

**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
KRAUS BRANDS INC., KRAUS CANADA LTD., KRAUS CARPET INC.,
KRAUS PROPERTIES INC., KRAUS USA INC., and STRUDEX INC.**

Applicants

**FACTUM OF THE APPLICANTS
(CCAA Initial Application)
(Returnable September 11, 2018)**

September 10, 2018

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PART I - OVERVIEW

1. This is an application by Kraus Brands Inc., Kraus Canada Ltd., Kraus Carpet Inc., Kraus Properties Inc., Kraus USA Inc. ("**Kraus US**"), and Strudex Inc. (collectively, "**Applicants**"), and together with the partnerships listed in Exhibit "A" to the Affidavit of Christopher Emmott, sworn September 10, 2018 ("**Emmott Affidavit**"), the "**Kraus Group**") for an order ("**Initial Order**") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("**CCAA**") (i) providing a stay of proceedings to allow the Kraus Group to complete and implement a going concern sale of its TPS Business (defined below); (ii) appointing Deloitte Restructuring Inc. ("**Deloitte**") as Monitor of the Kraus Group in these proceedings; (iii) granting an Administration Charge and Directors' Charge (each as defined below) over the Kraus Group's assets, undertakings and property ("**Property**"); (iv) authorizing the Kraus

Group to continue to use its existing cash management system; and (v) sealing certain confidential appendices to the Emmott Affidavit and the Pre-Filing Report of the Proposed Monitor, dated September 10, 2018 ("**Pre-Filing Report**").

2. The Kraus Group, established in 1959, is a vertically-integrated manufacturer of premium carpet for the commercial and residential market. It is also one of the largest distributors in North America of flooring products produced by other manufacturers.¹

3. In recent years, the Kraus Group's performance has been negatively impacted by a change in consumer preferences and a downturn in the carpet manufacturing industry generally. Since 2014, the Kraus Group has sustained substantial losses. As at July 31, 2018, the Kraus Group's liabilities, as recorded on its balance sheet, exceed its assets by at least \$46.7 million.²

4. The Kraus Group is insolvent and in default of its obligations to its secured lenders. Immediately prior to the commencement of these proceedings, the applicants entered into a form of forbearance agreement with their senior secured lender.

5. As explained below, the forbearance agreement, and these proceedings generally, contemplate a CCAA filing to permit the continued operation of, and to facilitate a going concern sale of, an important Kraus Group business division, the "trading product sales" division (or "**TPS Business**"). The proposed sale, for which court approval will be sought on September 18, 2018, is the product of an extensive

¹ Affidavit of Christopher Emmott, sworn September 10, 2018 ("**Emmott Affidavit**"), at paras 4,7.

² Emmott Affidavit, at para 53(a)-(b). See also Exhibit "E" of the Emmott Affidavit.

sales process commenced in March 2018 and supervised by Deloitte Corporate Finance Inc. (“**DCF**”).

6. In all of the circumstances, the Kraus Group has determined that it is in the best interests of the Kraus Group and its stakeholders for it to seek creditor protection at this time. If the Initial Order sought is granted, the Kraus Group will seek recognition of the order through proceedings under Chapter 15 of Title 11 of the United States Code before the United States Bankruptcy Court for the District of Delaware (“**Chapter 15 Proceedings**”).³

7. The breathing room afforded by the CCAA and the Chapter 15 Proceedings will maintain the stability of the TPS Business, preserve value for stakeholders and enable the Kraus Group to transition the TPS Business to the Purchasers, pursue closing of the TPS Transaction (defined below), and continue its efforts with respect to an orderly wind-down of its residual broadloom or soft flooring business (“**Broadloom Business**”).⁴

PART II - FACTS

8. The facts underlying this Application are more fully set out in the Emmott Affidavit. Mr. Emmott is a director of Kraus Carpet Inc.⁵

³ Emmott Affidavit, at para 2(f).

⁴ Emmott Affidavit, at para 136.

⁵ Emmott Affidavit, at para 1.

A. Corporate Overview

9. The Kraus Group operates across Canada and the United States with its control of operations centered in Waterloo, Ontario (“**Waterloo Premises**”). The Waterloo Premises is an 850,000 square foot flagship mill that is owned and operated by Kraus Brands LP, by its general partner Kraus Brands Inc. The Kraus Group also has a 162,000 square foot facility in Dalton, Georgia, that provides warehousing and logistics services for the Kraus Group (“**Dalton Premises**”). The Dalton Premises is owned and operated by Kraus US.⁶

10. The Kraus Group also maintains leased premises in Delta, British Columbia, Edmonton, Alberta, Mississauga, Ontario, Montreal, Quebec, and Winnipeg, Manitoba, in Canada, and Shippenville, Pennsylvania and Renton, Washington in the United States. These leased facilities range in size from 1,193 to 91,500 square feet and are used for the warehousing of inventory and logistical support for the Kraus Group.⁷

11. Other than Kraus US, each of the Applicants is incorporated pursuant to the laws of Ontario and has assets in Canada.⁸

12. Kraus US has a bank account at the Bank of Montreal, which was recently opened and contains funds on deposit.⁹

⁶ Emmott Affidavit, at paras 6, 11.

⁷ Emmott Affidavit, at para 12.

⁸ Emmott Affidavit, at para 6(a)-(k).

⁹ Emmott Affidavit, at para 6(k).

B. Debts and Obligations of the Kraus Group

i. Senior Secured Debt

13. Wells Fargo Capital Finance Corporation Canada ("**Wells Fargo**") is the senior secured lender to the Kraus Group. Pursuant to a credit agreement dated August 6, 2013, as amended ("**Wells Credit Agreement**"), Wells Fargo provided three credit facilities to Kraus Canada LP, Strudex LP, Kraus Carpet LP and Kraus US (collectively, the "**Kraus Operating Entities**"). The credit facilities consist of, most significantly, a term loan in the principal amount of \$4,650,000, an operating facility in the maximum principal amount of \$45,350,000 to be used for, among other purposes, working capital requirements ("**Wells Operating Facility**").¹⁰

14. As of August 31, 2018, the total indebtedness outstanding under the Wells Credit Agreement, as amended, was approximately \$48,229,000.¹¹

15. The indebtedness under the Wells Credit Facility is secured by a first-ranking charge against all assets and undertaking of the Kraus Group.¹²

ii. Junior Secured Debt

16. Red Ash Capital Partners II Limited Partnership ("**Red Ash**"), is the junior secured creditor of the Kraus Group. Red Ash's general partner is Pinnacle Capital Resources Limited. Hilco UK Limited ("**Hilco**") is the sole shareholder of Pinnacle Capital Resources Limited.¹³

¹⁰ Emmott Affidavit, at para 28.

¹¹ Emmott Affidavit, at para 30.

¹² Emmott Affidavit, at para 31.

¹³ Emmott Affidavit, at para 33.

17. In May 2012, Hilco acquired the predecessors of the Kraus Group ("**Predecessors**"). As part of this acquisition, Red Ash took an assignment of the credit facilities and security held by the secured creditors of the Kraus Group's Predecessors ("**Assigned Credit Facilities**"). Concurrent therewith, Hilco created the Kraus Group and the Kraus Group assumed the debts, liabilities and obligations of its Predecessors under the Assigned Credit Facilities through certain assignment and assumption agreements.¹⁴

18. In connection with the acquisition and creation of the Kraus Group, certain of the Predecessors executed and delivered a promissory note dated May 9, 2012, to Red Ash in an amount up to but not exceeding \$15 million. This promissory note was amended and restated by a promissory note dated June 29, 2012, issued to Red Ash by both Kraus Brands LP, by its general partner, Kraus Brands Inc., and Kraus US, in an amount up to but not exceeding \$25 million ("**2012 Red Ash Promissory Note**").¹⁵

19. On July 25, 2014, Kraus Canada LP, by its general partner Kraus Canada Inc., Kraus Carpet LP, by its general partner Kraus Carpet Inc., Strudex LP, by its general partner Strudex Inc., and Kraus US, issued a promissory note to Red Ash in an amount up to but not exceeding \$10 million. This promissory note was subsequently amended three times, most recently by a third amended and restated promissory note dated December 29, 2015, in an amount up to but not exceeding \$16 million ("**2014 Red Ash**

¹⁴ Emmott Affidavit, at para 34.

¹⁵ Emmott Affidavit, at para 35.

Promissory Note", with the Assigned Credit Facilities and 2012 Red Ash Promissory Note, collectively, the "**Red Ash Debt Agreements**").¹⁶

20. As of August 31, 2018, the total indebtedness outstanding under the Red Ash Debt Agreements was approximately \$99,940,956.¹⁷

21. The indebtedness under the Red Ash Debt Agreements is secured by a second-ranking charge against all assets and undertaking of the Kraus Group.¹⁸

22. The Kraus Group leases certain equipment and other personal property in connection with the operation of its business and a limited number of lessors have filed registrations in personal property registration systems in various provinces in respect of such leases.¹⁹

C. Kraus Group's Business

i. Business Divisions

23. As noted above, the Kraus Group has two business divisions: the TPS Business and the Broadloom Business. The Broadloom Business accounts for approximately 46% of the Kraus Group's revenues; the TPS Business accounts for the remaining 54%.²⁰

24. The Kraus Group markets its carpet and flooring products to both the commercial and residential markets. In respect of retail customers, the Kraus Group's products are sold to both independent stores and big box retailers. The TPS Business's American

¹⁶ Emmott Affidavit, at para 36.

¹⁷ Emmott Affidavit, at para 39.

¹⁸ Emmott Affidavit, at para 37(a).

¹⁹ Emmott Affidavit, at para 41.

²⁰ Emmott Affidavit, at para 9.

sales account for approximately 53% of total sales, and Canadian sales represent the remaining 47%. The Broadloom Business's American sales are approximately 60% of total sales, with Canadian sales comprising the remaining 40%.²¹

ii. Employees

25. The Kraus Group has approximately 540 active employees, consisting of 215 unionized and 326 non-unionized employees.²²

26. Strudex LP and United Food and Commercial Workers Union ("**UFCW**") are parties to a collective agreement dated July 5, 2015 ("**Strudex Collective Agreement**"). The Strudex Collective Agreement was in force until June 30, 2018. However, under the terms of the Strudex Collective Agreement, the parties continue to perform under the expired agreement until a new one is in place. Approximately 62 employees are subject to the Strudex Collective Agreement.²³

27. Kraus Carpet LP and UFCW are parties to a collective agreement dated July 5, 2015 ("**Kraus Carpet Collective Agreement**"). The Kraus Carpet Collective Agreement was in force until June 30, 2018. However, under the terms of the Kraus Carpet Collective Agreement, the parties continue to perform under the expired agreement until a new one is in place. Approximately 148 employees are subject to the Kraus Carpet Collective Agreement.²⁴

28. Kraus Canada LP and the Teamsters Local Union No. 213 (affiliated with the International Brotherhood of Teamsters, of the City of Vancouver, Province of British

²¹ Emmott Affidavit, at para 10.

²² Emmott Affidavit, at paras 14, 16-18.

²³ Emmott Affidavit, at para 16.

²⁴ Emmott Affidavit, at para 17.

Columbia) (“**Teamsters**”) are parties to a collective agreement dated October 1, 2011 (the “**Kraus Canada Collective Agreement**”). The Kraus Canada Collective Agreement remains in force until September 30, 2018, and five employees are subject to the agreement.²⁵

29. Certain of the Kraus Group companies also maintain employee pension plans which are defined contribution plans.²⁶

iv. **Cash Management**

30. The Kraus Group operates a centralized cash management system that is managed by the finance team at the Waterloo Premises. On a weekly basis, the Kraus Group’s finance team draws down on the Wells Fargo Operating Facility to meet the group’s working capital requirements. These funds are then allocated across the Kraus Group to satisfy the obligations of each entity.²⁷

D. **Financial Difficulties**

31. The Kraus Operating Entities are in default of the Wells Credit Agreement, as amended, because they have failed to meet the financial covenants required in the agreement.²⁸ The Kraus Operating Entities are unable to satisfy these obligations in full if required by Wells Fargo, however Wells Fargo is prepared to forbear from enforcing on its security so long as the Kraus Group’s operating cash flow is consistent with that set out in the Cash Flow Forecast (as defined below).²⁹

²⁵ Emmott Affidavit, at para 18.

²⁶ Emmott Affidavit, at paras 22, 23, 25, 26.

²⁷ Emmott Affidavit, at para 54.

²⁸ Emmott Affidavit, at para 60.

²⁹ Emmott Affidavit, at para 63.

32. By virtue of the Kraus Operating Entities' default of the Wells Credit Agreement, the Kraus Group is in default of the Red Ash Credit Agreements. The Kraus Group is also in default of the Red Ash Credit Agreements for failing to make interest payments when due thereunder, and failing to meet certain financial covenants specified therein.³⁰

33. The Kraus Group does not have sufficient liquidity to repay the outstanding indebtedness to Red Ash in full if Red Ash should make a demand for repayment.³¹

E. TPS Transaction

34. As noted above, in consultation with the management of the Kraus Group, Red Ash retained DCF in March 2018 to explore strategic alternatives for the continuation of their business.³²

35. In consultation with DCF, the Applicants concluded that it was in the best interests of the Applicants and their stakeholders to pursue a sale of the two operating divisions of the company, the TPS Business and Broadloom Business pursuant to sales processes run by DCF for each of the Businesses. This process resulted in the transaction ("**TPS Transaction**") contemplated by the asset purchase agreement between Kraus Canada LP, Kraus Properties LP and Kraus USA Inc. (collectively, the "**Kraus Sellers**") and Q.E.P. Co., Inc. and Roberts Company Canada, Ltd. (collectively, the "**Purchasers**") dated September 10, 2018 ("**Purchase Agreement**").³³

36. Pursuant to the terms of the Purchase Agreement, the Purchasers have agreed to purchase substantially all of the assets related to the TPS Business. The Purchasers

³⁰ Emmott Affidavit, at para 61.

³¹ Emmott Affidavit, at para 64.

³² Emmott Affidavit, at para 85.

³³ Emmott Affidavit, at para 86.

have also agreed to assume specified liabilities of the Kraus Group (including selected leases and trade accounts payable).³⁴

37. To facilitate an effective and efficient transition of the TPS Business to the Purchasers, the Kraus Sellers and Q.E.P. Co., Inc. are negotiating a form of transition services agreement ("**Transition Services Agreement**"). The transition services contemplated under the agreement include warehousing functions, information technology services, and employment of certain of the employees of the TPS Business, and collection of accounts receivable outstanding on closing.³⁵

38. Unfortunately, no going concern or *en bloc* purchaser was secured for the Broadloom Business.³⁶

F. Need for CCAA Protection

39. As a result of continuing liquidity challenges, the Applicants are insolvent and cannot meet their liabilities as they become due. It is apparent that the realizable value of the Applicants' assets is significantly less than its obligations.³⁷

40. The Applicants have determined that a CCAA proceeding is required in order to complete and implement a value-maximizing going concern sale (and supporting transition services agreements) of the TPS Business, and to otherwise address current financial challenges through an orderly sale or liquidation of its remaining assets.³⁸

³⁴ Emmott Affidavit, at para 105.

³⁵ Emmott Affidavit, at para 113.

³⁶ Emmott Affidavit, at para 86.

³⁷ Emmott Affidavit, at para 65.

³⁸ Emmott Affidavit, at para 5.

PART III - ISSUES

41. The key issues on this Application are as follows:
- (a) Should the Kraus Group be granted protection under the CCAA?
 - (b) Should the stay of proceedings be granted to the Applicants, the Partnerships and their directors and officers?
 - (c) Should the proposed Monitor be appointed as requested?
 - (d) Should the Directors' Charge and Administration Charge be approved?
and
 - (e) Should the Sealing Order be granted with respect to Confidential Exhibits?

PART IV - LAW

A. Jurisdiction

42. The CCAA applies to a "debtor company" with total claims against it or its affiliated debtor companies of more than \$5 million.³⁹

i. The Applicants are each a "company" as defined in the CCAA

43. The CCAA defines "company" as follows:⁴⁰

"company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province, any incorporated company having assets or doing business in Canada, wherever incorporated....

44. Aside from Kraus US, each of the members of the Kraus Group are incorporated pursuant to the laws of Ontario, use the Waterloo Premises as their registered office and have assets in Canada.

³⁹ CCAA, s 3(1).

⁴⁰ CCAA, s 2(1).

45. Kraus US is incorporated pursuant to the laws of Delaware, but has a bank account at the Bank of Montreal with funds on deposit.⁴¹

46. The existence of a bank account in Canada with nominal funds is sufficient to qualify a company to be a “company” under the CCAA.⁴²

47. Therefore each of the Applicants are a “company” as defined in the CCAA.

48. Further, since the chief place of business of the Kraus Group is located in Ontario, this Court has jurisdiction to hear this application pursuant to section 9(1) of the CCAA.⁴³

ii. Each of the Applicants are a “debtor company” as defined in the CCAA

49. A “debtor company” is “any company that is bankrupt or insolvent.”⁴⁴

50. The term “insolvent” is not expressly defined in the CCAA. However, for purposes of the CCAA, a debtor is “insolvent” if it meets the definition of an “insolvent person” in section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (“**BIA**”),⁴⁵ or if it is “reasonably expected to run out of liquidity within [a] reasonable proximity of time as compared with the time reasonably required to implement a restructuring.”⁴⁶

⁴¹ Emmott Affidavit, at para 6(k).

⁴² *Re Canwest Global Communications Corp.*, [2009] OJ No 4286 at para 30 (Ont Sup Ct J [Comm List]) [**Canwest Global 6184**], Book of Authorities of the Applicants [**BOA**] Tab A; *Re Cinram International Inc.*, 2012 ONSC 3767, at Schedule C, para 47, BOA Tab B; *Re Global Light Telecommunications Inc.*, 2004 BCSC 745 at paras 16-18, BOA Tab C.

⁴³ CCAA, s 9(1).

⁴⁴ CCAA, s 2(1).

⁴⁵ BIA, s 2.

⁴⁶ *Re Stelco Inc.*, [2004] OJ No. 1257 at para 26 (Ont Sup Ct J [Comm List]), BOA Tab D [**Re Stelco**]; followed in *Re Canwest Global 6184*, [2009] OJ No 4286 at para 25 (Ont Sup Ct J) BOA Tab A.

51. Section 2 of the BIA defines an “insolvent person” as a person who, among other things, is “insolvent” under one of the following tests:⁴⁷

- (a) is for any reason unable to meet his obligations as they generally become due;
- (b) has ceased paying his current obligations in the ordinary course of business as they generally become due; or
- (c) the aggregate of whose property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all of his obligations, due and accruing due.

52. A company satisfying any one of these tests is considered insolvent for the purposes of the CCAA.⁴⁸

53. As set out in the Emmott Affidavit, the book value of the Applicants’ assets is less than the book value of its liabilities by approximately \$46.7 million based on its internal unaudited financial reporting as at July 31, 2018.⁴⁹

54. Further, the Applicants have insufficient funds to pay their debts and are unable to meet their obligations as they generally become due and owing in the ordinary course of business. Notably, absent continued financial support and the availability of the Wells Operating Facility it is projected that the TPS Business cannot be sustained beyond October 1, 2018.⁵⁰

55. Accordingly, the Applicants are insolvent.

⁴⁷ BIA, s 2.

⁴⁸ *Re Stelco*, [2004] OJ No. 1257 at para 28 (Ont Sup Ct J [Comm List]), BOA Tab D.

⁴⁹ Emmott Affidavit, at para 53(a)-(b), see also Exhibit “E” of the Emmott Affidavit.

⁵⁰ Emmott Affidavit, at para 62.

iii. Claims Total More than \$5 Million

56. As described above, the Applicants' liabilities exceed the statutory threshold that a debtor company have claims against it that exceed \$5 million.⁵¹

57. The Applicants have met the other threshold requirements of section 10 of the CCAA.⁵²

B. Stay of Proceedings is Appropriate

58. Given its current financial condition, a stay of proceedings at this time is in the best interests of the Applicants, their stakeholders and is both appropriate and necessary.

59. The proposed Initial Order seeks a stay of proceedings. Pursuant to section 11.02 of the CCAA, the Court has discretion to make an order staying proceedings, restraining further proceedings, or prohibiting the commencement of proceedings, "on any terms that it may impose", provided the Court is satisfied that circumstances exist that make the order appropriate.⁵³

60. Here, the stay is necessary and appropriate to afford the Applicants, among other things, the stability to continue the TPS Business, pursue closing of the sale of the TPS Business (and related court approvals) and transition the TPS Business to the Purchasers, as further detailed in the Emmott Affidavit. A timely and well-transitioned completion of the sale and dispositions proposed will result in the highest realizations for affected creditors.

⁵¹ Emmott Affidavit, at para 65.

⁵² CCAA, s 10.

⁵³ CCAA, s. 11.02(1), (3).

61. The Applicants also respectfully request that the stay of proceedings be extended to the Kraus Group's Partnerships. The Court has broad inherent jurisdiction to impose a stay of proceedings that supplements the statutory provisions of Section 11 of the CCAA where it is just and reasonable to do so, including with respect to non-applicant parties.⁵⁴

62. In *Re Tamerlane Ventures Inc. and Pine Point Holding Corp.*,⁵⁵ the Court considered whether the stay of proceedings could be extended to non-applicant third parties. In that case, Justice Newbould explained:⁵⁶

Courts have an inherent jurisdiction to impose stays of proceedings against non-applicant third parties where it is important to the reorganization and restructuring process, and where it is just and reasonable to do so. See Farley J. in *Re Lehndorff* (1993), 9 B.L.R. (2d) 275 and Pepall J. (as she then was) in *Re Canwest Publishing Inc.* (2010), 2010 ONSC 222 (CanLII), 63 C.B.R. (5th) 115. Recently Morawetz J. has made such orders in *Cinram International Inc. (Re.)*, 2012 ONSC 3767 (CanLII), *Sino-Forest Corporation (Re.)*, 2012 ONSC 2063 (CanLII) and *Skylink Aviation Inc. (Re.)*, 2013 ONSC 1500 (CanLII).

63. Similarly, in *Re Jaguar Mining Inc.*,⁵⁷ Regional Senior Justice Morawetz stated:

The Jaguar Group operates in a fully integrated manner and depends upon its Subsidiaries for their value generating capacity. Absent a stay of proceedings not only in favour of Jaguar but also in favour of the Subsidiaries, various creditors would be in a position to take enforcement steps which could conceivably lead to a failed restructuring, which

⁵⁴ *Cinram International Inc.*, 2012 ONSC 3767, Schedule "C" at para 63, BOA Tab B.

⁵⁵ *Re Tamerlane Ventures Inc. and Pine Point Holding Corp.*, 2013 ONSC 5461, BOA Tab E [*"Re Tamerlane"*] citing *Re Canwest Publishing Inc.*, 2010 ONSC 222, BOA Tab F.

⁵⁶ *Re Tamerlane*, 2013 ONSC 5461 at para 21, BOA Tab E.

⁵⁷ *Re Jaguar Mining Inc.*, Court File No. CV-13-10383-00CL, Endorsement of RSJ Morawetz dated January 16, 2014, BOA Tab F [*"Jaguar Mining"*].

would not be in the best interests of Jaguar's stakeholders.⁵⁸

64. The Partnerships are the operating entities of the Kraus Group and as such are integral to the business operations of the organization.⁵⁹ Two of the three parties to the Purchase Agreement are Partnerships.⁶⁰ If creditors were able to enforce their security or otherwise pursue claims against the Partnerships, it would negatively impact the Applicants' CCAA proceedings, including their ability to sell and transition the TPS Business to the purchaser.

65. Accordingly, the Applicants submit that extending the stay of proceedings to the Partnerships is important to the restructuring process and is just and reasonable.

66. The Applicants also request that the stay extend to the directors and officers of the Kraus Group. Section 11.03 of the CCAA provides that an order made under section 11.02 of the CCAA may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under the CCAA and that relates to the obligations of the company.⁶¹

67. The Applicants submit that the stay should be extended to the Kraus Group's directors and officers so that they may focus on the CCAA proceedings and orderly transition of the TPS Business to the Purchasers.

⁵⁸ *Jaguar Mining*, at paras 39-40, BOA Tab G.

⁵⁹ Emmott Affidavit, at para 6.

⁶⁰ Emmott Affidavit, at para 3.

⁶¹ CCAA, s 11.03(1).

C. Appointment of Monitor

68. A Court is required to appoint a person to monitor the business and financial affairs of a debtor company at the same time that an initial CCAA order is made pursuant to section 11.7 of the CCAA.⁶²

69. Section 11.7 also sets out certain requirements for and restrictions who may act as a monitor, including that the monitor be a trustee within the meaning of subsection 2(1) of the BIA.⁶³

70. Deloitte is a trustee within the meaning of subsection 2(1) of the BIA and is not disqualified under any of the restrictions pursuant to section 11.7 of the CCAA. Deloitte has also consented to its appointment as Monitor.⁶⁴

D. Charges

71. The proposed Initial Order provides for the following charges, in the following priority:

- (a) **First** – the Administration Charge (to the maximum amount of \$1 million);
and
- (b) **Second** – the Directors' Charge (to the maximum amount of \$1 million).

72. The Applicants propose that the Administration Charge and Directors' Charge rank in priority to all other security interests, trusts, liens, charges, encumbrances and claims of secured creditors, statutory or otherwise (collectively, the "**Encumbrances**") in

⁶² CCAA, s 11.7.

⁶³ CCAA, s 11.7.

⁶⁴ Emmott Affidavit, at paras 80-81.

favour of any person, notwithstanding the order of perfection or attachment, other than (a) any validly perfected security interest under the *Personal Property Security Act* or other applicable provincial legislation, or (b) statutory super-priority deemed trusts and liens for unpaid employee source deductions. The proposed Initial Order authorizes the Applicants to seek an order granting priority of the charges ahead of all or certain other Encumbrances on a subsequent motion in these proceedings.⁶⁵

i. Administration Charge

73. The Applicants are requesting an Administration Charge in the amount of \$1 million (“**Administration Charge**”) to secure the pre- and post-filing professional fees and disbursements of the Monitor, counsel to the Monitor, and counsel to the Applicants.

74. A Court has jurisdiction to grant an administration charge pursuant to section 11.52 of the CCAA which states:⁶⁶

(1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor’s duties;

(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or

⁶⁵ Emmott Affidavit at para 79.

⁶⁶ CCAA, s 11.52.

charge is necessary for their effective participation in proceedings under this Act.

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

75. Courts have developed a non-exhaustive list of factors to be considered in approving an administration charge, including:⁶⁷

- (a) the size and complexity of the business being restructured;
- (b) the proposed role of the beneficiaries of the charge;
- (c) whether there is an unwarranted duplication of roles;
- (d) whether the quantum of the proposed charge appears to be fair and reasonable;
- (e) the position of the secured creditors likely to be affected by the charge; and
- (f) the position of the Monitor.

76. The Applicants submit that it is appropriate for the Court to exercise its jurisdiction and grant the Administration Charge. The beneficiaries of the Administration Charge will play a critical role in assisting the Applicants with the sale and transition of the TPS Business to the Purchasers and the progression of these CCAA proceedings. Further each proposed beneficiary of the Administration Charge is performing distinct functions; there is no duplication of roles. Further, the quantum of the proposed Administration Charge is in line with the nature and size of the Applicants' business and the involvement required by the professional advisors.

⁶⁷ *Canwest Global 6184*, [2009] OJ No 4286 at para 52 (Ont Sup Ct J) BOA Tab A; *Re Canwest Publishing Inc.*, 2010 ONSC 222, at para 54, as found in the Commercial List Authorities Book; *Jaguar Mining*, at paras 42-44, BOA Tab G.

77. The proposed Monitor is supportive of the granting and quantum of the Administration Charge.

ii. Directors' Charge

78. The proposed Initial Order contemplates the indemnification of the Applicants' directors and officers, the creation of a charge (the "**Directors' Charge**") in relation thereto, and a related stay of proceedings in respect of claims against the Kraus Group's directors and officers.

79. A court may grant a directors' charge on a super-priority basis pursuant to section 11.51 of the CCAA which provides:

(1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

(3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

(4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

80. The purpose of a directors' charge was described in *Canwest*:⁶⁸

The purpose of such a charge is to keep the directors and officers in place during the restructuring by providing them with protection against liabilities they incur during the restructuring. Retaining the current directors and officers of the applicants would avoid destabilization and would assist in the restructuring. The proposed charge would enable the applicants to keep the experienced board of directors supported by the experienced senior management.

81. In *Jaguar Mining*, the Court set out the following factors to be considered with respect to the approval of a directors' charge:⁶⁹

- (a) whether notice has been given to the secured creditors likely to be affected by the charge;
- (b) whether the amount is appropriate;
- (c) whether the applicant could not obtain adequate indemnification insurance for the director or officer at a reasonable cost; and
- (d) whether the charge does not apply in respect of any obligation incurred by a director or officer as a result of the director's or officer's gross negligence or wilful misconduct.

82. The Applicants' maintain an insurance policy for its directors and officers ("**Directors' Insurance**"). The Directors' Insurance insures directors and officers of the Kraus Group for certain claims that may arise against them in their capacity as directors or officers. However, the Directors' Insurance contains certain exclusions and limitations, and it is possible that the policy will not provide sufficient coverage in respect of potential directors and officer liabilities in these CCAA proceedings.⁷⁰

⁶⁸ *Canwest Global 6184*, [2009] OJ No 4286 at para 48 (Ont Sup Ct J [Comm List]), BOA Tab A.

⁶⁹ *Jaguar Mining*, at para 45, BOA Tab G.

⁷⁰ Emmott Affidavit, at para 73.

83. Further, the directors of the Kraus Group have advised that without the protection of the Directors' Charge they will resign.⁷¹ The Applicants submit that it is important to have the Directors' Charge to keep their directors and officers in place during the CCAA proceedings and to protect them against liabilities that they could incur throughout the CCAA proceedings in their capacity as directors and officers.

84. The Applicants have worked with the Monitor and the other professionals to estimate the proposed quantum of the Directors' Charge.⁷²

85. The Applicants respectfully submit that the Directors' Charge is reasonable in the circumstances. Accordingly, the Applicants request that this Court exercise its discretion to approve the Directors' Charge proposed in the Initial Order.

E. Sealing Order

86. The Applicants submit that the Confidential Exhibits should be sealed because they contain sensitive commercial information, including the purchase price, that could harm any future sale process if the sale of the TPS Business does not close.

87. The Court has jurisdiction to seal confidential documents under section 137(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended ("**CJA**"). Section 137(2) of the CJA states that "a court may order that any document filed in a civil proceeding before it be treated as confidential, sealed and not form part of the public record."

⁷¹ Emmott Affidavit, at para 75.

⁷² Emmott Affidavit, at paras 78.

88. In *Sierra Club of Canada (Minister of Finance)*, the Supreme Court of Canada established a two-part test for the granting of a sealing order. A sealing order will be granted where:⁷³

- (a) the order is necessary to prevent a serious risk to an important interest, including a commercial interest, in the context of litigation because reasonably alternative measures would not prevent the risk; and
- (b) the salutary effects of the order, including the effects on the right of civil litigants to a fair trial, outweigh its deleterious effects, including the effects on the right to free expression, which includes the public interest in open and accessible proceedings.

89. In *Re Comstock Canada Ltd.*, the court sealed an unredacted copy of a sale agreement for the sale of a debtor's assets because it contained commercially sensitive information and disclosure of that information could be harmful to the debtor's creditors.⁷⁴

90. The Applicants submit that they have satisfied both parts of the *Sierra Club of Canada* test and that the Confidential Exhibits should be sealed. As with the debtor in *Re Comstock Canada Ltd.*, the information contained in the Confidential Exhibits is commercially sensitive information which, if disclosed prior to the closing of the TPS Transaction, may harm the sale process and prejudice all stakeholders in the event that the TPS Transaction does not close. If the TPS Transaction does not close, and another sales process is required, in the absence of a sealing order, future bidders would have access to the amount that was accepted by the Applicants, which may adversely affect realizations. In such circumstances, a sealing order is appropriate.

⁷³ *Sierra Club of Canada v. Canada (Minister of Finance)*, 2002 SCC 41 at para 53, BOA Tab H.

⁷⁴ *Re Comstock Canada Ltd.*, 2014 ONSC 493 at para 15, BOA Tab I.

91. Further, the employee information that is contained in the Confidential Exhibit is sensitive personal information, the disclosure of which would harm the Kraus Group's employees' privacy interests.

92. The preservation of the integrity of the TPS SISP and the TPS Transaction, and the personal privacy of the Kraus Group's employees, outweigh the public interest in open and accessible court proceedings, as this information would not otherwise be available to the public in a private sale process.

PART V - RELIEF SOUGHT

97. The Kraus Group is insolvent and in default of its obligations to secured creditors. In the circumstances, and following the lengthy sales process described, the Kraus Group is initiating these CCAA proceedings to maintain the stability of its business while it works to seek court approval for and, subject to court approval, complete the going concern sale of its TPS Business segment.

98. The Applicants submit that they meet the qualifications required to obtain the requested relief under the CCAA, and respectfully request that the Court grant the proposed form of Initial Order.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 10th day of September, 2018.



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SCHEDULE "A"
LIST OF AUTHORITIES

1. *Re Canwest Global Communications Corp.*, [2009] OJ No. 4286 (Ont Sup Ct J [Comm List]).
2. *Re Canwest Publishing Inc.*, 2010 ONSC 222.
3. *Re Cinram International Inc.*, 2012 ONSC 3767.
4. *Re Comstock Canada Ltd.*, 2014 ONSC 493.
5. *Re Global Light Telecommunications Inc.*, 2004 BCSC 745.
6. *Re Jaguar Mining Inc.*, Endorsement of Justice Morawetz dated January 16, 2014, in Court File No. CV-13-10383-00CL (Ont Sup Ct J [Comm List]).
7. *Re Stelco Inc.*, [2004] OJ No. 1257 (Ont Sup Ct J [Comm List]).
8. *Re Tamerlane Ventures Inc. and Pine Point Holding Corp.*, 2013 ONSC 5461.
9. *Sierra Club of Canada v. Canada (Minister of Finance)*, 2002 SCC 41.

SCHEDULE "B"
RELEVANT STATUTES

Bankruptcy and Insolvency Act, RSC 1985, c B-3

Definitions

2. (1) In this Act,

"insolvent person".

"insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

(a) who is for any reason unable to meet his obligations as they generally become due,

(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due;

"trustee"

"trustee" or "licensed trustee" means a person who is licensed or appointed under this Act;

Companies' Creditors Arrangement Act, RSC 1985, c C-36

Definitions

2. (1) In this Act,

"company"

"company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province, any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies;

"debtor company"

"debtor company" means any company that

(a) is bankrupt or insolvent,

(b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts,

(c) has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, or

(d) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent;

Application

3. (1) This Act applies in respect of a debtor company or affiliated debtor companies if the total of claims against the debtor company or affiliated debtor companies, determined in accordance with section 20, is more than \$5,000,000 or any other amount that is prescribed.

Jurisdiction of court to receive applications

9. (1) Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company in Canada is situated, or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

Form of applications

10 (1) Applications under this Act shall be made by petition or by way of originating summons or notice of motion in accordance with the practice of the court in which the application is made.

Documents that must accompany initial application

(2) An initial application must be accompanied by

- **(a)** a statement indicating, on a weekly basis, the projected cash flow of the debtor company;
- **(b)** a report containing the prescribed representations of the debtor company regarding the preparation of the cash-flow statement; and
- **(c)** copies of all financial statements, audited or unaudited, prepared during the year before the application or, if no such statements were prepared in that year, a copy of the most recent such statement.

Publication ban

(3) The court may make an order prohibiting the release to the public of any cash-flow statement, or any part of a cash-flow statement, if it is satisfied that the release would unduly prejudice the debtor company and the making of the order would not unduly prejudice the company's creditors, but the court may, in the order, direct that the cash-

flow statement or any part of it be made available to any person specified in the order on any terms or conditions that the court

General power of court

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

Stays, etc. — initial application

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Stays — directors

11.03 (1) An order made under section 11.02 may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company if directors are under any law liable in their capacity as directors for the payment of those obligations, until a compromise or an arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

Exception

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the company's obligations or an action seeking injunctive relief against a director in relation to the company.

Persons deemed to be directors

(3) If all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the company is deemed to be a director for the purposes of this section.

Security or charge relating to director's indemnification

11.51 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Restriction — indemnification insurance

(3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

Negligence, misconduct or fault

(4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

Court may order security or charge to cover certain costs

11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a

debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

- (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
- (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and
- (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Court to appoint monitor

11.7 (1) When an order is made on the initial application in respect of a debtor company, the court shall at the same time appoint a person to monitor the business and financial affairs of the company. The person so appointed must be a trustee, within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*.

Restrictions on who may be monitor

(2) Except with the permission of the court and on any conditions that the court may impose, no trustee may be appointed as monitor in relation to a company

- (a) if the trustee is or, at any time during the two preceding years, was
 - (i) a director, an officer or an employee of the company,
 - (ii) related to the company or to any director or officer of the company, or
 - (iii) the auditor, accountant or legal counsel, or a partner or an employee of the auditor, accountant or legal counsel, of the company; or
- (b) if the trustee is
 - (i) the trustee under a trust indenture issued by the company or any person related to the company, or the holder of a power of attorney under an act constituting a hypothec within the meaning of the Civil Code of Quebec that is granted by the company or any person related to the company, or
 - (ii) related to the trustee, or the holder of a power of attorney, referred to in subparagraph (i).

Court File No. CV-18-604759-00CL
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF KRAUS BRANDS INC., KRAUS CANADA LTD.,
KRAUS CARPET INC., KRAUS PROPERTIES INC., KRAUS USA INC., and STRUDEX INC.

<p>ONTARIO SUPERIOR COURT OF JUSTICE (COMMERCIAL LIST)</p> <p>PROCEEDING COMMENCED AT TORONTO</p>	
<p>FACTUM OF THE APPLICANTS (CCAA Initial Application)</p>	<p>Cassels Brock & Blackwell LLP 2100 Scotia Plaza 40 King Street West Toronto, ON, M5H 3C2</p> <p>David S. Ward LSUC#: 33541W Tel: 416.869.5960 Fax: 416.640.3154 dward@casselsbrock.com</p> <p>Larry Ellis LSUC#: 49313K Tel: 416.869.5406 Fax: 416.640.3004 lellis@casselsbrock.com</p> <p>Erin Craddock LSUC#: 62828J Tel: 416.860.6480 Fax: 416.644.9324 ecraddock@casselsbrock.com</p> <p><i>Lawyers for the Applicants</i></p>