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 CCAA REPRESENTATIVES

(Sanction Hearing)
(Returnable June 11, 2021)

June 8, 2021

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To: The Service List

PART I ~ OVERVIEW

1. This sanction hearing under the *Companies' Creditors Arrangement Act* (the "**CCAA**") is the culmination of a two-year long process to obtain compensation for investors in Canada and the United States who lost hundreds of millions of dollars investing in stock of CannTrust Holdings Inc. ("**CannTrust Holdings**"). These investors invested in CannTrust Holdings' stock on the primary and secondary markets based on representations and disclosures about its business and affairs that were false and misleading because CannTrust Holdings was not licensed to produce and sell the cannabis product on which its financial statements and projections were based. Once these misrepresentations came to light, the shareholders sued CannTrust Holdings and its gate-keeping professionals for their losses in class actions filed in Canada and the United States. CannTrust Holdings' CCAA filing was made in response to these claims. [1]

2. To help facilitate CannTrust Holdings' restructuring, on May 8, 2020 this Court granted a Mediation Order. The order was designed to provide a forum in which all stakeholders could attempt to resolve their claims and liabilities—and to do so under a confidentiality protocol that was designed to ensure that nothing they disclosed in the mediation could be used for any purpose outside the mediation. Following months of complex negotiations with multiple parties facilitated by the Hon. Dennis O'Connor, Q.C. (the "**Court-Appointed Mediator**"), the CCAA Representatives and CCAA Representative Counsel reached agreements to resolve the Securities

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[1] Capitalized terms used and not defined herein have the meanings given to them in the Affidavit of Serge Kalloghlian, sworn June 2, 2021 ("**Kalloghlian Affidavit**"), Motion Record of the CCAA Representatives ("**Motion Record**"), Tab 1.

Claims against CannTrust Holdings and the related claims against a number of co-defendants to the Class Actions.[2]

3. The framework for these settlements was established by the Restructuring Support Agreement between the CannTrust Group, the CCAA Representatives and CCAA Representative Counsel (the "**RSA**").[3] The RSA was carefully designed to maximize the ability of all holders of Securities Claims ("**Securities Claimants**") to recover their losses, which vastly exceeded the CannTrust Group's liquidation value. The CCAA Representatives agreed to release the CannTrust Group from its enormous exposure and help it emerge from these CCAA proceedings in exchange for $50 million and the assignment of certain claims.

4. In particular, the CannTrust Group agreed to give the Securities Claimants what CCAA Representative Counsel believe may be its most valuable asset: its litigation claims, including its auditor negligence claim against KPMG LLP ("**KPMG**") and its claims against its insurers. In order to monetize these claims, the CannTrust Group will transfer the Assigned Claims to a trust (the "**Securities Claimant Trust**") to be established for the benefit of the Securities Claimants which will be managed by the CCAA Representatives.

5. Before these CCAA proceedings were commenced, this court gave carriage of the class action litigation in Canada to the Canadian members of the CCAA Representatives. Courts in the United States likewise appointed the US members of the CCAA Representatives as the lead class action plaintiffs. In these proceedings, the court appointed the Canadian and US representative plaintiffs as CCAA Representatives, and appointed Canadian and US class action counsel as

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[2] Kalloghlian Affidavit para 15, Motion Record, Tab 1.
[3] RSA, Motion Record, Tab 1E.

CCAA Representative Counsel. Therefore, the Securities Claimant Trust and the management of that trust by the CCAA Representatives is appropriate and consistent with the prior orders of the courts in Canada and the United States.

6. The RSA also provides a mechanism to facilitate settlement of Securities-Related Claims against co-defendants by allowing them to be added as Additional Settlement Parties and benefit from the releases contained in the CCAA Plan. To date, this framework, as reflected in and to be implemented by the CCAA Plan, has facilitated settlements pursuant to which cash contributions of $83 million and the assignment of certain claims will be made to the Securities Claimant Trust for the benefit of the Securities Claimants. As of the date of this factum KPMG and the insurers have not settled the claims against them—KPMG in respect of its negligent audit of CannTrust Holdings, and the insurers under their contracts of indemnity. If the CCAA Sanction Order is not granted, the settlements will not be implemented and the hundreds of millions of dollars of claims, and the contribution and indemnity claims that relate to them, will need to be determined by the applicable courts.

7. The CCAA Plan contains a proposed Allocation and Distribution Scheme (the "**A&DS**"), which dictates the method by which the settlement proceeds will be allocated to Securities Claimants. It was developed in conjunction with expert financial economists using fair and well-recognized methods.

8. CCAA Representative Counsel believe the settlements reached and the proposed A&DS are fair, reasonable and in the best interests of the Securities Claimants. The CCAA Representatives, CCAA Representative Counsel and Trustees of the Securities Claimant Trust should therefore be authorized to do all things necessary to implement them.

PART II ~ FACTS

A. The Securities Class Actions

9. Following CannTrust Holding's announcement on July 8, 2019 that it was growing cannabis in breach of federal law, CannTrust's share price fell significantly. Class actions in the U.S. and Canada were commenced against CannTrust Holdings, its directors, the underwriters of its share offering, and its auditor, KPMG.

10. CCAA Representative Counsel are counsel in the lead putative securities class actions commenced in Canada and U.S. (the "**Class Actions**"). The Class Actions allege that, among other things, CannTrust Holdings, its officers and directors made misrepresentations about the CannTrust Group's compliance with applicable laws.[4]

11. The Class Actions allege (amongst other claims asserted) that the defendants are liable for misrepresentations to shareholders that acquired their shares (i) on the TSX, NYSE, or other secondary market pursuant to Parts XXIII.1 of the Ontario *Securities Act* ("**OSA**") and under Rule 10b-5 and s 10(b) of the United States *Securities Exchange Act of 1934* ("**Secondary Market Claims**"); and (ii) pursuant to the May 2019 prospectus share offering pursuant to Part XXIII of the OSA and ss 11, 12(a)(2) and 15 of the United States *Securities Act of 1933* ("**Prospectus Claims**"). The Class Actions seek recovery of the losses sustained by investors because of those misrepresentations.[5]

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[4] Kalloghlian Affidavit para 20, Motion Record, Tab 1.
[5] Kalloghlian Affidavit para 21-23, Motion Record, Tab 1.

B. The Mediation Process

12. On May 8, 2020, following the commencement of these insolvency proceedings, the Court made an order (the "**Mediation Order**") appointing the Court-Appointed Mediator as a neutral third party to mediate a global settlement of the various securities actions and related claims made against CannTrust Holdings (the "**Mediation Process**").[6]

13. Since the beginning of the Mediation Process, CCAA Representative Counsel, on behalf of the Securities Claimants, attended numerous formal mediation sessions with counsel to the Applicants, the co-defendants, and the insurers and countless informal discussions with the Court-Appointed Mediator, the Monitor, and other mediation participants. At all times, CCAA Representative Counsel followed the directions of the Court-Appointed Mediator.[7]

14. Importantly, paragraph 11 (d) of the Mediation Order provides that:

> *all statements, discussions, offers made and documents produced by any of the parties in the course of the Mediation Process shall not be subject to disclosure through discovery or any other process; shall be confidential; shall not be referred to in Court and shall not be admissible into evidence for any purpose, including impeaching credibility or to establish the meaning and/or validity of any settlement or alleged settlement arising from the Mediation Process.*[8]

15. In January 2021, following protracted negotiations over six months, with the assistance of the Court-Appointed Mediator and the Monitor, the CCAA Representatives and the Applicants reached the agreement reflected in the RSA. In the five months since then, additional settlements have been reached with the following co-defendants to the Class Actions:

(a) Eric Paul and the Paul Family Trust (the "**Paul Settling Parties**");

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[6] Kalloghlian Affidavit para 25, Motion Record, Tab 1.
[7] Kalloghlian Affidavit para 26, Motion Record, Tab 1.
[8] Mediation Order, dated May 8, 2020 at para 11(d), Exhibit "E" to the Affidavit of Greg Guyatt, sworn June 2, 2021, Motion Record of the Applicants, dated June 2, 2021, Tab 2E.

(b) Canaccord Genuity Corp., Canaccord Genuity LLC, Citigroup Global Markets Inc., Citigroup Global Markets Canada Inc., Credit Suisse Securities (Canada) Inc., Credit Suisse Securities (USA) LLC, Jefferies Securities, Inc, Jefferies LLC, Merrill Lynch Canada Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, and RBC Dominion Securities Inc. (the "**Underwriters**");

(c) Mark Ian Litwin, Fred Litwin, Stan Abramowitz, Cannamed Financial Corp., Forum Financial Corporation, Mar-Risa Holdings Inc., York Capital Funding Inc., and Sutton Management Limited (the "**Litwin Group**");

(d) Ian Abramowitz; and

(e) Kenneth Brady Green.[9]

16. The CCAA Representatives have also entered into an agreement with Zola Finance Holdings Ltd. and Igor Gimelshtein (the "**Zola Plaintiffs**") to transfer their Securities Claims and certain related claims against CannTrust Holdings and the co-defendants to the Securities Claimant Trust in exchange for a payment of $3.25 million.[10]

17. It is CCAA Representative Counsel's view that each of these agreements is fair, reasonable, and in the best interests of the Securities Claimants.

C. Key Considerations in Negotiating the Settlements

18. CCAA Representative Counsel believe there was more than adequate information available from which to make an appropriate recommendation concerning the resolution of the claims against the settling defendants and to resolve certain matters with the Zola Plaintiffs.[11]

19. In coming to these settlement agreements, CCAA Representative Counsel considered a variety of factors informed by a detailed factual investigation of public and non-public information, the advice of accounting, auditing, underwriting, and financial economics expert, and

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[9] Kalloghlian Affidavit para 27, Motion Record, Tab 1.
[10] Kalloghlian Affidavit para 28, Motion Record, Tab 1.
[11] Kalloghlian Affidavit para 31, Motion Record, Tab 1.

analysis of the mediation briefs, information and documents provided, and positions taken by the parties during the Mediation Process.[12] The Kalloghlian Affidavit at paragraphs 30 to 51 details the key considerations, which include:

(a) estimates of damages under Ontario and US securities laws;[13]

(b) CannTrust Holdings' claim against KPMG;[14]

(c) the Settlement Parties' claims against Insurers;[15] and

(d) the risks and challenges of continuing litigation, including

 (i) CannTrust Holding's ability to satisfy a judgment;

 (ii) Part XXIII.1 liability limits; and

 (iii) substantive and procedural legal issues.[16]

20. Of these, two stand out as critically important: (i) CannTrust Holding's ability to satisfy a judgment, and (ii) the potential value of CannTrust Holding's claim against KPMG.

(i) CannTrust's Ability to Satisfy a Judgment

21. The most significant factor in negotiating the settlement with CannTrust Holdings was its ability to satisfy a judgment. It was always the CCAA Representatives' view that the case against CannTrust Holdings was very strong on the merits, and that the plaintiffs would prevail in establishing damages at trial well in excess of the $50,000,000 settlement payment contemplated by the RSA.[17]

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[12] Kalloghlian Affidavit para 30, Motion Record, Tab 1.
[13] Kalloghlian Affidavit paras 32 to 36, Motion Record, Tab 1.
[14] Kalloghlian Affidavit paras 37 to 42, Motion Record, Tab 1.
[15] Kalloghlian Affidavit para 43, Motion Record, Tab 1.
[16] Kalloghlian Affidavit paras 44 to 51, Motion Record, Tab 1.
[17] Kalloghlian Affidavit para 46, Motion Record, Tab 1.

22. Nevertheless, since CannTrust Holdings was and remains in a precarious financial situation and its insurers had denied coverage, any judgment would likely result in a contested liquidation over CannTrust Holdings' assets. The extent to which the Securities Claimants could collect on a judgment was therefore questionable and the time it would take to obtain a recovery was unknown. Accordingly, and as discussed further below, counsel determined that it was reasonable for the Securities Claimants to enter into the RSA and obtain the agreement from CannTrust Holdings to pay $50 million to the Securities Claimant Trust and cooperate to pursue litigation against, or obtain settlements with, the insurers and co-defendants to the Class Actions. For this reason, the Assigned Claims represented an important potential source of recovery for the Securities Claimants which they would not have had without the RSA.[18]

(ii) CannTrust Holdings' Claim Against KPMG LLP

23. KPMG was the auditor of CannTrust Holdings during the period that it issued false and misleading financial statements. KPMG is a defendant in the Class Actions and faces statutory claims by shareholders that acquired CannTrust Holdings' shares on the TSX or NYSE, or in the May 2019 prospectus offering.[19]

24. Early in the Mediation Process, CCAA Representative Counsel concluded that CannTrust Holdings' auditor's negligence claim against KPMG was the CannTrust Group's most valuable asset, although no such claim had been asserted. As discussed below, counsel's assessment of the significant value of this claim was a critical factor in the determination to enter into the RSA instead of seeking a judgment against CannTrust Holdings.[20]

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[18] Kalloghlian Affidavit para 47, Motion Record, Tab 1.
[19] Kalloghlian Affidavit para 37, Motion Record, Tab 1.
[20] Kalloghlian Affidavit para 38, Motion Record, Tab 1.

25. CannTrust Holdings' potential claim against KPMG is for breach of contract, negligence, negligent misrepresentation, and negligent performance in connection with its audit of CannTrust's 2018 annual financial statements and Q1 2019 review engagement. Counsel to KPMG have been aware of the intention of the CCAA Representatives to pursue CannTrust Holdings' potential claim against KPMG for several months and at least since the RSA was entered into.[21]

26. KPMG's counsel was given a draft of the statement of claim on May 3, 2021.[22] The draft claim alleges that KPMG owed a duty to CannTrust Holdings to conduct its audit and review engagements in accordance with applicable professional audit standards and practices. The gravamen of the claim is that had KPMG conducted a proper audit, CannTrust Holdings would have stopped the illegal activity and would not have issued US $230 million worth of shares in May 2019, thereby worsening its financial condition by incurring liabilities it was rendered unable to satisfy.[23]

27. CCAA Representative Counsel in consultation with their expert estimate potential damages in the proposed action to be well in excess of $270 million with reference to the damages analysis from *Livent v Deloitte & Touche*.[24] As detailed below, the assignment of this valuable claim to the Securities Claimants' Trust was fundamental to the CCAA Representatives' decision to enter into the RSA with the CannTrust Group.

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[21] Kalloghlian Affidavit para 39, Motion Record, Tab 1.
[22] Draft Statement of Claim, Motion Record, Tab 1B.
[23] Kalloghlian Affidavit paras 40-41, Motion Record, Tab 1.
[24] *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63, Book of Authorities of the CCAA Representatives ("**BOA**") Tab 1.

D. The Settlements

(i) The RSA

28. The settlement reflected in the RSA is with the CannTrust Group, Mark Dawber, Greg Guyatt, John Kaden, Robert Marcovitch, Shawna Page, Ilana Platt, Mitchell Sanders and Cajun Capital Corporation (the "**Original Settlement Parties**"). In exchange for releases of liability:

(a) CannTrust Holdings will pay a "**Cash Contribution**" of $50,000,000 to the Securities Claimant Trust;

(b) the Original Settlement Parties will assign their Assigned Claims to the Securities Claimant Trust; and

(c) CannTrust Holdings will provide information and cooperation to the plaintiffs in the prosecution of the continuing litigation.[25]

29. The CCAA Representatives' compromise with the Original Settlement Parties was driven primarily by CannTrust Holdings' ability to pay, the anticipated value of their cooperation against other defendants, the anticipated impact of a settlement with the Original Settlement Parties on the negotiations with other defendants, and the anticipated significant value of their Assigned Claims, including CannTrust Holdings' potential claim against KPMG and the potential claims against Insurers of the directors and officers who are Original Settlement Parties.[26]

30. The Original Settlement Parties other than CannTrust Holdings were not required to make separate monetary contributions. The Original Settlement Parties other than the Applicants were those directors and officers of CannTrust Holdings with respect to whom no evidence of wrongdoing was found during its internal investigation. The decision not to require separate

[25] Kalloghlian Affidavit para 52, Motion Record, Tab 1.
[26] Kalloghlian Affidavit para 53, Motion Record, Tab 1.

contributions from such persons was informed by that fact, as well as by counsel's understanding that such persons were not material sources of recovery because they had limited legal or financial exposure relative to the $50,000,000 payment and/or did not have the capacity to make a meaningful contribution to a settlement thereby making litigation against these parties uneconomic.[27]

31. CCAA Representative Counsel believe that the settlement reflected in the RSA is superior to the result that could be obtained through a judgment and contested liquidation of CannTrust Holdings' assets. In coming to this conclusion, CCAA Representative Counsel had regard to and considered the following:

(a) the RSA provided an orderly mechanism for the CCAA Representatives, with CannTrust Holdings' help, to obtain additional settlements and provide releases to additional parties;

(b) the Assigned Claims, particularly against the Insurers and KPMG, had significant value; and

(c) the RSA provided a mechanism to prosecute, on an expedited basis, the remaining Class Action claims and Assigned Claims in a single forum.[28]

32. As indicated above, the significant value of CannTrust Holdings' Assigned Claims, and specifically, its claim against KPMG, was fundamental to the decision of the CCAA Representatives to enter into the RSA. CCAA Representative Counsel would not have agreed to the settlement payment of $50,000,000 without confirmation that the Assigned Claims and, in particular, CannTrust Holdings' claim against KPMG, would be assigned to the Securities

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[27] Kalloghlian Affidavit para 54, Motion Record, Tab 1.
[28] Kalloghlian Affidavit para 55, Motion Record, Tab 1.

Claimant Trust where the class action counsel could pursue recovery along with the other claims held by the Securities Claimant Trust.[29] After KPMG, the most important of these potential defendants are the Insurers.

33. Here, the Securities Claimant Trust was an essential component of the RSA because the continuing litigation will involve both the Class Actions and the Assigned Claims. The Securities Claimant Trust is the mechanism through which the Securities Claimants will enjoy the benefits of the settlement proceeds from CannTrust Holdings and the Additional Settlement Parties, and through which they seek to realize the value of the remaining Assigned Claims alongside the Class Action claims.[30]

(ii) The Additional RSAs

34. The RSA contemplated a mechanism for co-defendants that wished to settle to enter into Additional RSAs and become Additional Settlement Parties, thereby giving them the benefit of the CCAA Plan releases. This has resulted in an additional $33 million to be paid to the Securities Claimants, assignment of claims against Insurers, and cooperation in continuing litigation pursuant to Additional RSAs as follows:

(a) the Paul Settling Parties will: (i) make a Cash Contribution of $12,000,000; and (ii) assign Eric Paul's claims against his insurers;

(b) the Underwriters will make a Cash Contribution of US $8,000,000

(c) the Litwin Group will make a Cash Contribution of $11,000,000

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[29] Kalloghlian Affidavit para 56, Motion Record, Tab 1.
[30] Kalloghlian Affidavit para 58, Motion Record, Tab 1.

(d) Ian Abramowitz will provide (i) cooperation in the continuing litigation; and (ii) assign his claims against his insurers; and

(e) Kenneth Brady Green will provide cooperation in the continuing litigation.[31]

35. A detailed explanation of CCAA Representative Counsels' rationale for entering into these settlements on behalf of the Securities Claimants is discussed at paragraphs 60 to 85 of the Kalloghlian Affidavit. In summary, for each group of defendants CCAA Representative Counsel considered (i) the claims asserted against the defendants under Ontario and U.S. law; (ii) the strengths of the allegations and the defendants' anticipated arguments; (iii) the estimated damages exposure; (iv) the defendants' capacity to withstand judgment or make a financial contribution; and (v) the value of the defendants' cooperation in the continuing litigation.[32]

(iii) The Zola RSA

36. The CannTrust Group, the CCAA Representatives and the Zola Plaintiffs entered into a restructuring support agreement as of May 5, 2021 (the "**Zola RSA**").[33]

37. The Zola Plaintiffs are Securities Claimants and fall under the definition of class members in the Ontario Class Action. However, they were excluded from the CCAA Representation Order and have their own counsel in these proceedings. The Zola Plaintiffs filed a proof of claim in these proceedings for voting purposes at the meeting of the Securities Claimants to vote on the CCAA Plan in the amount of $45 million. From before the commencement of the CCAA Proceedings, they announced an intention to opt out of the Ontario Class Action and pursue their own claims.

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[31] Kalloghlian Affidavit paras 62, 67, 72, 79, and 83, Motion Record, Tab 1.
[32] Kalloghlian Affidavit paras 60-85, Motion Record, Tab 1.
[33] Kalloghlian Affidavit para 86, Motion Record, Tab 1.

The Zola Plaintiffs commenced an individual action against CannTrust Holdings and others in November of 2019 ("**Zola Action**").[34] The Zola Action names many of the same defendants and many of its allegations and causes of action overlap with the Ontario Class Action. It also makes unique allegations and claims based on the Zola Plaintiffs' direct conversations with Eric Paul and Peter Aceto, as well as its direct purchase of shares from Fred Litwin (who is not named in any of the Class Actions).[35]

38. It was desirable for the CCAA Representatives to acquire these claims and secure the Zola Plaintiffs' support for the RSA settlement framework so they could (i) offer global releases to defendants that wished to settle; and (ii) strengthen the plaintiffs' position in any continuing litigation. It is CCAA Representative Counsel's view that the agreement with the Zola Plaintiffs has been a net benefit to the Securities Claimants and that it is fair and reasonable.[36]

E. Allocation & Distribution Scheme

39. The A&DS was designed with input and advice from Dr. Sunita Surana, a financial economics expert, and using fair and well-recognized methods. Paragraphs 92 to 123 of the Kalloghlian Affidavit discusses in detail the mechanics of, the rationale for, and the methodology used in designing the A&DS.

40. The proposed A&DS prescribes the process for Securities Claimants to seek compensation from the net proceeds of the settlements. Only claims by persons that acquired shares during the

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[34] Kalloghlian Affidavit para 87, Motion Record Tab 1; Zola Action Statement of Claim, Motion Record, Tab 1-M.
[35] Kalloghlian Affidavit para 88, Motion Record, Tab 1.
[36] Kalloghlian Affidavit paras 89-90, Motion Record, Tab 1.

period between June 1, 2018 and September 17, 2019 are eligible for compensation. Excluded from eligibility are the defendants in the Class Actions and certain persons related to them.[37]

41. The A&DS is designed to provide compensation to Securities Claimants based on

(a) "**Share Inflation**"—the artificial inflation at the time shares were acquired and disposed of; and

(b) "**Risk Adjustment Factor**"—determined by whether the shares were acquired pursuant to the May 2019 offering ("**Offering Shares**") or on the secondary market ("**Secondary Shares**").

(i) Share Inflation

42. Artificial inflation refers to the portion of a share's price that is attributable to one or more misrepresentations at a particular point in time. Under the A&DS, there are five distinct periods of artificial inflation. A claimant's recovery will depend on the artificial inflation at the time of purchase and disposition of their shares.[38] CannTrust Holdings' share price was artificially inflated by different amounts at different periods of time between June 1, 2018 and September 17, 2019. This is because different alleged misrepresentations began at different times, and because the artificial inflation declined incrementally after certain "partial corrections" of the misrepresentations were made by CannTrust Holdings.[39]

43. For example, the Ontario Class Action alleges that CannTrust Holdings made separate misrepresentations about compliance at its facility in Vaughan (the "**Vaughan**

[37] Kalloghlian Affidavit paras 93-95, Motion Record, Tab 1.
[38] Kalloghlian Affidavit paras 114, 120, Motion Record, Tab 1.
[39] Kalloghlian Affidavit para 116, Motion Record, Tab 1.

Misrepresentation") and its facility in Fenwick, Ontario (the "**Niagara Misrepresentation**"). It alleges that the Vaughan Misrepresentation began on June 1, 2018, and that the Niagara Misrepresentation began on October 1, 2018. Based on Dr. Surana's analysis, the Niagara Misrepresentation caused a higher amount of artificial inflation to CannTrust Holdings' shares than the Vaughan Misrepresentation.[40]

44. Accordingly, the artificial inflation between June 1 and September 30, 2018 (when only the Vaughan Misrepresentation was outstanding) was $1.29. But starting on October 1, 2018 (when the Niagara Misrepresentation began), artificial inflation increased to $5.02. This artificial inflation amount reflects both of the misrepresentations' effect on the share price.[41]

45. The A&DS calculates the net amount of artificial inflation that a claimant paid for a share by subtracting the artificial inflation at time of sale from the artificial inflation at time of purchase. For example, a claimant that bought a share on October 2, 2018 paid $5.02 of artificial inflation for that share. But if that share is sold on July 9, 2019 the price received for that share will include $3.57 of artificial inflation from which the claimant would have benefitted. At the end of the transaction, the claimant will be out of pocket for $1.45 worth of artificial inflation for that share.[42]

(ii) Risk Adjustment Factors

46. The Risk Adjustment Factor has the effect of discounting the per-share recovery of Secondary Shares by 20% compared to Offering Shares. The purpose of the Risk Adjustment Factor is to reflect CCAA Representative Counsel's view that the Prospectus Claims (both under

[40] Kalloghlian Affidavit para 117, Motion Record, Tab 1.
[41] Kalloghlian Affidavit para 118, Motion Record, Tab 1.
[42] Kalloghlian Affidavit para 120, Motion Record, Tab 1.

the OSA and U.S. securities laws) have higher prospects of recovery than Secondary Market Claims. Among other things, under the OSA, Prospectus Claims have no liability limit, and are not subject to a preliminary test for leave as are Secondary Market Claims.[43]

PART III ~ ISSUE

47. The court must determine the following issues in respect of these settlements:

(a) Should the CCAA Plan be approved and the CCAA Representatives, CCAA Representative Counsel and the Trustees of the Securities Claimant Trust be authorized to take all steps and do all things necessary to implement the CCAA Plan, the RSA, the RSA Supplemental Letter Agreement, the Additional RSAs and the Zola RSA?

The CCAA Representatives say that the answer is: **YES**

(b) Should the proposed A&DS be approved?

The CCAA Representatives say that the answer is: **YES**

48. In deciding the above issues, the court should:

(a) Reject KPMG's anticipated submissions that CCAA Representative Counsel is disqualified to act as the Trustees of the Securities Claimants Trust;

(b) Reject the anticipated submissions by KPMG and the insurers that the Assigned Claims against them have no value; and

(c) Reject the Zola Plaintiffs' objection to the A&DS.

PART IV ~ SUBMISSIONS

A. The Settlements are Fair and Reasonable

49. The CannTrust Group and CCAA Representatives are not seeking approval of the settlements detailed above (except the Zola RSA, for which approval is being sought). Rather,

[43] Kalloghlian Affidavit para 123, Motion Record, Tab 1.

they request that the Court authorize the relevant parties to take all steps and do all things necessary to implement the CCAA Plan, the RSA, the RSA Supplemental Letter Agreement, the Additional RSAs and the Zola RSA.

50. For the reasons set out below, if approval of the settlements was being sought, it would be appropriate to approve them. As a result, the CCAA Representatives submit that the narrower relief sought in the CCAA Sanction Order should be approved.

(i) The test for settlement approval

51. In assessing a settlement within the CCAA context, the court looks at the following three factors: (a) whether the settlement is fair and reasonable; (b) whether it provides substantial benefit to other stakeholders; and (c) whether it is consistent with the purpose and spirit of the CCAA.[44]

52. Where a settlement also provides for a release, courts assess whether there is "a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan." Applying this "nexus test" requires consideration of the following factors:

(a) are the claims to be released rationally related to the purpose of the plan?

(b) are the claims to be released necessary for the plan of arrangement?

(c) are the parties who have claims released against them contributing in a tangible and realistic way?

(d) will the plan benefit the debtor and the creditors generally?[45]

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[44] *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corp,* 2013 ONSC 1078 at [49], BOA Tab 2, aff'd *a Plan of Compromise or Arrangement of Sino-Forest Corporation*, 2013 ONCA 456, BOA Tab 3.
[45] *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corp,* 2013 ONSC 1078 at [50], BOA Tab 2, aff'd *a Plan of Compromise or Arrangement of Sino-Forest Corporation*, 2013 ONCA 456, BOA Tab 3.

53. The test for whether a class action settlement ought to be approved is substantially similar to the test for approval of a settlement under the CCAA and can provide guidance to this Court.

54. To approve a class action settlement, the test is whether "in all the circumstances, the settlement is fair, reasonable, and in the best interests of those affected by it."[46] In the *Class Proceedings Act* ("**CPA**") context and in the absence of evidence to the contrary, "the recommendation of experienced counsel is entitled to considerable weight given their ability to weigh the factors bearing on the reasonableness of the settlement."[47]

55. To reject the terms of a settlement and require the litigation to continue, a court must conclude that the settlement does not fall within a range of reasonableness.[48] The "range of reasonableness" test is flexible. It permits the court to apply an objective standard, allowing for variation between settlements, depending upon the subject matter of the litigation and the nature of the damages for which settlement provides compensation.[49] A "less than perfect settlement may be in the best interests of those affected [...] when compared to the alternative of the risks and costs of litigation."[50]

56. A class actions judge can approve or reject the settlement, but cannot modify its terms.[51] In deciding whether to reject a settlement, the Court should consider if doing so would put the settlement in "'jeopardy of being unraveled".[52] There is no obligation on parties to resume

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[46] *Parsons v Canadian Red Cross Society*, [1999] OJ No 3572, 1999 CarswellOnt 2932 (SCJ) at [68], BOA Tab 4.
[47] *Cygnus Electronics Corporation v Panasonic Corporation*, 2021 ONSC 2767 at [29], BOA Tab 5; *Cass v WesternOne Inc*, 2018 ONSC 4794 at [108], BOA Tab 6.
[48] *Nunes v Air Transat AT Inc*, [2005] OJ No 2527, 2005 CanLII 21681 (SCJ) at [7], BOA Tab 7, citing *Vitapharm v F Hoffman - La Roche Ltd*, [2005] OJ No 1118, 2005 CanLII 8751 (SCJ), at [110]-[118], BOA Tab 8.
[49] *Parsons v Canadian Red Cross Society*, [1999] OJ No 3572, 1999 CarswellOnt 2932 (SCJ) at [70], BOA Tab 4.
[50] *Robinson v Medtronic, Inc*, 2020 ONSC 1688 at [64], BOA Tab 9.
[51] *Cass v WesternOne Inc*, 2018 ONSC 4794, at [86], BOA Tab 6.
[52] *Semple v Canada (Attorney General)*, 2006 MBQB 285 at [26], BOA Tab 10.

settlement discussions if a settlement is rejected by the Court, as the parties may have reached their limits in negotiations and can backtrack from their positions or abandon the effort.[53]

(ii) The relief related to the settlements should be granted

57. The settlement agreements are fair and reasonable under all of the circumstances. They provide substantial benefit to other stakeholders. They are consistent with both the purpose and spirit of the CCAA and CPA, both of which encourage settlement after a reasonable investigation and careful consideration of the merits, costs and risks of continuing litigation.

58. CCAA Representative Counsel had the benefit of its own extensive investigations, document review, and the input and opinions of experts. The assessment and recommendation of the settlements rest on careful consideration of the risks and limitations to the success of claims against the defendants, as particularized in paragraphs 18-38 of this factum and in paragraphs 30 - 91 of the Kalloghlian Affidavit.

59. The release of the defendants is also fair and reasonable and should be approved. The release is "justified as part of the compromise or arrangement between the debtors and its creditors [...]. [There is] a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan."[54] In order to effect any distribution of settlement funds to Securities Claimants and implement the Securities Claimant Trust, the defendants' releases must be approved.

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[53] *Semple v Canada (Attorney General)*, 2006 MBQB 285 at [26], BOA Tab 10.
[54] *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corporation*, 2013 ONSC 1078 at [50], BOA Tab 2, citing *Metcalfe & Mansfield Alternative Investments II Corp (Re)*, 2008 ONCA 587 at [70], BOA Tab 11.

(iii) The Trustees of the Securities Claimant Trust

60. The CCAA Representatives anticipate that KPMG will object to CCAA Representative Counsel acting as Trustees to the Securities Claimant Trust. It would be against the Securities Claimants' interests to place control of this litigation in the hands of someone other than counsel which has (i) been appointed lead counsel for the litigation in Canada and the United States, and (ii) been appointed by this Court to represent the interests of the Securities Claimants.

61. Among other reasons: (a) CCAA Representative Counsel have worked on this matter for nearly two years and have developed a deep knowledge and understanding of the legal and factual issues in dispute; (b) appointing a different trustee (and hence counsel) to conduct the litigation of the Assigned Claims would eliminate the synergies and efficiency the RSA was designed to create for the continuing litigation; (c) CCAA Representatives will be deprived of their choice of counsel, who this court already found was the counsel group best-suited to pursue this litigation; (d) it will create unnecessary expense, complication, and the risk of inconsistent results in litigation being conducted over the same or similar facts for the benefit of the Securities Claimants, thereby potentially prejudicing them; (e) it would be inconsistent with the CPA's goals of judicial economy, access to justice, and behaviour modification; and (f) it is inconsistent with the party autonomy in litigation to permit a defendant to select the party and counsel against whom the defendant will be litigating.

B. The Allocation and Distribution Scheme Should be Approved

(i) The A&DS is fair and reasonable

62. The proposed A&DS should be approved, as it provides a fair and reasonable process for the allocation and distribution of settlement proceeds to Securities Claimants.

63. Whether in the context of Canadian insolvency proceedings or class proceedings, the test for approval of a plan of distribution is in essence the same: the plan must be fair and reasonable.[55] As with the approval of settlements, "[a]n allocation formula need only have a reasonable and rational basis, particularly if recommended by experienced and competent counsel."[56]

64. Canadian Courts have noted that the "test for approving a distribution plan is analogous to the test that the court applies when deciding whether to approve a settlement." In a joint panel of the Quebec and Ontario superior courts, Justices Perell and Masse noted that a plan of distribution "must fall within a zone of reasonableness to be approved", "[t]he zone of reasonableness assessment allows for variation between settlements (and distribution plans) depending upon the subject matter of the litigation and the nature of the damages for which the settlement provides compensation", and "a distribution plan is to be reviewed on an objective standard; that standard recognizes the inherent difficulty in crafting a universally satisfactory settlement or distribution plan."[57] The Justices also found that "distinguishing between different types of claimants is reasonable and appropriate. For example, in *Gould v BMO NesbittBurns Inc*, Justice Cullity approved a Plan where there were discounts for the claims of secondary market purchasers to reflect increased certification and substantive litigation risks affecting their claims."[58]

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[55] A plan of compromise under the CCAA is sanctioned where (a) there is compliance with all statutory requirements and previous orders; (b) nothing has been done that is not authorized by CCAA; and (c) the plan is fair and reasonable: *Sino-Forest Corporation (Re)*, 2012 ONSC 7050 at [51], BOA Tab 12. In class proceedings, a plan of distribution is approved "if in all the circumstances, the plan of distribution is fair, reasonable, and in the best interests of the class": *Zaniewicz v. Zungui Haixi Corporation*, 2013 ONSC 5490 at [59], BOA Tab 13.

[56] *In re FLAG Telecom Holdings, Ltd Sec Litig*, 2010 WL 4537550, at *21 (SDNY Nov 8, 2010), BOA Tab 14; *In re Initial Pub Offering Sec Litig*, 671 F Supp 2d 467, 479 (SDNY 2009), BOA Tab 15.

[57] *Brazeau v. Canada (Attorney General)*, 2020 ONSC 7229 at [74], BOA Tab 16.

[58] *Brazeau v. Canada (Attorney General)*, 2020 ONSC 7229 at [77], BOA Tab 16, citing *Gould v BMO Nesbitt Burns Inc*, 2007 CanLII 9239 (ON SC) at [19]-[23], BOA Tab 17.

65. US courts have also approved of this approach to distribution: “A reasonable plan may consider the relative strength and values of different categories of claims.”[59] Because they tend to mirror the complaint’s allegations, “plans that allocate money depending on the timing of purchases and sales of the securities at issue are common.”[60] Particularly “in the case of a large class action, the apportionment of a settlement can never be tailored to the rights of each plaintiff with mathematical precision,”[61] and “[e]xactitude is not required in allocating consideration to the class, provided that the overall result is fair, reasonable and adequate.”[62] Broad classifications may be used to promote the goals of efficiency, ease of administration, and conservation of resources.[63]

66. The proposed A&DS, which provides compensation based on the relative strength and estimated damages associated with each category of claim against the defendants, is fair, reasonable, and adequate.

(ii) The Court should reject the Zola Plaintiffs’ objection

67. The Zola Plaintiffs argue that the start of the $5.02 Share Inflation period ought to begin two weeks earlier, on September 15, 2018. This request should be rejected.

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[59] *In re IMAX Sec Litig*, 283 FRD 178, 192 (SDNY 2012), BOA Tab 18. See also *In re Hi-Crush Partners LP Sec Litig*, 2014 WL 7323417, at *10 (SDNY Dec 19, 2014), BOA Tab 19 (plan of allocation that distributes greater part of settlement proceeds to those most injured is reasonable).
[60] *Hi-Crush Partners LP*, 2014 WL 7323417, at *10, BOA Tab 19.
[61] *Fleisher v Phoenix Life Ins Co*, 2015 WL 10847814, at *12 (SDNY Sep 9, 2015), BOA Tab 20.
[62] *Silberblatt v Morgan Stanley*, 524 F Supp 2d 425, 430 (SDNY 2007), BOA Tab 21; *In re AOL Time Warner Shareholder Derivative Litig.*, 2010 WL 363113, at *20 (SDNY Feb 1, 2010), BOA Tab 22 (“Because the formulation of a presumptively reasonable fee is inherently an imprecise exercise, mathematical exactitude is not required.”).
[63] *In re PaineWebber Ltd P'ships Litig*, 171 FRD 104 at *135 (SDNY 1997), BOA Tab 23 aff'd, 117 F.3d 721 (2d Cir 1997); *Wal-Mart Stores, Inc v Visa USA, Inc*, 396 F 3d 96, 106 (2d Cir 2005), BOA Tab 24 (“Broad class action settlements are common, since defendants and their cohorts would otherwise face nearly limitless liability from related lawsuits in jurisdictions throughout the country.”).

68. As noted above, the A&DS ascribes different amounts of Share Inflation to five distinct periods between June 1, 2018 and September 17, 2019. The Ontario Class Action alleges that the Vaughan Misrepresentation began on June 1, 2018, and that the Niagara Misrepresentation began on October 1, 2018. Because the Zola Plaintiffs acquired their shares in the period between September 26-28, 2018 their Share Inflation per share is \$1.29, as opposed to \$5.02 per share if they had bought the shares a few days later on October 1, 2018.

69. The Zola Plaintiffs effectively argue that the CCAA Representatives' case theory is incorrect and that the Niagara Misrepresentation actually began earlier than October 1, 2018. They rely on the affidavit of Igor Gimelshtein, one of the Zola Plaintiffs, to argue that any decisions, preparations, and ramp-up to the illegal conduct at the CannTrust Group's facility in Fenwick, Ontario (i.e. the Niagara Misrepresentation) must have started no later than mid-September, and accordingly that should be the start date of the \$5.02 Share Inflation.

70. The court should reject this submission. Mr. Gimelshtein's evidence on this point consists entirely of improper opinion evidence and ought to be rejected.[64] His conclusion is purportedly based on his experience in the cannabis industry, however it amounts to mostly speculation regarding conduct that might have occurred prior to October 1, 2018.

71. CCAA Representative Counsel chose October 1, 2018 as the date the Niagara Misrepresentation began based on CannTrust Holdings' announcement that illegal growing in its Niagara Facility began in October 2018. That is the only admissible evidence on this motion, and,

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[64] *R v Abbey*, 2017 ONCA 640 at [48]-[49], BOA Tab 25.

as far as counsel is aware, no other public information exists that could provide further specificity of the start date.[65]

72. Based on the information available to CCAA Representative Counsel at this time, the proposed A&DS, and specifically the October 1, 2018 start date of the Niagara Misrepresentation, is sound and best accords with the evidence. This is also the case theory that CCAA Representative Counsel pleaded, publicized to Securities Claimants, and advanced throughout the Mediation Process.[66]

73. Although it is difficult to estimate with any precision the result that such a modification to the A&DS would have on the Zola Plaintiffs' ultimate entitlement, given the size of their share holdings, CCAA Representative Counsel expect that it would be significant. Because there is a fixed pool of money, counsel expects such an increase in distribution to the Zola Plaintiffs would necessarily mean that other Securities Claimants' distributions would be impacted negatively in a non-trivial way. It would be inconsistent with the duties as representative counsel, and as eventual Trustees of the Securities Claimant Trust, to modify the A&DS to the benefit of a particular claimant.[67]

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[65] Kalloghlian Affidavit para 128, Motion Record, Tab 1.

[66] *In re: Facebook, Inc, IPO Class Action Settlement*, 822 F App'x 40 (Mem), 44 (2d Cir 2020) (Summary Order), BOA Tab 26 (finding that lead plaintiffs and class counsel have discretion to make decisions involving the claims, and thus case theory, because "lead plaintiffs in securities class actions 'exercise control over the litigation as a whole'"); *Hevesi v Citigroup Inc*, 366 F 3d 70, 82 n 13 (2d Cir 2004), BOA Tab 27 (recognizing that the purpose of the PSLRA's lead-plaintiff provision is "to empower one or several investors with a major stake in the litigation to exercise control over the litigation as a whole.").

[67] Kalloghlian Affidavit paras 129-130, Motion Record, Tab 1.

PART V ~ ORDER SOUGHT

74. The CCAA Representatives request that the Court grant the CCAA Plan Sanction Order.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

CCAA Representative Counsel

SCHEDULE “A”
LIST OF AUTHORITIES

1. *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63
2. *Labourers' Pension Fund of Central and Eastern Canada v Sino-Forest Corp*, 2013 ONSC 1078
3. *a Plan of Compromise or Arrangement of Sino-Forest Corporation*, 2013 ONCA 456
4. *Parsons v Canadian Red Cross Society*, [1999] OJ No 3572, 1999 CarswellOnt 2932 (SCJ)
5. *Cygnus Electronics Corporation v Panasonic Corporation*, 2021 ONSC 2767
6. *Cass v WesternOne Inc*, 2018 ONSC 4794
7. *Nunes v Air Transat AT Inc*, [2005] OJ No 2527, 2005 CanLII 21681 (SCJ)
8. *Vitapharm v F Hoffman - La Roche Ltd*, [2005] OJ No 1118, 2005 CanLII 8751 (SCJ)
9. *Robinson v Medtronic, Inc*, 2020 ONSC 1688
10. *Semple v Canada (Attorney General)*, 2006 MBQB 285
11. *Metcalfe & Mansfield Alternative Investments II Corp (Re)*, 2008 ONCA 587
12. *Sino-Forest Corporation (Re)*, 2012 ONSC 7050
13. *Zaniewicz v. Zungui Haixi Corporation*, 2013 ONSC 5490
14. *In re FLAG Telecom Holdings, Ltd Sec Litig*, 2010 WL 4537550 (SDNY Nov 8, 2010)
15. *In re Initial Pub Offering Sec Litig*, 671 F Supp 2d 467 (SDNY 2009)
16. *Brazeau v. Canada (Attorney General)*, 2020 ONSC 7229
17. *Gould v BMO Nesbitt Burns Inc*, 2007 CanLII 9239 (ON SC)
18. *In re IMAX Sec Litig*, 283 FRD 178 (SDNY 2012)
19. *In re Hi-Crush Partners LP Sec Litig*, 2014 WL 7323417 (SDNY Dec 19, 2014)
20. *Fleisher v Phoenix Life Ins Co*, 2015 WL 10847814 (SDNY Sep 9, 2015)
21. *Silberblatt v Morgan Stanley*, 524 F Supp 2d 425, 430 (SDNY 2007)
22. *In re AOL Time Warner Shareholder Derivative Litig.*, 2010 WL 363113 (SDNY Feb 1, 2010)
23. *In re PaineWebber Ltd P'ships Litig*, 171 FRD 104 (SDNY 1997), aff'd, 117 F.3d 721 (2d Cir 1997)
24. *Wal-Mart Stores, Inc v Visa USA, Inc*, 396 F 3d 96, 106 (2d Cir 2005)
25. *R v Abbey*, 2017 ONCA 640
26. *In re: Facebook, Inc, IPO Class Action Settlement*, 822 F App'x 40 (Mem), 44 (2d Cir 2020) (Summary Order)
27. *Hevesi v Citigroup Inc*, 366 F 3d 70, 82 n 13 (2d Cir 2004)

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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