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 THE RESPONDENT, ERIC PAUL

(Motion to Approve Meeting Order, Returnable March 19, 2021)

March 18, 2021

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PART I: OVERVIEW

1. Despite the Applicants' statements to the contrary in their materials, their proposed plan materially and negatively impacts the rights of the Respondent, Eric Paul (the former CEO and Chairman of CannTrust Inc.). It essentially eliminates contractual rights of indemnification that Mr. Paul negotiated with CannTrust, and it proposes to do so without even allowing Mr. Paul the opportunity to vote on the plan. Multiple courts have noted that such a result is unfair and unreasonable.

2. In their materials the Applicants' blithely dismiss this concern. They then attempt to distinguish this matter from several prior decisions that hold that individuals whose rights are affected by a plan must be allowed to vote on it. These efforts are inapt and should not be accepted. More fundamentally, the Applicants fail to address the fundamental unfairness of this treatment of Mr. Paul. At the end of the day, the proposed plan is not one that the Court would approve at a sanction hearing, and, as such, the Court should not grant the Applicants their meeting order.

3. Mr. Paul generally shares the concerns of the other Respondents who oppose this motion and supports their submissions. The submissions below are specific to how the plan affects Mr. Paul, and why these are sufficient reasons to dismiss the motion.

PART II: LAW & ARGUMENT

A. Courts will not issue meeting orders where the proposed plan affects the rights of parties not entitled to vote

4. Courts will refuse to grant meeting orders where the plan does not have a reasonable

chance of being approved at a sanction hearing.[1] One factor that has led several courts to come to such a conclusion is where the plan at issue purports to bind parties who are not allowed to vote on it. The *Doman Industries* decision is instructive. There, the Court refused to grant a meeting order because the plan at issue proposed to bind a class of creditors without giving them an opportunity to vote on the plan. Tysoe J. (as he then was) explained:

> It would be inappropriate for me to authorize the calling of creditor meetings to consider the Reorganization Plan when I know that this Court would refuse to sanction it on the basis that it purports to bind parties who were not given the opportunity to vote on it.[2]

5. In coming to this conclusion, Tysoe J. relied on the earlier decision of this Court in *Philip Services Corp*.[3] The Applicants attempt to distinguish *Philip Services* by pointing to the factual context in which that case was decided.[4] Those distinctions are irrelevant. *Philip Services* was about whether it was fair and reasonable to approve of a settlement plan that would cause a party to lose a right of contribution and indemnity it had against a CCAA Applicant without providing that party with a vote on the plan. As the Court noted in in its refusal to approve of the plan:

> [38] ***In my opinion it is the loss of the right to vote in the Canadian Plan which lies at the heart of the present dilemma***. … In Canadian insolvency proceedings under the CCAA, however, ***it is the right to vote on the compromise or arrangement which the debtor company proposes to make with them which is the central counterpart, on the part of the creditors, to the debtors right to attempt to make that compromise or arrangement***. In my view, having chosen to initiate and take advantage of the CCAA proceedings, Philip cannot now evade the implications and

[1] *Target Canada Co. (Re)*, 2016 ONSC 316, ¶67-69.

[2] *Re, Doman Industries Ltd. (Trustee of)*, 2003 BCSC 376, ¶9.

[3] *Menegon v. Phillip Services Corp*, [1999] OJ no 4080 (SCJ).

[4] Applicants' Factum, ¶46, 49.

> statutory requirements of those proceedings by seeking to carve out certain pesky—and potentially large—contingent claimants, and to require them to be dealt with under a foreign regime (where they will be treated less favourably) while at the same time purporting to bind them to the provisions of the Canadian Plan. All of this without the right to vote on the proposal.[5] [emphasis added]

6. This is the issue to be determined at the sanction hearing, and in order to obtain a meeting order, the Applicants need to show that the plan they propose has a reasonable chance of satisfying this test.

7. The Applicants argue that the holding in *Philip Services* has been overtaken by amendments to the CCAA (which clarify that equity claims do not have a right to vote). This misses the mark. The focus is on what is *fair and reasonable*. Here, the company has not provided a convincing explanation of why it is *fair and reasonable* to provide a vote to holders of certain equity claims (*i.e.*, the Securities Claimants), but not to others whose equity rights will be negatively impacted (such as Mr. Paul). Indeed, other decisions released post-amendment have noted their concerns about scheduling meetings where equity claims will be affected without providing the holders of those claims with a vote.[6]

8. Finally, the Applicants' argument that the circumstances of the present matter "bear more similarity" to the second *Philip Services* decision is unpersuasive. There, the plan did not affect the rights or interests of the objecting parties. Indeed, as the quotation in the Applicants' factum demonstrates, this point was conceded by those objecting parties themselves.[7] As will be

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[5] *Menegon v. Phillip Services Corp*, [1999] OJ no 4080, ¶38 (SCJ).

[6] See, for example, *Unique Broadband Systems (Re)*, 2013 ONSC 676, ¶126.

[7] *Philip Services Corp., Re*, 1999 CarswellOnt 4673, ¶9, 11 (Gen. Div.).

discussed below, that is a far cry from the current matter.

B. The plan purports to derogate from Mr. Paul's right of indemnification

9. The Applicants take the position that the current iteration of the plan does not in a "practical sense" affect Non-Settling Defendants, such as Mr. Paul.[8] This statement does not withstand scrutiny.

10. With respect to Mr. Paul, he and the Applicant CannTrust entered into an indemnity agreement in November 2014 that provided Mr. Paul with a broad scope of protection. Pursuant to this indemnity agreement, CannTrust agreed to indemnify and save Mr. Paul harmless:

> (a) From and against ***any and all claims of every nature and kind whatsoever*** which may be made against him/her by any person, firm, corporation, government […] arising out of or in any way connected with the management, operation, activities or existence of the Indemnitor;
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> (b) From and against ***any and all liability, losses, damages, costs, charges, expenses, fines and penalties*** which the Indemnitee may sustain, incur or be liable for in consequence of him/her acting as a Director of the Indemnity whether sustained or incurred by reason of his/her negligence, default, breach of duty, breach of trust, failure to exercise due diligence or otherwise in relation to the Indemnitor; […]
>
> (d) From and against ***all costs and expenses***, including all amounts paid to settle an action or satisfy any judgment, reasonably incurred by the Indemnitee in respect of any civil, or administrative action or proceeding to which the indemnitee is made a party by reason of being or having been a director of the Indemnitor, if:
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>> (i) the Indemnitee acted honestly and in good faith with a view to the best interests of the Corporation, and […][9]

[8] Applicants' Factum, ¶33.

11. As the company's affiant testified on cross-examination, indemnity provisions such as the one above are "standard".[10] And the significance of such provisions to someone in Mr. Paul's position would have been obvious to the company. Indeed, the company's affiant readily conceded that "nobody would join a public company without having appropriate indemnities in place".[11]

12. Despite this recognition, in its proposed plan the company seeks to unilaterally vary this contract in a way that will significantly erode the indemnification rights for which Mr. Paul negotiated. The company's late-coming amendments to the plan—purportedly made for the purpose of addressing this concern[12]—do not change this. Specifically, the plan derogates from Mr. Paul's indemnification rights in three ways:

(a) *First*, the proposed plan provides that Mr. Paul would only be able to access this indemnification right if he had "successfully defended" a claim to which the indemnity would apply.[13] The indemnity that Mr. Paul negotiated with the Company has no such precondition to its application.

(b) *Second*, because Mr. Paul must first successfully defend a claim before he can access the indemnity, he would have to use his personal assets to pay for his defence while the action was ongoing and would only be reimbursed at the end (if successful). Given the potential costs of such a defence, this is a significant

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[9] Affidavit of Susan Bartlett, sworn March 11, 2021, Exhibit "A", Eric Paul Responding Record, Tab 1(a), p 5. [emphasis added]

[10] Cross-examination of Greg Guyatt, March 17, 2021 (**"Guyatt Transcript"**), p 10, ln 10.

[11] Guyatt Transcript, p 10, ln 23-25.

[12] Affidavit of Greg Guyatt, sworn March 13, 2021 (**"Guyatt Affidavit"**), ¶4, 5, Supplementary Motion Record, Tab 1, p 2.

[13] Guyatt Affidavit, Exhibit "B" (s. 2.3(i)), Supplementary Motion Record, Tab 1(b), p 89.

change to the indemnification right. Overarching this is the additional uncertainty as to what steps the company has taken (if any) to ensure that funds will actually be available to fund this obligation. At cross-examination the company's affiant was unable to provide any answers to questions surrounding this issue.[14] This concern is heightened by the fact that although the company currently has more than enough cash reserves to honour this obligation,[15] it has unilaterally decided to spend a significant portion of those reserves to satisfy the equity claims of the Securities Claimants and now will likely be forced to offer wrap-around security to the DIP lenders from which it is seeking financing.[16]

(c) *Third*, whereas the above indemnity unambiguously provides Mr. Paul with broad protection from and against "any and all liability, losses, damages", the "indemnity" in the plan provides him with far less certainty. It would essentially leave the issue of the scope of his protection to the discretion of the presiding judge to determine based on his or her consideration of a number of factors. Specifically, the plan calls for:

> […] any judgment or other award obtained by a Securities Claimant or the Securities Claimant Trust in respect of any Securities-Related Claim against a Non-Settlement Party … shall be reduced by the amount, if any, ***that the court or other tribunal adjudicating the Securities-Related Claim determines would have been recovered by such Non-Settlement Party or other Person pursuant to a Securities-Related Indemnity Claim held by it against a Released Party in respect of such Securities-Related Claim*** but for the release of such Securities-Related Indemnity Claim pursuant to the CCAA Plan or the CCAA Sanction Order, determined as of the moment before the Effective Time and, for greater certainty, ***taking into account*** (i) the Cash Contribution to be made by CannTrust Holdings to the Securities Claimant Trust and (ii) all other Securities-Related Indemnity Claims of other

[14] Guyatt Transcript, p 68, ln 14-20, p 69, ln 15-21.

[15] Guyatt Transcript, p 132, ln 4-9.

[16] Guyatt Transcript, p 64, ln 3-10.

> Non-Settlement Parties or other Persons participating in any recovery on a pro rata basis.[17] [emphasis added]

13. And this is not the only contractual interest of Mr. Paul's that the plan will affect. Mr. Paul's family trust, the Paul Family Trust, was a shareholder of CannaMed Financial Corp. (**"CannaMed"**). It was through this corporation that the Paul Family Trust sold its shares of CannTrust via the May 2019 public offering.[18] These trades are at the heart of the class proceeding claims being asserted against Mr. Paul. CannaMed and CannTrust Holdings Inc. entered into an "Indemnification and Contribution Agreement" in relation to this sale of CannaMed's shares.[19] The agreement purports to indemnify not only CannaMed, but also its shareholders, such as the Paul Family Trust.[20] It also prohibits the Applicants from settling any litigation over which the indemnity could apply without "the prior written consent of the Indemnified Parties".[21] The company was aware that the Paul Family Trust was a shareholder of CannaMed and that Mr. Paul was generally involved in CannaMed.[22] Despite this, it never sought Mr. Paul's consent before settling with the class proceeding plaintiffs; nor did it seek his consent before filing the plan that seeks to erode this indemnification right.[23]

14. With respect to the CannaMed indemnification, not only does the company seek to unilaterally change this contractual right without giving Mr. Paul a vote at the meeting, it seeks

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[17] Guyatt Affidavit, Exhibit "B" (s. 7.3(2)), Supplementary Motion Record, Tab 1(b), p 103.

[18] Guyatt Transcript, p 22, ln 23-p 23, ln 16.

[19] Affidavit of Jocelyn Kemp, sworn March 11, 2021 (**"Kemp Affidavit"**), Exhibit "I", Liwin Responding Record, Tab 1(i), pp 39-52.

[20] Kemp Affidavit, Exhibit "I", Litwin Responding Record, Tab 1(i), p 42.

[21] Kemp Affidavit, Exhibit "I", Litwin Responding Record, Tab 1(i), p 44.

[22] Guyatt Transcript, p 134, ln 24-p 135, ln 6.

[23] Guyatt Transcript, p 135, ln 21-p 136, ln 20.

to do so *in the face of a contractual provision that explicitly states that it must seek Mr. Paul's consent before affecting that right.* This is precisely the type of conduct that concerned Justice Blair in *Philip Services* and led him to refuse to approve the agreement in that matter:

> For instance, Philip is contractually bound under the terms of its Underwriting Agreement with the Underwriters to indemnify and hold the Underwriters harmless against all claims based on allegations of untrue statements or alleged untrue statements in a prospectus. ***More to the point, Philip is not entitled without the consent of the Underwriters, under the terms of the same Agreement, to settle any action in which such claims are made against it*** and unless the settlement includes an unconditional release in favour of the Underwriters. Approval of the proposed Settlement at this stage of the restructuring proceedings would deprive the Underwriters of that contractual right. What is significant at this point is not the attempt to compromise the claim, including the contractual right to the release, ***but rather the loss of the bargaining chip on the part of the Underwriters in the process as a result of the unilateral settlement as between Philip and the plaintiffs***.[24]

15. The plan misleadingly categorizes Mr. Paul's indemnification rights as "Unaffected Claims". In reality, there can be no doubt that the plan in fact derogates from the indemnification rights that Mr. Paul negotiated (either for himself or on the behalf of his family trust). The significance of this "Unaffected Claim" characterization, however, is that, "Unaffected Creditors will not be entitled to vote on the CCAA plan".[25] The company's unilateral changes to Mr. Paul's indemnity rights will negatively impact him. Taking these steps in order prefer the interests of the Security Claimants, who are in the same class of creditors (*i.e.*, both hold equity claims) as Mr. Paul, while not providing him with any right to participate in the

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[24] *Menegon v. Phillip Services Corp*, [1999] OJ no 4080, ¶31 (SCJ).

[25] Guyatt Affidavit, Exhibit "B" (s. 2.3), Supplementary Motion Record, Tab 1(b), p 89.

meeting, is fundamentally unfair and unreasonable. Such an agreement has no reasonable chance of being approved and thus, the meeting order should not be granted.

PART III: ORDER REQUESTED

16. Mr. Paul respectfully requests the dismissal of this motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 18th day of March, 2021.

Per: Paul H. Le Vay / Gerald Chan / Carlo Di Carlo
STOCKWOODS LLP

Counsel for the Respondent, Eric Paul

SCHEDULE “A” – LIST OF AUTHORITIES

1. *Target Canada Co. (Re),* 2016 ONSC 316
2. *Re, Doman Industries Ltd. (Trustee of)*, 2003 BCSC 376
3. *Menegon v. Phillip Services Corp*, [1999] OJ no 4080 (SCJ).
4. *Unique Broadband Systems (Re),* 2013 ONSC 676
5. *Philip Services Corp., Re*, 1999 CarswellOnt 4673,

SCHEDULE "B" – RELEVANT STATUTES, REGULATIONS & BY-LAWS

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDEDAND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CANNTRUST HOLDINGS INC., CANNTRUST INC., CTI HOLDINGS (OSOYOOS) INC., AND ELMCLIFFE INVESTMENTS INC.

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