

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT
ACT
R.S.C. 1985 c.C - 36, as amended**

- and -

**IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF
KOREX DON VALLEY ULC**

APPLICANT

EIGHTH REPORT OF IRA SMITH TRUSTEE & RECEIVER INC.

VOLUME 3

**IN ITS CAPACITY AS COURT-APPOINTED MONITOR OF
KOREX DON VALLEY ULC**

DATED JUNE 25, 2009

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1.0 INTRODUCTION

This Eighth Report Volume 3 ("**Volume 3**") is filed by Ira Smith Trustee & Receiver Inc. ("**ISI**") in its capacity as court-appointed monitor (the "**Monitor**") of all of the assets, undertakings and properties of Korex Don Valley ULC ("**Korex**" or the "**Company**").

All background information regarding this administration and prior Court attendances and Orders is contained in the Monitor's prior Reports to Court.

2.0 PURPOSE OF VOLUME 3

At the Chambers attendance on June 23, 2009, the Monitor provided its Eighth Report to Court, Volumes 1 and 2 to Mr. Justice Wilton-Seigel and provided Volume 1 only to those in attendance in Chambers. After consideration and discussion of the issues raised by the Monitor and its legal counsel in and related to the Eighth Report, His Honour directed the Monitor to file an additional Report dealing solely with the issues of: (i) the assignability of the lease (the “**Factory Lands Lease**”) to the premises occupied by Korex described as 21 Don Valley Parkway, Toronto, ON (the “**Factory Lands**”); (ii) if assignable, who would be entitled to any realization from such assignment, the trustee or the landlord; and (iii) the nature and extent of the population of potential purchasers of a trustee in bankruptcy’s interest in the Factory Lands Lease.

3.0 TRANSFER OF INTEREST IN FACTORY LANDS LEASE

Korex purchased the plant, buildings and equipment (the “**Plant and Equipment**”) of UL Canada Inc. (the “**Unilever**”) located at the Factory Lands pursuant to an asset purchase agreement, dated May 21, 2002 (the “**Purchase Agreement**”). The Factory Lands were excluded from the purchase assets under the Purchase Agreement and Korex leased the Factory Lands from Unilever for a 21-year term.

The assignability of the Factory Lands Lease is a legal question. The Monitor requested its legal counsel, Aird & Berlis LLP (“**Aird**”) to provide the Monitor with its opinion. Aird considered this matter, and opined in its memo to the Monitor dated June 25, 2009 (the “**Aird Memo**”), a copy of which is attached hereto as **Exhibit “A”**.

3.1 Assignment or Sublease by Company

The Aird Memo concludes that if the Company sells substantially all of the buildings and equipment located on the Factory Lands (a “**Comprehensive Sale**”) to a purchaser who agrees to be bound by the Factory Lands Lease and by the Purchase Agreement, it can do so: (i) without seeking Unilever’s consent; (ii) without being subject to any right of first refusal by Unilever; and (iii) without paying over to Unilever any consideration the Company receives for an assignment of the Lease or any rent premium it receives pursuant to the sublease (each, a “**Premium**”). The Company would require Unilever’s consent to the sublease of the Real Property or assignment of the Lease occurring in conjunction with such Comprehensive Sale, but such consent could likely not be refused as long as the new tenant was not a competitor to Unilever.

If the Company was to sublease the Real Property or assign of the Lease outside of a Comprehensive Sale of the Plant and Equipment, it would have to pay over any Premium to Unilever.

3.2 Assignment by Trustee in Bankruptcy

The Aird Memo concludes that if the Company were to make an assignment in bankruptcy, its trustee would have the statutory right pursuant to Subsection 38(2) of the Ontario *Commercial Tenancies Act* to assign the Factory Lands Lease to a party wishing to purchase the trustee’s right, subject to the purchaser meeting the statutory test and complying with the terms of the lease. Aird also concluded that the trustee in bankruptcy, as distinct from the Company, would be entitled to retain any Premium derived as a result of such assignment even the assignment does not occur in conjunction with a Comprehensive Sale of the buildings and equipment.

4.0 POPULATION OF POTENTIAL PURCHASERS

In the short period of time, the Monitor has not been able to determine the total population of potential purchasers for the Factory Lands Lease. It is possible that the population of potential purchasers is larger than originally anticipated as the permitted use clause in the Factory Lands Lease is open to a broad interpretation.

The Monitor contacted the realtor who provided the Monitor with its valuation assessment contained in Volume 2 of the Eighth Report, and asked for the realtor's estimate of how long it would take for the realtor to procure one or more offers for the Factory Lands Lease from a party willing to pay a trustee in bankruptcy an amount equal or greater to \$1.0 million. Although there is no assurance, the realtor advised that it would not take a long period of time.

5.0 SUMMARY

Based on the information contained in this Volume 3, the Monitor's view is that it is possible for: (a) the Company to assign the Factory Lands Lease as part of a Comprehensive Sale of the building and equipment; or (b) a trustee in bankruptcy to assign the Factory Lands Lease subject to the statutory requirements being met, and that, in such cases, the Company or trustee in bankruptcy (as the case may be), and not the Landlord, would be entitled to retain the proceeds from such assignment, which proceeds will be significant.

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All of which is respectfully submitted at Toronto, Ontario this 25th day of June, 2009.

IRA SMITH TRUSTEE & RECEIVER INC.
solely in its capacity as Court-Appointed Monitor
of Korex Don Valley ULC and not in its personal Capacity



Per: _____
President

5474476.3

M E M O R A N D U M

TO: Ira Smith Trustee & Receiver Inc.

DATE: June 25, 2009

RE: Assignment of Lease

Korex Don Valley ULC (the "**Company**") purchased the plant, buildings and equipment (the "**Plant and Equipment**") of UL Canada Inc. (the "**Unilever**") located at the property known municipally as 21 Don Valley Parkway, Toronto (the "**Real Property**") pursuant to an asset purchase agreement, dated May 21, 2002 (the "**Purchase Agreement**"), a copy of which Purchase Agreement (less its schedules) is attached at **Schedule "A"** hereto. The Real Property itself was excluded from the purchase assets under the Purchase Agreement. Unilever leased the Real Property to the Company for a 21-year term pursuant to a lease dated August 18th, 2002 (the "**Lease**"), a copy of which is attached at **Schedule "B"** hereto. Unilever and the Company also entered into a manufacturing agreement, pursuant to which the Company made product for Unilever (the "**Manufacturing Agreement**"), the six-year term of which has since expired.

This memo examines the options available with respect to assignment of the Lease or sublet of the Real Property either (i) by the Company in the context of its *Companies' Creditors Arrangement Act* ("**CCAA**") proceedings, or (ii) by a future trustee in bankruptcy of the estate of the Company.

Terms of the Lease and the Purchase Agreement

Pursuant to the Lease and the Purchase Agreement, at the end of the Lease term, Unilever is to buy back the buildings included in the Plant and Equipment, for the originally allocated purchase price (adjusted for capital expenditures, depreciation and inflation). Now that more than six years have passed since the date of the Purchase Agreement, if the Company wishes to sell the Plant and Equipment to a third party before the end of term, it can do so by a sale of substantially all the Plant and Equipment (such sale defined in Subsection 7.8(a)(ii) of the Purchase Agreement as a "**Comprehensive Sale**"). There are two restrictions on such a sale. One restriction arises from Subsection 7.8(a)(vi) in respect of the sale of the main building; the purchaser must agree to be bound by the Purchase Agreement and, to the extent they are still in effect, the Lease and the Manufacturing Agreement. The other restriction arises from Subsection 7.8(a)(i) and Section 7.15 in respect of a class of assets define as "Defi Assets" used in the manufacture of a specific kind of soap; Unilever retains an option to purchase such Defi Assets for US \$530,000 (plus adjustments for any capital expenditures and depreciation).

If the Company wishes to assign the Lease or sublet the Real Property (in conjunction with a Comprehensive Sale or otherwise), its rights are governed by Article 14 of the Lease. Under Section 14.01, the Company can only assign the Lease or sublet the Real Property with prior, written consent of Unilever, which consent is not to be unreasonably withheld, delayed or conditioned. The Section stipulates that it would be reasonable for Unilever to refuse to consent to an assignment to a competitor or to an assignment to any party that will not be bound by the Unilever's end-of-term buy-back rights. Certain transfers to related parties do not required Unilever's consent.

The Company also cannot assign or sublet to any party whose intended use would not be a permitted use under Article 11 of the Lease. Pursuant to Article 11, the Real Property can be used for any purpose that is "not incompatible" with the production of detergents or warehousing, and that does not

detract from the value of the Real Property and the buildings (any more than would production of detergent).

Where Unilever's consent to an assignment or sublet is required, Section 14.02 sets out the conditions to such consent. These conditions include, at Subsection 14.02(c), the requirement that the Company pay over to Unilever any consideration it receives for an assignment of the Lease or any rent premium it receives pursuant to the sublease (each, a "**Premium**"). This condition concerning Premiums does not, however, apply if the assignment or sublease occurs in conjunction with a Comprehensive Sale.

Transfer by the Company

Now that we are more than six years past the date of the Purchase Agreement, if the Company sells the Plant and Equipment in a Comprehensive Sale to a purchaser who agrees to be bound by the Purchase Agreement and the Lease, it can do so (i) without seeking Unilever's consent, (ii) without being subject to any right of first refusal by Unilever, and (iii) without paying over any Premium to Unilever. The Company would require Unilever's consent to the sublease of the Real Property or assignment of the Lease occurring in conjunction with such Comprehensive Sale, but such consent could likely not be refused as long as the new tenant was not a competitor to Unilever. Sale of the Defi Assets as part of such a transaction would remain subject to Unilever's option to purchase.

If the Company was to sublease the Real Property or assign of the Lease outside of a Comprehensive Sale of the Plant and Equipment, it would have to pay over any Premium to Unilever.

Any sublease of the Real Property or assignment of the Lease by the Company would require that the intended use of the transferee be "not incompatible" with the production of detergents or warehousing, and not detract from the value of the Real Property and the buildings (any more than would production of detergent). In our view this language is broad enough to allow just about any use short of something that would require rezoning incompatible with its current industrial use. A narrower reading might be that the basic infrastructure of the detergent manufacturing facilities would have to be maintained, so that such manufacturing would continue to be possible.

Transfer by a Trustee in Bankruptcy

If the Company made an assignment in bankruptcy, the trustee's right to assign the Lease would arise from Subsection 38(2) of the Ontario *Commercial Tenancies Act*.

Rights of assignee

(2) Despite any provision, stipulation or agreement in any lease or agreement or the legal effect thereof, in case of an assignment for the general benefit of creditors, or an order being made for the winding up of an incorporated company, or where a receiving order in bankruptcy or authorized assignment has been made by or against a tenant, the person who is assignee, liquidator or trustee may at any time within three months thereafter for the purposes of the trust estate and before the person has given notice of intention to surrender possession or disclaim, by notice in writing elect to retain the leased premises for the whole or any portion of the unexpired term and any renewal thereof, upon the terms of the lease and subject to the payment of the rent as provided by the lease or agreement, and the person may, upon payment to the landlord of all arrears of rent, assign the lease with rights of renewal, if any, to any person who will covenant to observe and perform its terms and agree to conduct upon the demised premises a trade or business which is not reasonably of a more objectionable or hazardous nature than that which was thereon conducted by the debtor, and who on application of the assignee, liquidator or trustee, is approved by a judge of the Superior Court of Justice as a person fit and proper to be put in possession of the leased premises. R.S.O. 1990, c. L.7, s. 38 (2); 2006, c. 19, Sched. C, s. 1 (1).

Because the trustee's rights to transfer would arise by statute rather than by the Lease, the transfer would not be subject to the conditions of Article 14 of the Lease.

As a result, the Real Property could be subleased or the Lease could be assigned outside of a Comprehensive Sale without paying any Premium over the Unilever. Under Section 14.02 of the Lease, payment of the Premium is a condition that only arises if Unilever's consent to the transfer is required. The trustee does not need Unilever's consent, and thus payment of the Premium is not a condition to the transfer.

Despite this plain reading of the language of Section 14.02, it might be argued that the language of Subsection 14.02(c) of the Lease means that the right to any additional value under the Lease was not part of the bundle of exclusive rights transferred to the Company by the Lease and thus that the Premium does not form part of the estate. In order for a premium paid over to the trustee to not be divisible amongst the Company's creditors, it would have to be property held by the Company in trust for Unilever¹. In *Allan Realty of Guelph Ltd., Re*, (1979) 29 C.B.R. (N.S.) 229 (Ont. S.C.) at paragraph 28, the Bankruptcy Court cited *Underhill's Law of Trusts and Trustees* as authority on the requirements for a common law trust:

At p. 99, under the heading, "The Three Certainties", we find the following:

1. Certainty of Intention
2. Certainty of Subject-Matter
3. Certainty of Objects

¹ See Section 67.(1) of the *Bankruptcy and Insolvency Act*.

Property of bankrupt

67. (1) The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person;

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides;

(b.1) goods and services tax credit payments that are made in prescribed circumstances to the bankrupt and that are not property referred to in paragraph (a) or (b);

(b.2) prescribed payments relating to the essential needs of an individual that are made in prescribed circumstances to the bankrupt and that are not property referred to in paragraph (a) or (b); or

(b.3) without restricting the generality of paragraph (b), property in a registered retirement savings plan or a registered retirement income fund, as those expressions are defined in the Income Tax Act, or in any prescribed plan, other than property contributed to any such plan or fund in the 12 months before the date of bankruptcy, but it shall comprise

(c) all property wherever situated of the bankrupt at the date of the bankruptcy or that may be acquired by or devolve on the bankrupt before their discharge, including any refund owing to the bankrupt under the Income Tax Act in respect of the calendar year — or the fiscal year of the bankrupt if it is different from the calendar year — in which the bankrupt became a bankrupt, except the portion that:

(i) is not subject to the operation of this Act, or

(ii) in the case of a bankrupt who is the judgment debtor named in a garnishee summons served on Her Majesty under the Family Orders and Agreements Enforcement Assistance Act, is garnishable money that is payable to the bankrupt and is to be paid under the garnishee summons, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

For a trust to come into existence, it must have three essential characteristics. As Lord Langdale M.R. remarked in *Knight v. Knight* (1840), 3 Beav. 148, 49 E.R. 58, affirmed (sub nom. *Knight v. Boughton*) 11 Cl. & Fin. 513, 8 E.R. 1195 (H.L.), in words adopted by Barker J. in *Reehan v. Malone* (1897), 1 N.B. Eq. 506, and considered fundamental in common law Canada, first, the language of the alleged settlor must be imperative; secondly, the subject matter or trust property must be certain; thirdly, the objects of the trust must be certain. This means that the alleged settlor, whether he is giving the property on the terms of a trust or is transferring property on trust in exchange for consideration, must employ language which clearly shows his intention that the recipient should hold on trust. No trust exists if the recipient is to take absolutely, but he is merely put under a moral obligation as to what is to be done with the property. If such imperative language exists, it must secondly be shown that the settlor has so clearly described the property which is to be subject to the trust that it can be definitively ascertained. Thirdly, the objects of the trust must be equally clearly delineated. There must be no uncertainty as to whether a person is, in fact, a beneficiary. If any one of these three certainties does not exist, the trust fails to come into existence or, to put it differently, is void.

We would expect it to be difficult for Unilever to establish these three essential characteristics of a trust, particularly the requirement that there be certainty in the language creating the trust.

Note that we could find no case law dealing specifically with the issue of rights to such Premiums in bankruptcy. We asked for the same from counsel to the Company and counsel to Unilever, but received none.

Although the trustee would not need Unilever's consent to a transfer, the trustee's selected transferee would, pursuant to Subsection 38(2) of the *Commercial Tenancies Act*, have to covenant to observe the terms of the Lease, intend to conduct activities that the Court finds not "of a more objectionable or hazardous nature" than the present use of the Real Property, and be a fit proper tenant in the eyes of the Court. As discussed above, the permitted uses under the Lease are potentially quite broad, and thus the class of uses that the Court might find not "of a more objectionable or hazardous nature" would be at least as broad.

SCHEDULE "A"
PURCHASE AGREEMENT

(see attached)

SCHEDULE "B"

LEASE

(see attached)

5470731.2

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ARRANGEMENT ACT
R.S.C. 1985 c.C - 36, as amended**

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APPLICANT

Court File No. 08-CL-7925

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