actors Guild-American Federation of Television and Radio Artists.

23. Toonbox advises that no monies are owed to the above mentioned creditors. Accordingly, the Proposal Trustee/Interim Receiver has not incurred the expense of requesting an independent legal opinion of the respective security interests at this time.

Tax Credits

24. Toonbox advises that it is eligible to receive certain Tax Credits for the production of a film titled "Far Fetched". Toonbox estimates these Tax Credits would approximate \$679,242 and become available on finalizing the film, obtaining required certificates and filing necessary returns. The Proposal Trustee/Interim Receiver has not yet determined the feasibility of completing the film.

Machinery, Equipment, Furniture and Fixtures

25. On ceasing operations on March 21, 2019, Toonbox moved its equipment, furniture and fixtures (collectively "Equipment") from its registered place of business to a third party warehouse facility. The Proposal Trustee/Interim Receiver is taking necessary steps to safeguard the Equipment and has commissioned an appraisal of the Equipment.

Franchise Rights and Intellectual Property Rights

26. Toonbox claims to own franchise rights and intellectual property rights (collectively "Rights") in a number, but not all, of its produced films. As noted previously in this Report, Toonbox also engaged in co-production and distribution agreements with Redrover pursuant to which Redrover was responsible for financing certain films, including the Film.

27. The Rights and agreements are being reviewed by LZW.

Other Issues - Nut Job

28. The Proposal Trustee/Interim Receiver conducted a search under the *Personal Property Security Act* and confirmed that the following creditors have registered security interests against Nut Job:

- ACTRA Performer's Rights Society;
- Screen Actors Guild-American Federation of Television and Radio Artists;
- PMB; and
- Redrover.

29. Nut Job advises that monies are owed only to PMB. The Proposal Trustee/Interim Receiver has requested an independent legal opinion on the validity of PMB's security, and on the security claimed by Redrover.

Tax Credits

30. Nut Job is eligible to receive certain Tax Credits for the production of the Film. Nut Job's accountant has estimated total Tax Credits available of \$12,493,483, but only \$9,143,925 was received in October 2018. The Proposal Trustee/Interim Receiver is working with Nut Job's accountant to investigate the discrepancy between the amounts available and received, and to determine whether the remainder is still to be collected.

31. Nut Job's accountant estimates that, in addition to the foregoing amounts, at least \$319,000 of Tax Credits are available for fiscal 2018, once corporate tax returns are available and claims submitted. The Proposal Trustee/Interim Receiver intends to support the accountant's efforts in filing for such Tax Credits.

Potential Employee Claims

32. According to management, Toonbox's employees were paid wages, vacation pay and termination/severance pay at the time of their termination, when Toonbox ceased operations on March 20, 2019. However since the Proposals were filed, some employees have contacted the Proposal Trustee/Interim Receiver to advise that they were not paid their termination and/or severance pay. The Proposal Trustee/Interim Receiver has invited these employees to file proofs of claim.

33. The Proposal Trustee/Interim Receiver is reviewing the books and records of the Companies to determine whether all employees received their proper entitlement pursuant to the Employment Standards Act.

34. In a bankruptcy of Toonbox, the employees would be entitled to claim under the *Wage Earner Protection Program Act*. This entitlement is not normally available in restructurings pursuant to proposals. The Proposal Trustee/Interim Receiver has discussed this matter with Mr. Frank Bennett, counsel to Toonbox. Mr. Bennett has advised that Toonbox would consider amending the Proposal to enable employees to receive similar benefits even under the Proposal.

PROPOSED SALES PROCESS

35. As agreed between the Companies and PMB, as set out in the Proposals, and as discussed with the creditors at the General Meetings of Creditors held on May 21, 2019, The Proposal Trustee is tasked with conducting a sales process for the assets of the Companies (the "Proposed Sales Process"). Since the Proposals have not been accepted by the Companies' creditors yet and approved by Court, and since the Interim Receivership Order granted on April 18, 2019 (see Appendix I) did not grant the Interim Receiver with the Authority to sell the Companies' assets, the Proposal Trustee/Interim Receiver requests the approval of the Proposed Sales Process by this Honourable Court.
36. The details of the Proposed Sales Process are set out in the attached Appendix "V" entitled "Procedures for the Sales Process", which procedures were also attached to Toonbox's Proposal, as filed. The terms of the Proposed Sales Process were negotiated between the Companies and PMB, with the concurrence of the Proposal Trustee/Interim Receiver.
37. The Proposed Sales Process facilitates a bid or bids for the business and assets of the Companies, *en bloc*. The Proposal Trustee/Interim Receiver cannot estimate a potential realization to creditors at this point in time, but expects that the Proposed Sales Process should result in a higher realization to creditors than would be the case in a liquidation process in a bankruptcy scenario. This would be so, as the value of the Companies' intangible assets, such as intellectual property and goodwill of the Companies, would likely be enhanced in an orderly sales process.
38. For the foregoing reasons, the Proposal Trustee/Interim Receiver requests this Honourable Court's approval of the Proposed Sales Process.

CONSOLIDATION OF PROPOSAL PROCEEDINGS FOR ADMINISTRATIVE PURPOSES

39. The Proposal Trustee/Interim Receiver proposes to administer the Companies' Proposal proceedings separately, as each of Toonbox and Nut Job have their own asset pools and separate creditors.
40. However, given that the Companies share common management, share certain creditor obligations and have co-mingled certain assets, it is proposed that Court applications with respect to the Proposal proceedings would be made on an administratively consolidated

basis. This should reduce professional fees and costs and avoid duplication of proceedings before the Court.

41. Additionally, where appropriate to facilitate the administration of the Proposal Proceedings, the Proposal Trustee/Interim Receiver proposes to consolidate certain reports to creditors and the Official Receiver, as may be required by the BIA.
42. In the view of the Proposal Trustee/Interim Receiver, creditors will not be prejudiced by the proposed administrative consolidation of the Companies' Proposal Proceedings. Instead, such administrative consolidation is intended to represent the most efficient and practical approach to dealing with the Proposal Proceedings.
43. For the foregoing reasons, the Proposal Trustee/Interim Receiver requests this Honourable Court's permission to consolidate the administration of the Companies' Proposal Proceedings, as set out herein.

ADMINISTRATION CHARGE

44. As the Companies terminated all operations effective on or about March 20, 2019, there is no cash flow available for professional fees and costs, other than funds which may become available from the assets of the Companies. The Proposal Trustee/Interim Receiver and LZW accordingly seek the protection of a \$200,000 first ranking priority charge over all of the Companies' assets, undertakings and property to secure payment of professional fees and costs incurred in the administration of these proceedings.
45. In the view of the Proposal Trustee/Interim Receiver, the quantum of the proposed Administration Charge is reasonable given the complexities of the transactions between Toonbox and Nut Job on the one hand, and PMB and Redrover on the other hand, and time to be spent on investigations and potential litigation related thereto. Additionally, professional fees and costs will need to be expended on a realization of remaining Tax Credits which may still be available, and on the Proposed Sales Process.

CONCLUSION

46. In conclusion, the Proposal Trustee/Interim Receiver requests the approval of this Honourable Court of this Report and the activities of the Proposal Trustee/Interim Receiver, as reported herein, and recommends that the Court grant an order providing the relief described in paragraph 6(b) of this Report.

All of which is respectfully reported, this 27th day of May, 2019.

BDO CANADA LIMITED

In its capacity as Proposal Trustee/Interim Receiver
of Toonbox Entertainment Ltd. and The Nut Job 2
Productions Inc., and not in its personal capacity

Per:

A handwritten signature in black ink, appearing to read 'Vince Siciliano', written over a horizontal line.

Vince Siciliano, CPA, CGA, CIRP, LIT
Senior Vice President