Court File No. CV-20-00638930-00CL

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 CANNTRUST HOLDINGS INC., CANNTRUST INC., CTI HOLDINGS (OSOYOOS) INC., and ELMCLIFFE INVESTMENTS INC.

Applicants

FACTUM OF ZOLA FINANCE HOLDINGS LTD. AND IGOR GIMELSHTEIN
(Opposing the Stay Extension)
Motion Returnable October 28, 2020

October 26, 2020

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PART I - INTRODUCTION

1. Igor Gimelshtein and Zola Finance Holdings Ltd. (the "**Zola Plaintiffs**") are both sophisticated and significant investors in CannTrust Holdings Inc. ("**CannTrust**") who have lost most of their $37 million investment in the company as a consequence of CannTrust's and others' misconduct. Their action to recover against the alleged wrongdoers (the "**Zola Action**") has been stayed under the *Companies Creditors Arrangement Act* ("***CCAA***") since March.

2. The Zola Plaintiffs entered the *CCAA* process in good faith to negotiate and give CannTrust a reasonable period of time to resolve the claims against it. It is now clear that the Zola Plaintiffs' attempt to negotiate a good faith compromise to their claims is not being reciprocated.

3. Even though they appear to be the largest shareholder participating in the *CCAA* process, they have been effectively excluded from the ongoing mediation. CannTrust refuses to negotiate with the Zola Plaintiffs and the coalition of class action plaintiffs that is directly negotiating with the company will not allow it to participate in their ongoing negotiations.

4. Meanwhile, CannTrust is burning through its cash on hand, much of which is the fruit of the conduct that gave rise to the actions commenced by Zola and the other investor plaintiffs, in pursuit of what is, at best, a questionable effort to relaunch CannTrust's business. CannTrust refuses to provide timely and adequate responses to the Zola Plaintiffs legitimate inquiries into the very high cash expenditures that are being used to not simply restart but to expand CannTrust's operations. This is

particularly problematic in the present circumstances because CannTrust's cash is the primary asset that the Zola Plaintiffs can recover their damages from. As the failed Sale and Investor Solicitation ("**SISP**") process shows, the realizable value of CannTrust's other assets is suspect and CannTrust has no reasonable prospect of being cash flow positive in the foreseeable future.

5. CannTrust has been given a reasonable period of time — close to 7 months — to propose an acceptable compromise to the Zola Plaintiffs. It has not done so. Instead, CannTrust has used the shelter of the *CCAA* stay to unilaterally compromise the claims of the Zola Plaintiffs by wasting the assets that ought to have formed the basis of an early settlement, which is the premise of this entire proceeding. An extension of the stay will only result in the further wasting of CannTrust's cash resources to the benefit of CannTrust.

6. All of these facts are particularly problematic when there is no evidence before the Court of any circumstance necessitating the stay of proceedings. Neither the efforts to restart CannTrust's business nor the mediation of the shareholder claims require the stay. There are no judgments or security interests the enforcement of which are being prevented by the stay. Indeed, the stay is hindering, rather than facilitating, the resolution of the shareholder claims.

7. In these circumstances, CannTrust cannot meet its burden to establish good faith or that the extension of the stay is appropriate in the circumstances. CannTrust and its management should not be allowed to "bet the farm of someone else"[1] (the Zola

[1] *Stelco Inc., Re*, 2006 CanLII 1773 (ON SC) at para 18.

Plaintiffs and other investors) to continue their ill-conceived relaunch and expansion. This Court ought to exercise its discretion to refuse to extend the stay or, alternatively, to extend the stay for a one-month period with the conditions proposed by the Zola Plaintiffs.

PART II - THE FACTS

A. The Zola Plaintiffs have been excluded from the mediation

8. The Zola Plaintiffs are significant CannTrust investors who purchased 3 million CannTrust shares for approximately $37.8 million in late September 2018 and continue to hold the large majority of those shares.[2]

9. The Zola Plaintiffs have extensive experience expertise in the cannabis business. Mr. Gimelshtein is the former Chief Financial Officer of a large publicly-traded licensed producer, MedReleaf. His colleague Mr. Ouass, was a significant investor in MedReleaf and Zola and Gimelshtein have investments in approximately 10 cannabis companies.[3]

10. In November, 2019, the Zola Plaintiffs commenced the Zola Action, which makes claims against CannTrust, Eric Paul, Fred Litwin and others for making misrepresentations that ultimately resulted in the Zola Plaintiffs losing most of their CannTrust investment.[4]

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[2] The Affidavit of Igor Gimelshtein affirmed October 26, 2020 ("**Gimelshtein Affidavit**") at para 10. Respondents' Motion Record ("**Respondents' MR**"), Tab 1

[3] *Ibid.* at para 7.

[4] *Ibid.* at para 11.

11. The Zola Action does not make the same claims as those of the other class action plaintiffs. Among other things, the Zola Plaintiffs relied on numerous unique oral communications they had with senior CannTrust officers and insiders.[5] They are differently and better positioned to advance their claims.

12. The Zola Action, along with other investors' actions against CannTrust, was stayed after CannTrust filed for *CCAA* protection in March. CannTrust's purported need for the stay was clear from the outset: the Zola Plaintiffs and other injured investors had significant meritorious claims against CannTrust and others that entitles them to all or, substantially all, of CannTrust's assets.[6] Indeed, CannTrust's primary aim (following the entirely unsuccessful SISP process) is the settlement of investors' claims through mediation.[7]

13. However, the mediation has not succeeded. Despite the passage of almost 7 months since the stay was granted, CannTrust acknowledges that a resolution is not close.[8] All the while (as is explained further below), CannTrust continues to deplete its cash resources at a high rate, thereby continually and irreversibly worsening the prospects of the Zola Plaintiffs and other investors obtaining a meaningful recovery of their damages from CannTrust.

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[5] See the Statement of Claim in the Zola Action at paras 101-113, Exhibit A to the Gimelshtein Affidavit, Respondents' MR, Tab 1-A.
[6] Factum of the Applicants in support of the Initial Order, dated March 31, 2020 at para 27, Respondents' MR, Tab 3.
[7] Affidavit of Greg Guyatt, sworn October 21, 2020 (the "**Oct. 21 Guyatt Affidavit**") at para 58, Applicant's Motion Record ("**Applicant's MR**") Tab 2.
[8] *Ibid.* at para 56.

14. Despite the fact that the Zola Plaintiffs have both the largest damage claim and largest shareholding of those seeking to participate in the mediation, they have been largely excluded from it. CannTrust has refused to negotiate with the Zola Plaintiffs and has provided only slow and inadequate responses from the company on questions crucial to the current mediation process regarding the purpose and scale of CannTrust's expenditures during the stay.[9]

15. In addition, the coalition of class action plaintiffs (whose individual losses are not nearly as large as those of the Zola Plaintiffs) has chosen to exclude the Zola Plaintiff from any ongoing discussions, even as the mediator has ceased providing the Zola Plaintiffs with any details about offers exchanged in any mediation sessions.[10] At this point, the Zola Plaintiffs' role is limited to receiving cursory updates on the state of the negotiations, which have no apparent sign of resolution.

B. CannTrust's excessive and illogical cash burn

16. Before CannTrust's illegal conduct became public in July 2019 and its operations were subsequently shut down, it had approximately $250 million in cash.[11] Since then, CannTrust has attempted to re-launch and expand its business during the *CCAA* stay, using the cash it obtained through its misconduct. It has burnt through that cash astonishingly quickly:

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[9] Gimelshtein Affidavit at para 16. Respondents' MR Tab 1.
[10] *Ibid.* at paras 21-22.
[11] This number is based on CannTrust's first quarter 2019 financial statement plus money the company raised in the public offering closing on or around May 6, 2019.

December 31, 2019:	$175 million[12]
March 31, 2020:	$134.7 million[13]
November 1, 2020 (projected):	**$82.1 million**[14]

17. In the circumstances, CannTrust's spending is unusually high and unjustified. The Zola Plaintiffs have used their expertise in the cannabis space to analyze CannTrust's spending. Their conclusion is troubling: CannTrust is improperly "using its significant cash on hand … not only to maintain its operations but to expand them, although even that decision is not a sufficient explanation for the amount of cash being consumed."[15]

18. These concerns have been repeatedly raised with CannTrust and the Monitor and only untimely and inadequate cursory replies have been received in response.[16]

C. CannTrust's ill-conceived relaunch

19. CannTrust is using money it raised from investors through its misconduct to fund its re-launch. However, its chances of successfully doing so and achieving profitability appear slim.

[12] Affidavit of Greg Guyatt, sworn March 31, 2020 at para 121(a), Respondents' MR Tab 2.
[13] *Ibid.* at para 175.
[14] Third Report of the Monitor dated June 29, 2020 at para 43. Respondents' MR Tab 4.
[15] Gimelshtein Affidavit at para 15. Respondents' MR Tab 1.
[16] *Ibid*. at para 16.

20. There has been a significant decline in the prospects of the cannabis industry since June 2019. The market capitalization of licensed producers has declined precipitously with the average share price of CannTrust's competitors has decreased by more than 72% since July 5, 2019 [17] Licensed producers are having difficulty attracting new capital to fund operations, as is evidenced by the failure of CannTrust's SISP. There is far more cannabis being supplied than there is demand and cannabis prices have declined.[18] CannTrust has not provided a forecast for achieving profitability and its revenues are paltry.[19]

21. CannTrust faces even greater hurdles than other licensed producers in this difficult operating environment. CannTrust is currently only selling in bulk (*i.e.* to other licensed producers) and, predictably given the lower overall margin on bulk sales and oversupply in the industry, the pricing on those sales is low.

22. CannTrust has not disclosed a plan to enter the retail market.[20] In fact, CannTrust has not disclosed any agreement with, or even an attempt to reach an agreement with, the Ontario Cannabis Store or anyone else to do so. It would be extremely difficult for CannTrust to operate profitably in the retail market and nearly impossible to operate profitably on bulk sales.[21]

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[17] *Ibid.* at para 17.
[18] *Ibid.*
[19] Third Report of the Monitor dated June 29, 2020 at para 43.
[20] Guyatt Affidavit at para 21, Applicant's MR Tab 2.
[21] Gimelshtein Affidavit at para 18. Respondents' MR Tab 1.

PART III - ISSUES AND THE LAW

A. CannTrust has not acted with good faith

23. CannTrust must satisfy this Court that it is acting with good faith to obtain an extension of the stay.[22] This requires CannTrust to prove that it is acting "candidly, honestly, forth-rightly and reasonably" with other stakeholders, including the Zola Plaintiffs, in the mediation process.[23]

24. CannTrust has not met its good faith obligation in its dealings with the Zola Plaintiffs or in these *CCAA* proceedings generally. Indeed, CannTrust's refusal to engage with the Zola Plaintiffs — the largest party to seek to participate in the mediation — and instead seek an agreement with others (presumably with the intention of imposing that deal on the Zola Plaintiffs), if successful, cannot possibly be considered good faith.

25. CannTrust has not been forthright with the Zola Plaintiffs. As detailed above, despite the Zola Plaintiffs legitimate concerns with the extent and nature of CannTrust's cash burn — the availability of which is crucial for CannTrust to satisfy its debt to investors — CannTrust has only provided an untimely and a wholly inadequate cursory response to the Zola Plaintiff's detailed inquiries. The result is that the Zola Plaintiffs and other investors cannot know if CannTrust's previous or future planned expenses are appropriate.

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[22] *Companies' Creditors Arrangement Act,* RSC 1985, c C-36, s. 11.02(3)(a).

[23] Jannis Sarra, "La bonne foi est une considération de base — Requiring Nothing Less than Good Faith in Insolvency Law Proceedings", 2014 ANNREVINSOLV 6 at p. 13,

B. An extension of the stay is not appropriate in the circumstances

26. CannTrust must also satisfy the Court "that circumstances exist that make the order appropriate".[24] Appropriateness is assessed "by inquiring whether the order sought advances the policy objectives underlying the *CCAA*."[25] While the "the *CCAA* generally prioritizes 'avoiding the social and economic losses resulting from liquidation of an insolvent company'"[26], the "*CCAA* is fundamentally insolvency legislation, and thus it also 'has the simultaneous objectives of maximizing creditor recovery, preservation of going-concern value where possible, preservation of jobs and communities affected by the firm's financial distress ... and enhancement of the credit system generally'".[27]

27. Preventing the Zola Plaintiffs and other Plaintiffs from pursuing recovery in the courts while CannTrust's cash resources are being depleted, especially where that cash is being spent on items that cannot reasonably be expected to generate a positive return, is contrary to creditor recovery maximization. At its current trajectory, the Zola Plaintiffs' and other investors will only be able to recovery pennies on the dollar from CannTrust, even though the company entered into the *CCAA* process with over $138 million in cash.

28. All the while, CannTrust has been free to pursue its ill-advised restructuring without any input from its creditors. Effectively, by ignoring the Zola Plaintiffs

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[24] *Companies' Creditors Arrangement Act,* RSC 1985, c C-36, s. 11.02(3)(b).
[25] *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 at para 50 quoting from *Ted Leroy Trucking [Century Services] Ltd, Re*, 2010 SCC 60 at para 70.
[26] *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 at para 41.
[27] *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 at para 42.

while aggressively restructuring, CannTrust has subverted the purpose of the *CCAA* to promote compromises between creditors and debtors and instead is going to seek to unilaterally impose a compromise on the Zola Plaintiffs.[28]

29. Rather than facilitating the resolution of the claims advanced, the stay currently gives CannTrust all the leverage in any negotiations. As long as the stay persists, CannTrust has no incentive to make any real effort to resolve these claims. It can continue to pursue the restructuring, primarily for the benefit of its management, knowing that by the time it ever has to "face the music" in the litigation, there will only be pennies left to recover. In these circumstances, the stay is a disincentive to the resolution of these claims.

30. The stay also does not preserve the status quo between the different creditors. CannTrust has chosen to prioritize its negotiations with class action plaintiffs, whose claims overlap only in part with those of Zola, given the extent of oral misrepresentations made exclusively to Zola by CannTrust's officers and directors. Meanwhile the Zola Plaintiffs claims have stagnated as they are unable to pursue them through either negotiations or litigation.

31. In addition, the duration of CannTrust's requested stay extension is unreasonable. The reasonableness of the time to reach a compromise is context specific and, where a debtor's assets are wasting, that time period is necessarily shorter or it will

[28] *Cliffs Over Maple Bay Investments Ltd. v Fisgard Capital Corp.*, 2008 BCCA 327 at para 38: "What the Debtor Company was endeavouring to accomplish in this case was to freeze the rights of all of its creditors while it undertook its restructuring plan without giving the creditors an opportunity to vote on the plan. The *CCAA* was not intended, in my view, to accommodate a non-consensual stay of creditors' rights while a debtor company attempts to carry out a restructuring plan that does not involve an arrangement or compromise upon which the creditors may vote."

wholly subvert the aim of creditor recovery.[29] Here, CannTrust's cash resources are what creditors are entitled to and that resource is wasting, declining from $250 million in June 2019 to $82.1 million. Any further extension and continued cash burn is unreasonable in these circumstances.

32. In any event, there is simply no immediate risk of liquidation or bankruptcy proceedings causing social or economic loss of the type that the *CCAA* aims to protect against if the stay is lifted. There will be no immediate move to enforce judgment on all CannTrust's resources by the Zola Plaintiffs or other investors because no judgment has yet been obtained against CannTrust.

33. Moreover, CannTrust *has* relaunched its business. Its licenses have been reinstated. It is selling cannabis. If that business is unable to survive on its own as a profitable going concern after the lift of the stay at this stage, then all the stay is doing is temporarily delaying inevitable economic and social loss. What a continuation of the stay guarantees is greater economic losses for the Zola Plaintiffs as a consequence of CannTrust's continued wasting of its cash resources and the Court imposed delay in the Zola Plaintiffs ability to access those resources.

PART IV - ORDER REQUESTED

34. The Zola Plaintiffs respectively request that CannTrust's motion to extend the stay be dismissed or, alternatively, that the stay be extended for a period of one month

[29] *Shire International Real Estate Investments Ltd., Re*, 2010 ABQB 84 at para 9: "Having regard to the objectives of the *CCAA*, the large number of unsecured investors is, or more properly, was an appropriate consideration in granting *CCAA* protection. However, that cannot trump the interests of secured creditors when the facts show that continuing *CCAA* proceedings is putting their security at risk. That is so particularly in circumstances where there is a strong likelihood that continuing *CCAA* proceedings will do nothing to enhance the value of the properties and thereby increase the potential for return to the investors."

with directions that CannTrust address the Zola Plaintiffs' cash flow concerns and mediate directly with the Zola Plaintiffs in good faith.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 26th day of October, 2020

Siskinds LLP and Wright Henry LLP

Lawyers for the Respondents

SCHEDULE "A"
LIST OF AUTHORITIES

1. *9354-9186 Québec inc. v Callidus Capital Corp.*, 2020 SCC 10
2. *Cliffs Over Maple Bay Investments Ltd. v Fisgard Capital Corp.*, 2008 BCCA 327
3. *Shire International Real Estate Investments Ltd., Re*, 2010 ABQB 84
4. *Stelco Inc., Re*, 2006 CanLII 1773 (ON SC)
5. *Ted Leroy Trucking [Century Services] Ltd, Re*, 2010 SCC 60

SCHEDULE "B"
RELEVANT STATUTES

Companies' Creditors Arrangement Act, RSC 1985, c C-36, s. 11.02(3)(a) and s. 11.02(3)(b).

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.

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 CANNTRUST HOLDINGS INC. ET AL.

Court File No.: CV-20-00638930-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

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