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 LITWIN NON-SETTLING DEFENDANTS IN COMBINED RESPONSE TO COALITION PLAINTIFFS' FACTUM AND PLAN #3

(Returnable April 16, 2021)

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1. This factum is divided into two parts. The first deals briefly with the factum filed by the Coalition Plaintiffs counsel. The second deals with Plan #3 sent out late on April 9, 2021 once again without prior discussion with these Non-Settling Defendants.

<u>Reply to Coalition Plaintiffs' Factum</u>

2. The Plaintiffs' argument starts in paragraph 1 with an assumption that the allegations in the various claims that have been initiated "are found to be true". Obviously that is not an assumption that these Non-Settling Defendants consider a tenable starting point.

3. The Plaintiffs then anticipate and state an assumption as to why "opposition arises" from the Non-Settling Defendants. The facta filed by the Non-Settling Defendants made it clear that Plaintiffs' counsel's anticipatory assumption in this regard was incorrect.

4. Next, under the section headed Facts an argument is framed in pejorative terms that the Non-Settling Defendants "have all attempted to shift their liabilities onto CannTrust by using contracts of indemnity". Given the evidence of Mr. Guyatt as to the importance of indemnities in attracting qualified people to serve on public company boards and the almost universal practice in public company financing in providing indemnities, that the indemnitees

are seeking to rely on the rights they bargained for and received is not a "shifting" but rather the enforcement of an agreed allocation of risk that the Company (and the Plaintiffs) now seek to avoid.

5. The Company raised funds on the basis that if it turned out that what it said was not accurate it would bear the responsibility and hold the indemnitees harmless from the fallout. The CCAA regime requires the insolvent entity and all its stakeholders to deal with the contractual obligations and priorities that exist at the time of filing. Just as it is not possible to ignore security interests that have been granted, it is not permissible to simply expropriate contractual rights because to some stakeholders the rights are inconvenient to their plans. It is possible to compel an alteration in rights through a double majority vote; it is possible to disclaim a contract under the CCAA conditions and deal with the resultant claim; and it is possible to make the rights unaffected (so long as they truly are); but the Coalition/Company have to date chosen none of those paths but rather at present are attempting to do one of the few things the CCAA does not countenance - overriding contractual rights without any recognition of the rights in one of the permissible ways set out above.

6. Later in the Facts it is argued that "Representative Counsel have compromised in at least two ways" - as to the amount to be received from CannTrust and by agreeing to the faulty Pierringer language. With respect to the former, there is simply no evidence before the Court as to the quantum of compensable damages; and the defects in the latter are fully addressed in the Non-Settling Defendants' facta (and partially acknowledged by the Company simply by virtue of the filing of Plan #3).

7. Finally under "Facts", Plaintiffs' counsel speculate as to the quantum of claim to be attributed to the Non-Settling Defendants, how the Non-Settling Defendants would vote if

they were given a vote and leverage sought by the Non-Settling Defendants. Again a review of the facta actually filed illustrates the weakness of this speculation.

8. In the remaining paragraphs 15-21 of the factum, Plaintiffs' counsel attempt to invoke the public interest case law under the CCAA on the assertion that it would "be contrary to the public interest to deny persons harmed by CannTrust the right to vote" and to prefer "the private goals of the Non-Settling Defendants to veto" a plan to help the Non-Settling Defendants "avoid their liabilities to the investing public".

9. The argument sets up a series of straw men to knock down.

10. No one is seeking to or could deny the equity claims a right to vote on a proper plan capable of sanction. The problem is, in part, that the plans proffered to date (including the latest iteration - Plan #3) do not meet that criteria.

11. The assumption that the Non-Settling Defendants have liabilities to the investing public is unproven and these Non-Settling Defendants assert unsupportable. There is no "avoidance" in asserting and establishing tenable defences and relying upon contractual rights of indemnity.

12. Indeed if public policy factors are to be considered, the relevant ones all relate to the lack of material before this Honourable Court to support the consideration of the Plan and the class action settlement aspect. The deficiencies in respect of the Plan are detailed in the Non-Settling Defendants' facta previously filed.

13. With respect to the class action settlement itself, the current material is wholly deficient when compared against the test for approval of a class action settlement - which this is given the classifications and voting allocations make this essentially a fait accomplit. If

this were presented or considered as a straight class action settlement it could not be approved.[1]

14. In addition to the information missing there are other problems. Leaving aside the lack of discovery and stage of the actions, there is a more fundamental issue: this settlement is not an arms length deal between unconflicted parties. The Plaintiffs side is driven by plaintiffs counsel who are to receive an undisclosed fee (as well as control of ongoing litigation together with funding for that on undisclosed terms). The decision makers on the company side are using the company's money to all obtain for themselves full releases for no payment by them (and retention of equity, jobs and a KERP payment).

15. The Company says it doesn't know and hasn't required the Coalition to inform the Court (or those voting on the Plan) how much of the settlement payment is going to Plaintiffs counsel, information which surely would be material for those making opt-out decisions and is standard in class action settlements. Even more importantly from the Non-Settling Defendants point of view there is no disclosure of the terms of the trust (and partial and uneven disclosure of some unspecified information that is said on some basis to be confidential which turned out to be because the Coalition required it to be).[2] The inevitable inference is that the "Company" hasn't and won't press on these points because the decision makers have the conflict set out above and are getting the personal benefits already described.

[1] See for example the summary of relevant factors in *McBain v. Hyundai*, 2021 ONSC 1734, at paras 72-89.
[2] Continued cross-examination of Greg Guyatt taken April 13, 2021, Q. 454, p. 144-147

Plan # 3

16. The Company served Plan # 3 effective April 10, 2021. The Company did not discuss or consult with the Non-Settling Defendants as to amendments that could potentially address or at least ameliorate obvious issues with the Plan .

17. Again, given the interest of the decision makers the exercise appears to be limited at the Company level to what it can persuade the Coalition to agree to rather than making changes to make the Plan CCAA compliant, let alone fair and reasonable. As a result, each successive change is a half-measure or worse still introduces new issues and problems. This does not need to be the Company's position given the terms of the RSA but it manifestly is nonetheless.

18. The changes in Plan #3 both create new issues and make even more clear the defects in the Plan. Those problems are briefly dealt with below.

19. However it must be said that the Coalition (and hence its partner in this aspect the Company) are having some measure of success in using the negotiating pressure created by uncertainty over time to get some of the Non-Settling Defendants with vulnerabilities and limited economic means to make a deal. In one case with respect to an economically and merit-strong group - the Underwriters - one surmises that the Plaintiffs Coalition moved its "ask" into the range of economic indifference for the Underwriters.

20. The fact that we and at present the Court are left to make assumptions or surmises is because to date the salient terms of either their deals or the basis on which these four previous objectors are not pursuing their objections is not before the Court. The exception is

Brady Green who is making no dollar contribution.[3] The Company has undertaken to provide that information when it is available so the Court and the remaining Non-Settling Defendants are in the invidious position of not knowing those terms and therefore cannot assess at present the impact those deals have on the issues. These Non-Settling Defendants hypothesize that the deals create a choice of losing alternatives for the Coalition/Company but full development of that position must await the terms.

21. As noted above, what the Coalition/Company can point to is success in whittling down the numbers of objectors so that their main possible argument at this stage might be – “let us proceed and by the time of the sanction order we will have everyone lined up and fixed the plan to make it CCAA compliant”. This pragmatic approach may be more credible to the Court than trying to defend what is currently indefensible. It is true that by proceeding to a meeting the Company foregoes one of the ways to fix the Plan - proper classification and voting - but presumably they believe there are other ways to fix it.

22. If that is the view adopted by the Court, the Litwins can and will be available to address all issues in the interim before the meeting and sanction hearing but consider it important to be clear. Plan #3 as framed at present is incapable of sanction. If the Coalition/Company want to roll the dice and spend two months and major money because they are confident they can fix those issues and convince the Litwins to withdraw their objection as well that may be a course this Honourable Court can permit them to take. However all are fixed with the knowledge as to the issues that the Litwins (and others in the facta that were filed but are now not being pursued) have raised. The Litwins have preserved the ability to oppose sanction without anyone later saying “you are too late - you

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[3] Continued cross-examination of Greg Guyatt taken April 13, 2021, Q. 471-472, p. 156

should have addressed these issues at the meeting stage" - the usual Hobsons choice or cleft stick that plan-presenting companies try to impale objections on.

23. For completeness we briefly set out below some of the issues with respect to the changes that have been made in Plan #3.

Change #1 – "Channeling" Insurance – What it Reveals/Attempting to Contract out of CCAA Prohibitions

24. The inference arising from this change is that there was a realization that the insurance claims weren't assignable without consent and the consent was not forthcoming from the insurers. Company counsel said "I'm not going to agree with that" but no other explanation has been proffered.[4]

25. There was general agreement by the Company with the description of the impact of the change. In a nutshell, the Original Settlement Parties and Additional Settlement Parties stay in as defendants in the ongoing proceedings, are subject to discovery and being witnesses at trial (with the attendant costs that entails) but if the insurance policies apply then the Plaintiffs will be limited to recovery under the policies. What is also key is that there could be a finding as to their conduct that disentitles them to insurance but they nonetheless get the releases. Mr. Guyatt was examined in this area and said this:

> 461. Q. All right. And if, in broad terms, the finding is negligence, you still have coverage; but if there's finding of knowledge or intentional misrepresentation, you wouldn't have coverage, so there wouldn't be a recovery, but you still would have received a release.
>
> A. Yes.
>
> 462. Q. That that's the same, for example, if you reach an accommodation with Eric Paul, that would be the same for him?

[4] Continued cross-examination of Greg Guyatt taken April 13, 2021, Q. 457, p. 151

A. I believe so. Is my understanding correct on that, Mr. Steep?

MR. STEEP: Yes.

THE WITNESS: Yes.

463. Q. So in the sense of the contributions that the original settling parties were making to the – you personally weren't making any dollar contribution, right?

A. I am not.

464. Q. And what you were contributing was – you talked about assignment of insurance proceeds. But if it turns out there's no cover and you had no right to insurance, you're still getting a release?

A. Yes.

465. Q. And that's the same for all the other settling parties?

A. Yes.

466. Q. Okay. So not to draw too fine a point on this, if you, as the CFO at the time, you're still in the litigation, you go through trial, there's a finding that you had knowledge, so that supports intentional misrepresentation, you're out of it, you've got a release, you have no liability?

A. I'm not sure I could have knowledge of something that happened before I joined the company.

26. In the context of this case, that is both an impermissible and in the alternative manifestly unfair result especially when the Plan purports to prohibit the claims over that would otherwise be made. As already noted, Mr Guyatt joined the Company as CFO in February 2019 and certified financial statements for the financing in May 2019 so his last answer is more argument than fact, akin in ancient pleading argot to confession and avoidance.

27. As developed at some length previously, Mark Litwin and Stan Abramowitz remained as director and officer respectively after the summer of 2019 because the Company concluded after extensive investigation that they were not involved in or responsible for the

existence and hence non-disclosure of the unlicensed rooms. Those where an opposite conclusion was reached were terminated or asked to resign.

28. Equally and as an example, Mr. Guyatt was the CFO from February 2019, and he familiarized himself with operations to certify 2018 audited financial statements and interim Q1 financial statements. Some or all of the current lawsuits (or Actions as defined in the Plan) allege that he had knowledge or constructive knowledge of the unlicensed rooms.[5] Presumably the Plaintiffs will amend the pleadings now to try and bring the allegations inside the insurance cover but the point is that it is entirely possible that at trial there could be a finding of knowledge on the part of any of the Settlement Parties.

29. The issues this raises are obvious. Under section 5.1(2) of the CCAA, it is impermissible to attempt to use a Plan to compromise claims against a director for misrepresentation and/or wrongful or oppressive conduct.[6] The "plumbing" in the Plan is a little complicated but it is clear that the effect of the Plan would be to compromise at least the Litwins' claim against the released directors for all such conduct, which is not permitted. Even assuming that obstacle could be overcome, it would be manifestly unfair to limit the claims of people who were determined at trial to be either innocent or at the worst negligent of claims over against others who are found to have made intentional misrepresentations. In that scenario, as the insurance cover would not apply to those people, they would nonetheless be released without having made any contribution whatsoever to the Plan (even assuming the assignment previously contemplated fit the "contribution" case law criteria which it doesn't).

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[5] See for example *Earl* claim para 3(d); *Webb* claim para 2(e); *Hrusa* claim paras 97 and 101; *Rosen* claim para 95.

[6] Oppression is alleged in at least some of the actions. See for example *Hrusa* claim at para 95 and following; *Earl* claim at para 3(i).

30. This mode of proceeding also exacerbates another problem previously identified and discussed below. There will be a considerable cost to all these people remaining as parties through trial and presumably they will all have counsel and want their counsel paid. Who or what is going to pay those costs – presumably the Company or the Litigation Trust – but there is either no information on that at present or it adds to the problems discussed below with respect to the indemnities. Again this issue cannot be fully addressed without the terms of the Litigation Trust and the deals with Additional Settlement Parties.

Change #2 – Removal of the "Success" Element of the Costs Indemnity Treatment Proposed in Plan #2

31. What the Company has done in Plan #3 is delete part of the change it proposed in Plan #2 where it sought to use the Plan to change the terms of indemnity contracts and impose that change on the contracting parties by calling them Unaffected Claims. As the facta filed demonstrated, this was an obvious non-starter. The Coalition/Company have now in essence at least acknowledged this, without it must be said, apologizing for the time and expense all have incurred because they attempted this clearly impermissible gambit. However this change creates or leaves open other concerns which were explored with Mr. Guyatt and where undertakings are outstanding and therefore both the Court and the parties lack information.

32. In his first examination, Mr. Guyatt the CEO said the Company would continue to honour the Litwins' indemnity reimbursement requests until Plan sanction unless he was "instructed otherwise". On April 9 2021 Company counsel advised that the Company would not be honouring the Litwin reimbursement requests now outstanding and going forward,

and Mr. Guyatt said on examination that this was “Correct although they continue to be indemnified”[7].

33. As a side note, Mr. Guyatt confirmed that the Board had not met to consider the issue so he hadn’t received instructions from the Board[8], which leaves him again a choice of losing alternatives as to the genesis of the “instructions” or decision (Company counsel or the Coalition or both) and it is evident, we say, that the change is retaliation for raising objections.

34. At all events, since these are supposed to be Unaffected Claims to be dammed up and paid after Plan sanction when the stay ends, it is germane to know how these are being addressed by the Company so there can be some assurance that they will be paid (i.e. the entity will be solvent on emergence). A number of information requests were made and remain outstanding but Mr. Guyatt was clear that at present these liabilities - current and contingent - are NOT being included in forecasts used to seek funding from lenders:

> 486. Q. I get that. I understand the answer. But we discussed last time, and in your affidavits, you’re also seeking financing from third parties, and I’m assuming you’re putting together packages for those third parties?
>
> A. Well, we provided them our forecast, if that’s what you mean.
>
> 487. Q. That might be one thing. And how is that being accounted? Is this liability being accounted for in those forecasts that are provided to lenders?
>
> A. No, it’s not. The lenders are aware of the 50 million that’s going to be going into trust. They’re also aware of, you know, the general unsecured creditor claims. But in terms of other contingent liabilities, there has not been any specific amount for those included in our financial forecast.

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[7] Continued Cross-examination of Greg Guyatt taken April 13, 2021, Q. 479, pp. 160-161
[8] Continued Cross-examination of Greg Guyatt taken April 13, 2021, Q. 476-477, p. 160

It is inconceivable that these liabilities aren't in the forecasts or being provided for given the amounts, proposed treatment as Unaffected Claims and the answers above. The solvency and viability of the emerging entity will depend in part on its ability to fund these amounts and the other costs that the insurance change now bakes into the future. This is something that can only be fully addressed once the further information is provided although it should be noted that the request for some important information was taken under advisement/refused.

35. The bona fides of the label "Unaffected Claims" is under a considerable cloud at present.

Change #3 – Moving Closer to Real Pierringer Protection but not There Yet

36. The problems identified in the previous facta largely remain. In addition these Non-Settling Defendants adopt and won't repeat the position taken on behalf of KPMG in the Blakes letter dated April 14, 2021 which is before the Court.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 15th day of April, 2021.

Peter Howard

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SCHEDULE “A”

McBain v. Hyundai, 2021 ONSC 1734

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FACTUM AND BOOK OF AUTHORITIES (RESPONDING TO COALITION PLAINTIFF'S FACTUM RETURNABLE APRIL 16, 2021)

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