CITATION: In the Matter of the Proposal to Creditors of Conforti Holdings Limited, 2022 ONSC 5420
COURT FILE NO.: CV-31-2675583
DATE: 20220923

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: IN THE MATTER OF THE PROPOSAL TO CREDITORS OF CONFORTI HOLDINGS LIMITED, A CORPORATION INCORPORATED UNDER THE ONTARIO BUSINESS CORPORATIONS ACT, R.S.O. 1990, C. B.16

BEFORE: Justice Cavanagh

COUNSEL: *R. Brendan Bissel* and *Joël Turgeon*, for Crowe Soberman Inc. in its capacity as trustee to the proposal to creditors of Conforti Holdings Ltd.

Clifton P. Prophet, for the Moroccanoil, Inc.

Bobby Sachdeva and *Erin Craddock* for Conforti Holdings Limited

Carmine Scalzi for Antonio Conforti

Michael Noel for Cadillac Fairview

S. Michael Citak for Oxford Properties

J. Wuthmann for five landlords

HEARD: March 15, 2022

ENDORSEMENT

Introduction

[1] This is a motion by Crowe Soberman Inc. in its capacity as proposal trustee (in such capacity, the "Proposal Trustee") to the creditors of Conforti Holdings Limited (the "Company") in respect of the court's approval of the Company's amended proposal to creditors dated March 31, 2022 (the "Proposal") pursuant to s. 58 of the *Bankruptcy and Insolvency Act* (Canada) (the "*BIA*").

[2] Moroccanoil, Inc. ("Moroccanoil") is a contingent creditor of CHL. Moroccanoil opposes this motion.

[3] For the following reasons, I approve the Proposal.

Factual Background

Business of the Company

[4] The Company's business was the operation of hair salons in malls and commercial office spaces, almost all of which were indoors. Before these proceedings, there were 52 such locations. Now there are 35. The Company became insolvent due to reduced business caused by the pandemic and imposed restrictions. The Company currently has approximately 540 employees.

Notice of Intention to Make a Proposal and Creditors' Meeting

[5] The Company filed a notice of intention to make a proposal on September 28, 2020. Notice thereof was given to known creditors as declared by the Company. This notice excluded Moroccanoil until rectified from June 2021 onwards.

[6] Extensions of time to file a proposal were granted by the court on three occasions into March 2021. The Company filed a holding proposal on March 12, 2021. A holding proposal was necessary because the Company could not formulate a final proposal in the uncertain and ongoing pandemic circumstances. The creditors adjourned the creditors' meeting to October 28, 2021 and subsequently to March 31, 2022.

[7] The Company filed its substantive Proposal on March 21, 2022 which was re-amended on March 28, 2022. Both were forwarded to every known creditor and the Official Receiver together with a notice of reconvened meeting of creditors in respect of the meeting adjourned to March 31, 2022, the Proposal Trustee's report to creditors, and attendant documents tabled at the meeting. These documents were posted on the Proposal Trustee's website.

[8] The Proposal was updated at the March 31 creditors' meeting to address certain creditors' questions and comments as to section 65.11 of the *BIA*.

[9] The Proposal as re-amended and updated was approved by the requisite majorities at the March 31, 2022 meeting.

The U.S. litigation

[10] Moroccanoil is a manufacturer of luxury haircare and body care products. In April 2015, Moroccanoil commenced proceedings against Salon Distribution Inc. ("SDI"), a predecessor to the Company, and now the Company, in the United States District Court District of New Jersey (the "New Jersey Court"). In this litigation, Moroccanoil alleges that SDI and Mr. Conforti breached a settlement agreement with Moroccanoil. Moroccanoil moved before the New Jersey Court to enforce the settlement agreement in April 2015. Morrocanoil asserts that it is owed $2,807,478.12 by the Company. The Company and Mr. Conforti brought a cross-motion in response. They claim damages from Moroccanoil for breach of an alleged obligation to supply products to the Company.

Terms of Proposal

[11] The material terms of the Proposal are:

a. Claims compromised are all claims of any person, excluding claims of security creditors.

b. The Proposal is made to the Crown.

c. The Company shall not dispose of assets other than as contemplated in the Proposal or in the normal course of business.

d. The order of payments under the Proposal is in accordance with the *BIA*:

   i. Administrative fees and expenses (except as may be set out in the *BIA*).

   ii. Proven unsecured claims of preferred creditors in accordance with the scheme for distribution set forth in the *BIA*.

   iii. Proven unsecured claims and claims of landlords in accordance with the *BIA*.

e. Proposal Trustee to provide notice to all known affected creditors 30 days before the claims bar date.

f. Company to constitute a lump-sum Creditor Payment Fund of $2,430,000 upon court approval of the Proposal. This represents 22.7% of the dollar value of claims admitted for voting on the Proposal.

g. As stated in the Proposal, the Company and Mr. Conforti are in litigation with Moroccanoil in the United States. If the Company is successful on its claim against Moroccanoil and collects its claim, the Proposal provides for the "Paid Judgment and Bond Funds" to be added to the creditor payment fund in accordance with an agreement with the Company's principal, Mr. Conforti, which is anticipated to provide for him to retain a portion (expected to be 40%) of the Paid Judgment and Bond Funds in consideration for his financing of all of the Company's costs in the US proceeding.

h. All directors and officers to be released from all claims that arose on or before the filing date and that relate to an obligation of the Company where the director or officer is liable in such capacity, upon the issuance of a required certificate of full performance, such release to have no effect in case of the Company's bankruptcy.

i. No release of claims (i) based in fraud or gross negligence, or (ii) against directors or officers relating to contractual rights, based in

misrepresentations or wrongful or oppressive conduct, asserted by secured creditors, or based in fraud.

j. *BIA* ss. 95 to 101 and any similar legislation do not apply to the Proposal or payments made thereunder.

Company failed to give notice of its NOI filing to Morrocanoil

[12] The Company filed a Notice of Intention to make a proposal on September 28, 2020 ("NOI"). Notice thereof was given to known creditors as declared by the Company. This notice excluded Moroccanoil until rectified from June 2021 onwards.

[13] The Company's position based on evidence given by its principal, Antonio Conforti, is that Morrocanoil was inadvertently left off the list of creditors set out in the NOI filing.

Moroccanoil becomes aware of the Company's NOI proceeding

[14] Moroccanoil is not included on the Company's statement of affairs either at the time that the notice of intention was filed on September 28, 2020 or when the holding proposal was filed on March 12, 2021.

[15] Moroccanoil learned of the Company's *BIA* proceedings on June 7, 2021 through its American attorneys in the US proceeding.

Initial failure by the Company to disclose a related party debt and security

[16] The Company, in its statement of affairs filed with its notice of intention on September 28, 2020, failed to disclose that Beauty Experts Inc. ("BEI"), a related corporation owned by the Company's principal, Mr. Conforti, was a secured creditor of the Company for approximately $1.5 million. The Company failed to disclose this in subsequent motions to the Court for extensions of time heard on October 26, 2020, December 14, 2020, and January 27, 2021.

[17] In the statement of affairs filed with its March 12, 2021 holding proposal, the Company included an indication that BEI was a secured creditor of the Company for approximately $1.5 million.

[18] Mr. Conforti's evidence is that he did not believe that he had to disclose the BEI debt or security because it was owed to a related third party.

Challenge to BEI security

[19] Moroccanoil made a motion challenging the BEI security. The Court released its reasons on May 31, 2022, holding that the BEI security was invalid. As a result, the Proposal provides that the Company offers its creditors $2,430,000, including the $1.5 million set aside.

Analysis

[20] The issue on this motion is whether the Proposal should be approved.

General principles

[21] Pursuant to section 54(2)(d) of the *BIA*, a proposal is deemed to be accepted by the creditors if it has achieved the requisite "double majority" voting threshold (a majority in number and two thirds in value of the votes of unsecured creditors of each class present, personally or by proxy, at a duly constituted meeting of creditors).

[22] On acceptance of a proposal by the creditors, the proposal trustee is required to apply to the court for an appointment for the hearing of an application for the court's approval of the proposal: s. 58 of *BIA*.

[23] The *BIA* provides in section 59(1) that the court shall, before approving the proposal, hear a report of the proposal trustee respecting the terms thereof and the conduct of the debtor and, in addition, 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.

[24] Section 59(2) of the *BIA* provides that 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 expenses mentioned in sections 198 to 200.

[25] In order to satisfy s. 59(2), the courts have held that the following three-pronged test must be met: (a) the proposal is reasonable; (b) the proposal is calculated to benefit the general body of creditors; and (c) the proposal is made in good faith. See *Kitchener Frame Limited (Re)*, 2012 ONSC 234, at para. 19.

[26] On a motion for court approval of a proposal, the court must consider the interests of the debtor (in restructuring debt and staying in business), the creditors (in resolving claims in a reasonable fashion), and the public (in maintaining the integrity of the bankruptcy process and the need to preserve commercial morality). The court must also consider the interests of all stakeholders, and weigh the effects of the approval of the proposal against those of a bankruptcy. See *Re Wander (Proposal)*, 2007 ABQB 153, at para. 11; *Kitchener Frame*, at para. 20, 22.

[27] The courts have accorded significant deference to the majority vote of creditors at a meeting of creditors and courts have also accorded deference to the recommendation of the proposal trustee: *Kitchener Frame*, at para. 21.

[28] The burden of proving that the proposal should be approved by the court lies with the debtor making the proposal, although the court hears the proposal trustee's report. See *Magi (Syndic de)*, 2006 QCCS 5129 (CanLII), at para. 19.

[29] Subsection 59(3) of the *BIA* provides:

> 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.

Approval by requisite majorities (BIA, section 54(2)(d))

[30] Under s. 54(2)(d) of the *BIA*, the proposal must be accepted by a majority in number and two thirds in value of the creditors present and voting in each class of unsecured creditors. Here, there is only one class provided in the Proposal and the majorities are reached by way of approval of 26 of 27 unsecured creditors present and voting, representing all but $1 in value of claims accepted for voting purposes ($10,709,205.04).

[31] The only voting creditor that voted against the Proposal is Moroccanoil. Its claim, asserted in the U.S. Proceeding, was admitted at a value of $1, for voting purposes only, due to its contingency. If the amount claimed by Morrocanoil ($2,807,478.12) had been accepted as proved in full, the two thirds majority in value would still be reached.

Release of claims against directors and officers (BIA section 50(14))

[32] The Proposal's drafting in this respect copies the limitations set out in section 50(14) of the *BIA*.

Proposed order of distributions (BIA, section 60)

[33] The Proposal's order of distributions is in accordance with the *BIA*.

Should the Court refuse to approve the Proposal pursuant to s. 59(3) of the BIA?

[34] Morrocanoil relies on s. 59(3) of the *BIA*. Morrocanoil submits that facts mentioned in s. 173 (1)(o) of the *BIA* have been proved against the Company and the Company has not provided reasonable security for the payment of not less than fifty cents on the dollar.

[35] Morrocanoil submits that I should not approve the Proposal or, in the alternative, I should adjourn the approval hearing and require the Company to provide consideration sufficient to satisfy the fifty cent threshold mandated by subsection 59(3) of the *BIA*.

[36] The facts mentioned in s. 173(1)(o) of the *BIA* are "the bankrupt has failed to perform the duties imposed on the bankrupt under this Act or to comply with any order of the court".

[37] Morrocanoil submits that the Company has failed to perform the duties imposed on it under the *BIA* and, therefore, section 59(3) applies in the circumstances.

[38] Morrocanoil relies on subsection 50.4(1) of the *BIA* which provides that, on the commencement of an NOI, a debtor has a duty to file an initial creditor list which includes the names of creditors with claims amounting to two hundred and fifty dollars or more.

[39] The duties of a debtor include those set out in section 158. Subsection 158(d) of the *BIA* provides:

> **Duties of bankrupt**
>
> 158 A bankrupt shall
>
> …
>
> (d) within five days following the bankruptcy, unless the time is extended by the official receiver, prepare and submit to the trustee in quadruplicate a statement of the bankrupt's affairs in the prescribed form verified by affidavit and showing the particulars of the bankrupt's assets and liabilities, the names and addresses of the bankrupt's creditors, the securities held by them respectively, the dates when the securities were respectively given and such further or other information as may be required, but where the affairs of the bankrupt are so involved or complicated that the bankrupt alone cannot reasonably prepare a proper statement of affairs, the official receiver may, as an expense of the administration of the estate, authorized the employment of a qualified person to assist in the preparation of the statement;

[40] Morrocanoil submits that the Company knowingly failed to disclose the Morrocanoil claim and the BEI debt and security on the Initial Creditor List.

[41] The Company submits that the failures to disclose the BEI debt and security and to disclose the Morrocanoil claim on the Initial Creditor List are administrative irregularities that are not failures by the Company to perform the duties imposed on it under the *BIA*.

[42] I disagree that the Company's failures should be dismissed as administrative irregularities. I am satisfied that the Company, with knowledge of the BEI debt (and the security BEI asserted for this debt) and with knowledge of the Morrocanoil claim, failed to disclose them on the Initial Creditor List.

[43] In failing to make these required disclosures, the Company failed to perform its duty under the *BIA*.

[44] Moroccanoil submits that in addition to the general duties set out in s. 158 of the *BIA*, all interested persons in a *BIA* proceeding, including a debtor, have a duty to

act in good faith under s. 4.2(1) of the *BIA*. Morrocanoil submits that the Company has breached this duty of good faith. I have found that the Company failed to perform its duty under the *BIA*. Having so found, it is not necessary for me to analyze the application or effect of s. 4.2(1) of the *BIA*.

[45] I now address whether I should refuse to approve the Proposal, or adjourn the motion for approval, because the Company has not provided reasonable security for the payment of not less than fifty cents on the dollar on all unsecured claims provable against the debtor's estate.

[46] Morrocanoil relies on several authorities in support of its submission that I should not approve the Proposal.

[47] In *Wander (Proposal)*, 2007 ABQB 153 (CanLII), the debtor brought an application for court approval of his proposal to his unsecured creditors. The application was opposed by the largest unsecured creditor, the Canada Revenue Agency ("CRA"). The proposal affected eight unsecured creditors and CRA's claim represented about 60% of the total unsecured debt. Under the proposal, the debtor would pay an amount in 36 installments with the first installment due on filing of the proposal and continuing monthly payments thereafter. CRA's negative vote and proxy did not arrive in time for the meeting of creditors to vote on the proposal, and the proposal was approved by the votes of two creditors (with a combined claim value of $13,645.56 of total claims of $148,001). The proposal trustee recommended that the Court approve the proposal. CRA contended that s. 59(3) mandates performance security in the debtor's circumstance.

[48] The application judge in *Wander* reviewed the jurisprudence concerning the mandate for performance security under s. 59(3) of the *BIA* and its predecessor provisions, as well as parallel legislation in the United Kingdom. The application judge held, at para. 24, that performance security must be meaningful and the onus of proof of which rests on the debtor. The application judge, at para. 32, held that the prohibition against approving a proposal where any of the s. 173 facts have been proved against the debtor unless the debtor provides reasonable security for the payment serves to protect not only the interests of creditors but also the public's interest in commercial morality.

[49] In *Wander*, the application judge held that the debtor's proposal, viewed in its best light, provided for security only for the initial payment which equated to 0.027 per cent of the total amount due under the proposal. This security was held not to be reasonable performance security. The application judge held that there must be some evidence presented to justify the court exercising its discretion to lower the percentage of performance security and there was none. The application for approval of the proposal was dismissed.

[50] The Company's Proposal provides for the Company to constitute a lump-sum Creditor Payment Fund of $2,430,000 to be paid to unsecured creditors. This represents between 16% and 22% of the claims of unsecured creditors. The

variation is because of uncertainty concerning whether the Morrocanoil claim will be proven, whole or in part, as a claim. The funds to be paid are in the hands of the Company or the Proposal Trustee. The Company has shown that it is able to provide reasonable security for the amounts to be paid under the proposal, which are less than fifty cents on the dollar of all unsecured claims.

[51] The fact that the Company has provided security for the amounts to be paid under the Proposal distinguishes the facts on the motion before me from those in *Wander*.

[52] Morrocanoil also cites *Re Milan*, 2012 ONSC 2899. In *Milan*, the motion was for approval of a proposal that provided for payment of 15 cents on the dollar. The motion judge, Pattillo J., held that in the absence of the production by the debtor of any books and records and other relevant documents to enable the trustee to do an independent review of the debtor's affairs, there is no basis to permit the court or the creditors to determine that the amount being offered as a settlement is reasonable. Pattillo J. found that facts mentioned in s. 173 of the *BIA* had been proved. He held the proposal itself does not provide sufficient security for the proposed payments (which were to be provided by an individual known to the debtor).

[53] Pattillo J. declined to exercise his discretion provided for by s. 59(3) of the *BIA* for several reasons including his general concern arising from the debtor's failure to produce any books and records relating to his affairs, such that Pattillo J. was unable to accept that the debtor had no records or access to records in respect of his personal affairs and of his many and varied businesses. Pattillo J. was concerned with the secrecy shown by the evidence surrounding details of where the monies to fund the proposal were coming from and he found that the initial information that was provided was contradictory and lacking in detail. Pattillo J. held that the integrity of the bankruptcy proposal process requires full and complete disclosure by the proponent to enable creditors and the court to determine whether the proposal is reasonable and in the best interests of all interested parties. He found that this had not happened and that, by proceeding as he has, the debtor was attempting to use the proposal process to compromise all claims against him without properly accounting for his assets and any transactions that may constitute a preference or an improper transfer of property. The motion judge concluded that it is important for creditors in the bankruptcy process generally that a proper review of the debtor's assets take place. The debtor's approval motion was dismissed.

[54] The facts in *Milan* differ materially from those on the motion before me. The Company has disclosed the source of funding of payments to be made under the Proposal, and these payments are secured. Unlike in *Milan*, there is no suggestion that the Company is using the proposal process to avoid a review of its financial affairs or to compromise possible claims in respect of transactions that may constitute a preference or an improper transfer of property. The reasons that Pattillo J. gave for declining to exercise his discretion under s. 59(3) to reduce the amount of security to less than 50 cents on the dollar do not apply on this motion.

[55] Morrocanoil also relies on *Sumner Company (1984) Ltd. (Bankrupt), Re*, 1987 CanLII 7591 (NB QB). In *Sumner*, an application was brought for court approval of a proposal. The application judge concluded that facts and offences under the statute had been committed such that it was mandatory for the court to refuse to approve the proposal unless it provides reasonable security for the payment of not less than fifty cents on the dollar on all unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct. The application judge noted that the proposal called for full payment to persons involved in the affairs of the bankrupt, in priority to the unsecured creditors, and he commented that three agreements that formed part of the proposal contained terms that were, as the application judge put it, "mind-boggling". The application judge, at para. 36, concluded that the proposal does not provide sufficient security and, accordingly, refused to approve the proposal. The application judge went on to consider the fact that a majority of creditors had voted to accept the proposal. The application judge, at para. 37, expressed his doubt that the creditors were able to appreciate the full implications of the proposal and the conditions attached to it. The application judge was satisfied that the creditors' interest will be better protected under a general bankruptcy then would be the case under the proposal. The application judge refused the application for approval of the proposal.

[56] The facts in *Sumner* are also materially different than those on the motion before me. The Proposal does not provide for payments to persons involved in the affairs of the Company in priority to unsecured creditors. The evidence does not support a finding that creditors are unable to appreciate the full implications of the Proposal.

[57] The Proposal was supported by all unsecured creditors except for Morrocanoil. At the hearing of this motion, several creditors appeared and made submissions supporting approval of the proposal. These creditors are landlords in malls where the Company operates hair salons. I accept that the landlords are in a different position than Morrocanoil because they will benefit from future rental receipts from the Company as a tenant. Nevertheless, I regard the support for the Proposal from the Company's creditors be a significant factor that supports the motion. If the Proposal is not approved, the result will be that the Company will be bankrupt, an outcome that will have negative effects for the Company, its landlords, suppliers, employees, and shareholders.

[58] I accept that the requirements (i) for support from the Company's creditors, and (ii) that the proposal provides for a better outcome than a bankruptcy, are separate from the requirement under s. 59(3), where it applies, that 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 unsecured claims provable against the debtor's estate or such percentage thereof as the court may direct. In *Wander*, at para. 25, the application judge held that s. 59(2) and s. 59(3) should be read disjunctively. However, the circumstances which inform the exercise of discretion under s. 59(3) include the extent of approval by creditors and the fact that the outcome under the proposal is better than under a bankruptcy. This is shown in

Wander and *Sumner*. The circumstances also include the public's interest in commercial morality.

[59] The evidence on this application in relation to the conduct of the Company is not, in my view, similar to the facts in *Wander*, *Milan*, or *Sumner*, where, notwithstanding support from creditors who voted at the creditors' meeting (in *Wander*, there was opposition by the largest creditor who failed to appear at the meeting), the hearing judge in each case declined to exercise discretion to approve security of less than 50 cents on the dollar of unsecured claims. I do not regard the Company's failure to disclose the Morrocanoil claim or the BEI debt and security on its Initial Creditor List to be conduct that rises to such a level that the public's perception of the bankruptcy process would be undermined if the Proposal is approved.

[60] On the evidence before me, I exercise my discretion to approve the Proposal notwithstanding that it provides security for payment of less than 50 cents on the dollar on all unsecured claims provable against the Company's estate.

Is the Proposal reasonable under s. 59(2) of the BIA?

[61] Under section 59(2) of the *BIA*, 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 or more of the offences mentioned in sections 198 to 200.

[62] The Proposal Trustee submits that the terms of the Proposal are calculated to benefit the general body of creditors. The Proposal Trustee's opinion is that the Proposal provides for a greater recovery than bankruptcy. The Proposal Trustee estimates, based on claims filed and not including contingent claims, that the return to creditors in the bankruptcy would be approximately 13%, versus approximately 20% under the Proposal.

[63] If the Proposal Trustee added contingent claims to the estimate (approximately $3.2 million, including Morrocanoil's claim), the return to creditors in a bankruptcy would be approximately 11% versus 16% under the Proposal. In addition, the Proposal offers funding and a vehicle for the Company to seek to recover on a claim for damages against Morrocanoil, which, if successful, may result in additional creditor recovery.

[64] The Proposal Trustee notes that beyond creditors, the wider group of stakeholders of the Company, including 540 employees, suppliers and customers, have their interest in the Company's business preserved in a going concern proposal, unlike a bankruptcy and liquidation.

[65] The Proposal Trustee submits that the requirements of section 59(2) of the *BIA* are satisfied.

[66] I accept the submissions of the Proposal Trustee in this respect.

Disposition

[67] For these reasons, I approve the Proposal.

[68] If the parties are unable to resolve costs, they may make written submissions in accordance with a timetable to be agreed upon and provided to me for approval.

Cavanagh J.

Date: September 23, 2022