

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
Court No. 31-2504276

**ONTARIO
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)**

BETWEEN:

PACIFIC MERCANTILE BANK

Applicant

- and -

THE NUT JOB 2 PRODUCTIONS INC. and TOONBOX ENTERTAINMENT LTD.

Respondent

**THIRD REPORT OF THE PROPOSAL TRUSTEE AND INTERIM RECEIVER
October 31, 2019**

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. (“NJ2 Prodco”), 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 Hainey 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 Appointment Order is attached to BDO’s First Report, dated May 27, 2019, 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 to BDO’s First Report as Appendix “II” and Appendix “III”. Lipman Zener Waxman LLP (“LZW”) act as counsel to the Proposal Trustee/Interim Receiver.
5. On May 21, 2019, separate First Meetings of Creditors were held for each of Toonbox and NJ2 Prodco. 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 to BDO’s First Report as Appendix “IV”.
6. By its First Report, BDO as Proposal Trustee/Interim Receiver advised this Honourable Court of its activities to the date of the Report, described the assets of Toonbox and NJ2 Prodco and detailed a proposed sales process for the assets, which it wished to initiate, requested authorization to consolidate the proposal proceedings of Toonbox and NJ2 Prodco for administrative purposes, requested approval of a \$200,000 Administration Charge, and

asked for approval of its Report and the conduct and activities of the Proposal Trustee/Interim Receiver, as described in its Report.

7. In paragraphs 15 to 17 of its First Report, BDO indicated the Companies were subject to co-production agreements with Redrover Co. Ltd. ("Redrover"), a South Korean company which had funded various animation films produced by the Companies.
8. Immediately after issuance of its First Report, BDO became aware that the relationship between the Companies and Redrover is considerably more complicated than had first been realized.
9. Accordingly, prior to attending at Court, the parties (being Redrover, BDO and PMB), agreed to defer requesting approval of a proposed sales process until the relationship and agreements between the Companies and Redrover could be better understood, issues of ownership of assets determined, and an accounting obtained from Redrover for monies potentially owing by it to Toonbox, or claimed by Redrover as owing to it by Toonbox.
10. By Order of the Honourable Mr. Justice Conway, dated June 6, 2019, the Court provided the relief sought by the Proposal Trustee, being the consolidation of the proposal proceedings of each of Toonbox and NJ2 Prodco for administrative purposes, the provision of a \$200,000 Administration Charge, and approval of the conduct and activities of the Proposal Trustee, as set out in the First Report. A copy of the Order is attached to BDO's Second Report, as Appendix "I".
11. In its Second Report, dated June 21, 2019, the Proposal Trustee/Interim Receiver advised the Court of its activities from the date of the First Report to the date of the Second Report. These included further investigation of the complexities of the relationship between Toonbox and Redrover. Toonbox through various subsidiary companies, which were production companies, produced various animated films on behalf of Redrover, which then owned 100% of the productions, in exchange for financing the costs of production. Toonbox was obligated to pay over to Redrover any tax credits it received from the Canadian federal or provincial governments, related to the specific productions funded by Redrover.
12. The Proposal Trustee/Interim Receiver advised that the assets of Toonbox include computer and other equipment, as well as furniture and fixtures used by the production

companies in the various films produced for Redrover. Redrover claims to be entitled to that equipment, as it was charged by Toonbox for equipment as part of the production costs of such films. Toonbox claims that these assets belong to Toonbox, not to Redrover. Further, Toonbox claims it was never provided any accounting by Redrover as to the net receipts earned by it on the distribution of prior films, including particularly The Nut Job (“NJ1”) and The Nut Job 2: Nutty by Nature (“NJ2”), despite being entitled to 50% of any net receipts, and further alleges that Redrover suspended funding ongoing productions, without justification.

13. The Proposal Trustee/Interim Receiver asked the Court to require Redrover to provide the Proposal Trustee with Property Proofs of Claim and supporting evidence to establish its claim to various films and other assets in the possession of the Companies, as already required of Redrover by the Proposal Trustee, pursuant to formal notices issued to it under sec. 81(4) of the BIA on June 21, 2019, and to forthwith supply the Proposal Trustee with an accounting of all monies owing by the Companies and Redrover to each other.
14. By the Endorsement of Hainey J. dated June 25, 2019, the Court adjourned the motion before it to a date to be fixed by the Commercial List, but required Redrover’s counsel to provide BDO with all contracts and agreements in its possession, to advise by June 28, 2019 as to when full and complete accounting can be provided, and to make best efforts to advise by June 28, 2019 of any funds collected by Redrover for a number of identified productions. The Endorsement is attached hereto, as Exhibit 1.

PURPOSE OF REPORT

15. This is the Third Report of the Proposal Trustee/Interim Receiver (the “Third Report”) for both Companies’ estates. The purpose of the Third Report is to:
 - (a) provide this Court with information regarding the activities of the Proposal Trustee/Interim Receiver from the date of the Second Report to the date of the Third Report;
 - (b) request that this Court grant an order or orders to convert the existing interim receiverships of Toonbox and NJ2 ProdcO into receiverships pursuant to the provisions of Sec. 101 of the *Courts of Justice Act, R.S.O. 1990, c.C.43, as amended*, with the usual powers granted to Court-appointed receivers, and to additionally place one of

Toonbox's wholly-owned subsidiaries, The Nut Job 3 Productions Inc. ("NJ3 Prodco") into receivership, for the reasons set out in this Report; and to

(c) approve this Third Report and the conduct and activities of the Proposal Trustee/Interim Receiver described herein.

DISCLAIMER

16. 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, including the electronic files of the Companies, and discussions with the Companies' representatives. The Proposal Trustee/Interim Receiver has not performed an audit or other verification of such information.

BACKGROUND

17. Toonbox was incorporated on June 19, 2008 as Red Rover Creative Ltd. The first page of the Certificate of Incorporation is attached hereto as Exhibit 2. The name was changed to Toon Box Entertainment Ltd. on January 13, 2009, as per Articles of Amendment, the first page of which is attached hereto as Exhibit 3, and further changed to Toonbox Entertainment Ltd. on June 10, 2011, as per Articles of Amendment, the first page of which is attached hereto as Exhibit 4. At all times, Toonbox 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, as set out on the Organization Chart attached as Exhibit 5.
18. The Nut Job 2 Productions Inc. (NJ2 Prodco) was incorporated on April 5, 2013 and is a wholly owned subsidiary of Toonbox. NJ2 Prodco is an animation studio and produced the film "The Nut Job 2: Nutty by Nature" (NJ2).
19. On December 19, 2017, NJ2 Prodco entered into a loan agreement with PMB for 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.
20. NJ2 Prodco was eligible to claim various federal and provincial refundable tax credits for the production of the NJ2 film. These tax credits were expected to total more than \$11.6 million CDN.
21. NJ2 Prodco was to use the Tax Credits to repay PMB in full. Pursuant to the loan agreement with PMB, 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, following receipt. NJ2 Prodco did not comply with the terms of the PMB Loan Agreement. Instead, the refunded Tax Credits were co-mingled with Toonbox's funds and the major portion thereof apparently used by Toonbox to fund other ongoing film productions and operations.

22. The Loan matured on March 19, 2019 and NJ2 Prodco failed to repay it.
23. 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 62 active and 10 non-active employees.

ACTIVITIES OF THE PROPOSAL TRUSTEE/INTERIM RECEIVER from June 21, 2019 to October 31, 2019

Redrover Co. Ltd.

24. The Proposal Trustee/Interim Receiver during this period reviewed the accounting records of Toonbox, as well as its extensive electronic files, and the Corporate Minute Books.
25. The relationship between Toonbox and Redrover appears to have been extremely close, throughout. Indeed, Toonbox was first incorporated as Redrover Creative Ltd. (see para. 17, above).
26. Further, Redrover subscribed to "Special Share Class 'C'" shares of Toonbox as follows:
 - December 14, 2011 - 60,000 - \$6 plus \$1,799,994
 - August 24, 2012 - 90,000 - \$9 plus \$2,699,991
 - March 20, 2015 - 110,000 - \$11 plus \$3,299,989.

In total, Redrover contributed \$7,799,974 as "Contribution Surplus", and the records of Toonbox recorded these amounts, in addition to the other nominal amounts paid for shares, as share capital.

Redrover's claim to assets of Toonbox and NJ2 Prodco

27. On or about July 5, 2019 Redrover provided the Proposal Trustee with Property Proofs of Claim, pursuant to sec. 81(4) of the BIA.
28. The Claim against Toonbox is essentially a claim for an interest in any property which may have been diverted to Toonbox by NJ2 Prodco or other production companies. By correspondence dated of July 22, 2019, BDO as Proposal Trustee disputed Redrover's claim, seeking "better evidence that the assets of have been diverted as alleged." To the date of drafting this Report, Redrover has supplied no further evidence in support of its claim.
29. The Claim against NJ2 Prodco is essentially a claim for an interest in all property related to the NJ2 film, including fixed assets "relating to the film". By correspondence dated July 22, 2019, the Proposal Trustee disputed Redrover's claim, again seeking "better evidence". To the date of drafting this report, Redrover has supplied no further evidence in support of its claim.
30. Indeed, the only other information of substance received from Redrover in connection with the Endorsement of Hainey J. (Exhibit 1 hereto), was an email report of August 12, 2019, whereby Redrover provided a brief summary of net receipts received by it with respect to the NJ1 film. Redrover reported total "Project Receipts" of about US\$ 28 million, and total "Project Costs" of about US\$ 37 million, resulting in a shortfall of just under US\$ 9 million. Support consisted of excel spreadsheets in the Korean language, and various electronic reports from collection houses apparently accounting regularly for the film revenue collected in various international regions. No attempt was made by Redrover to tie these email reports to the summary of net receipts. In the view of the Proposal Trustee/Interim Receiver, the information provided did not adequately document the summary of net receipts. No other accounting was received, but counsel for Redrover asserted that there were no net receipts for NJ2..

Nut Job 3 (NJ3)

31. The Nut Job 3 Productions Inc. ("NJ3 Prodco") was incorporated on January 20, 2016 for the purposes of producing a third "Nut Job" film. Like the other production companies, it is a wholly owned subsidiary of Toonbox. The first page of its Certificate of Incorporation is attached hereto as Exhibit 6.
32. Toonbox and NJ3 Prodco entered into the usual agreements with Redrover, related to the NJ3 film. Essentially, Redrover was to fund the production of the film, in exchange for

owning the intellectual property related to the NJ3 film, and being entitled to exploit the distribution of the film. Similar to the agreements for the NJ1 and NJ2 films, Toonbox was to contribute any tax credits received for the NJ3 film (the "NJ3 Tax Credits"), once actually received.

33. Production of the film commenced in or about June 2016, and Toonbox started issuing weekly invoices to Redrover. The records of Toonbox indicate that for the period from June 28, 2016 to April 19, 2017 Toonbox issued 40 invoices to Redrover, totaling \$5,400,000.00. All invoices were paid by Redrover.
34. Subsequently, on or about August 4, 2017, Toonbox issued one more invoice to Redrover for NJ3, for \$912,333.50. However, it appears this invoice was never paid by Redrover. It appears that Redrover ceased making any payments to Toonbox after April 2017.
35. Based on Toonbox's General Ledger, and other information reviewed by the Proposal Trustee/Interim Receiver, it appears that total NJ3 production costs incurred by Toonbox until March 20, 2019, when Toonbox ceased operations, were \$17,208,707.13. Of that sum, it appears that Redrover contributed only \$5,400,000.00. It appears that Toonbox then used other funds coming into its possession, including monies borrowed from PMB (US\$ 8.17 million) and tax credits received by NJ2 Prodco in 2018 (\$9.1 million), to keep funding NJ3 production costs. Thus, it appears that Toonbox must have paid over \$10 million of the production costs from other sources.
36. During its review of these matters, the Proposal Trustee/Interim Receiver located a letter dated October 4, 2018, whereby Goodmans, as counsel for Toonbox, wrote to Redrover to document Toonbox's allegations that Redrover had ceased without justification to fund the NJ3 production costs after April 2017, and that this cessation constitutes a breach of the terms of the Co-Production Agreement of June 11, 2015. Accordingly, Toonbox exercised its rights to terminate the Agreement. The termination letter is attached hereto, as **Exhibit 7**.
37. On providing Redrover's counsel with a copy of Goodman's termination letter, the Proposal Trustee/Interim Receiver was subsequently provided with a copy of Redrover's response to the letter. The response, dated October 10, 2018, is attached as **Exhibit 8**. The response denied the allegations of default, and alleged that Toonbox, among other things, had failed "to account for and pay the tax credit." It is not clear what specific tax credit was referred to, but the Proposal Trustee/ Interim Receiver had previously been

given to understand that Redrover had justified its failure to continue to fund the NJ3 film by noting that Toonbox had failed to remit the NJ2 tax credits when received.

38. Subject to any evidence to the contrary which may be provided by Redrover in the future, it is the preliminary opinion of the Proposal Trustee/Interim Receiver that Toonbox's termination of the NJ3 agreements with Redrover may have been justified. Redrover's counsel has been so advised, and disputes that position.
39. The NJ3 Tax Credits are the only known asset of NJ3 Prodco. It is estimated that these tax credits total about \$6.3M.

SUMMARY

40. In conclusion, it is noted that there are ongoing disagreements between the Proposal Trustee/Interim Receiver and Redrover as to the ownership of the assets of Toonbox and NJ2 Prodco, and as to whether the purported termination of the production agreements between Toonbox and Redrover was valid. If it was valid, then not only did the intellectual property rights pertaining to the NJ3 film revert to Toonbox, but Toonbox would also be entitled to recover and retain any tax credits earned on the production costs incurred to date.
41. In an attempt to resolve these disagreements, the Endorsement of the Honourable Mr. Justice Haïney, dated October 17, 2019, scheduled a Judicial Mediation for December 19, 2019 and all parties are required to attend. In the event the Judicial Mediation is unsuccessful, a hearing has been scheduled for January 27, 2020 to determine the issues. A copy of the Endorsement is attached hereto, as **Exhibit 9**.
42. Unfortunately, at present the Proposal Trustee/Interim Receiver has no control over the activities or assets of NJ3 Prodco, as that corporation is not currently subject to any insolvency proceedings. As such, the role of the Proposal Trustee/Interim Receiver in dealing with NJ3 Prodco is not clear. Accordingly, the Proposal Trustee/Interim Receiver requests that its existing roles related to Toonbox and NJ2 Prodco be strengthened, and that the receivership of NJ3 Prodco be added to its mandate.

CONCLUSION

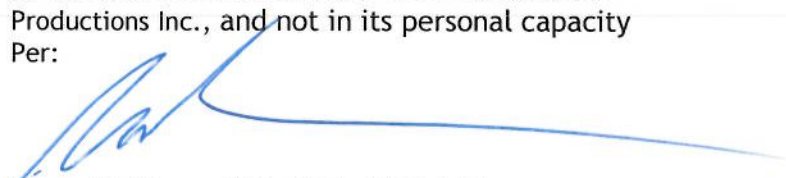
43. In conclusion, the Proposal Trustee/Interim Receiver requests the approval of this Honourable Court of this Third Report and the activities of the Proposal Trustee/Interim

Receiver as reported herein, and requests that the Court grant an order or orders providing the relief requested in paragraph 15 of this Third Report.

All of which is respectfully reported, this 31st day of October, 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:



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