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

(VARYING ALLOCATION AND DISTRIBUTION SCHEME)

Motion Returnable June 11, 2021

June 9, 2021

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PART I - INTRODUCTION

1. Igor Gimelshtein and Zola Finance Holdings Ltd. (**"Zola**" and 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 the misconduct of CannTrust and others.

2. The Zola Plaintiffs support the second amended and restated plan of compromise, arrangement and reorganization (the "**CCAA Plan**") but ask that this court make a single but important variation to the proposed Allocation and Distribution Scheme ("**A&DS"**) under the CCAA Plan before approving it,[1] as the current A&DS treats them and similarly situated investors in a harsh and inequitable manner.

3. This unfairness arises from the fact that under the A&DS the rate of artificial inflation per share[2] is set to $1.29 for the period between June 1, 2018 – September 30, 2018, before nearly quadrupling to $5.09 on October 1, 2021, which is the arbitrary date chosen by the CCAA Representatives for when CannTrust began to misrepresent the operations in its Niagara Facility.

4. The Zola Plaintiffs purchased their shares between September 26-28, 2018, which was the Wednesday-Friday before the Monday, October 1st date when the artificial inflation dramatically rises. As a result, the decision of the Zola Plaintiffs to

[1] Schedule "B" to the CCAA Plan, Exhibit "A" to the Affidavit of Greg Guyatt, sworn June 2, 2021.
[2] A explained below, for the Zola Plaintiffs and numerous others the artificial inflation rate is the main determinant of the amount they stand to recover under the A&DS.

purchase shares before a weekend, rather than after it, results in a nearly 75% reduction of their entitlement under the current A&DS.

5. There is limited factual support for these differing outcomes. The CCAA Representatives acknowledge that "there is no public information of which we are aware which could provide further specificity of the [October 1] start date."[3] Instead, they say they cannot deviate from their pleaded case theory, which was premised on CannTrust's disclosures that illegal growing began in CannTrust's Niagara facility "in October." The expert analysis that underpins the artificial inflation calculations is premised on the same factual theory.[4]

6. Furthermore, Zola Plaintiff Igor Gimelshtein, who is a former Chief Financial Officer ("**CFO**") of a large cannabis company with extensive knowledge about cannabis operations, has provided specific evidence on this motion as to why October 1, 2018 is not a logical start point for the increase in "artificial inflation" to begin. He points out that if CannTrust's illegal growing began in October then the decision and concrete preparations to begin the illegal operations must have occurred 1-2 weeks and up to at least 4 weeks prior to the growth start date, due to the logistics of cannabis growing. The Zola Plaintiffs' position is that these actions undertaken in support of and preparation for the unlicensed growing ought to have

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[3] June 1, 2021 Letter from Serge Kalloghian to Michael G. Robb, Exhibit "A" to the Affidavit of Igor Gimelshtein, sworn June 2, 2021 (the "**Gimelshtein Affidavit**").

[4] According to the CCAA Representatives, "As is typical, we provided Dr. Surana with instructions and assumptions based on our factual investigation, the allegations and case theories in the Ontario and U.S. Class Actions, and damages principles under Ontario and U.S. securities laws. To determine the artificial inflation figures in the proposed A&DS, Dr. Surana then conducted an analysis of CannTrust's share price reaction to various public announcements related to the alleged misrepresentations in the Class Actions." Letter from Serge Kalloghlian to Michael G. Robb, Exhibit "B" to the Gimelshtein Affidavit.

been disclosed as they would have jeopardized CannTrust's license, if known. If his uncontroverted evidence is correct, then all investors who purchased shares from mid-to-late September were doing so after the decision to commence illegal growing had been made and preparations to do so were underway.

7. As a result, in order to ensure that the A&DS is as fair as possible and aligns with the best available evidence, the Zola Plaintiffs ask that this court modify the second row of Table "C" of the A&DS so that the period of $5.02 share inflation begins on September 15, 2018, which is the date that most closely aligns with the best available evidence.

PART II - THE FACTS

A. The Zola Plaintiffs and Their Investment in CannTrust

8. The Zola Plaintiffs are sophisticated investors with operational knowledge in the cannabis industry. Between March 2015 and December 2018, the plaintiff Igor Gimelshtein was the CFO of MedReleaf Corp, a privately owned cannabis company that became public during his tenure. Mr. Gimelshtein departed following the successful sale of MedReleaf to Aurora Cannabis[5] He was also on the board of Columbia Care, a large cannabis producer.[6]

9. Mr. Gimelshtein's responsibilities at MedReleaf included managing all floor level operations, including the design and development of infrastructure to house cannabis cultivation and post-harvest operations as well as the development of

[5] Gimelshtein Affidavit at para 5.
[6] Gimelshtein Affidavit at para 8.

timelines and schedule optimization, as well as sales forecasting.[7] He also aided the VP of Quality Assurance in preparing for and responding to audits by Health Canada and other government agencies.[8] In mid-2018 Mr. Gimelshtein's friend Tarik Ouass, who was also a large investor in MedReleaf formed Zola. Zola and Mr. Gimelshtein are often co-investors and currently maintain investments in approximately 10 cannabis companies.[9]

10. Between September 26-28, 2018, following an intensive due diligence exercise into CannTrust operations, which included conversations with the company's senior executives and owners and focused on the state of CannTrust's regulatory compliance, the Zola Plaintiffs purchased 3 million shares, paying approximately $37.8 million for the shares.[10] In late October and early November they sold 391,8000 CannTrust shares and continue to hold the remaining 2,608,200 shares.[11]

B. The Zola Plaintiffs' Participation in the *CCAA* Process

11. In November, 2019, following the revelations regarding CannTrust's illegal growing, the Zola Plaintiffs commenced an action against CannTrust and other related parties (the "**Zola Action**") for making misrepresentations that ultimately resulted in the Zola Plaintiffs losing most of their CannTrust investment.[12] The Zola Action was subsequently stayed when CannTrust entered into this process under the *Companies' Creditors Arrangement Act*.

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[7] Gimelshtein Affidavit at para 6.
[8] Gimelshtein Affidavit at para 6.
[9] Gimelshtein Affidavit at para 7.
[10] Gimelshtein Affidavit at para 10.
[11] Gimelshtein Affidavit at para 10.
[12] Gimelshtein Affidavit at para 11.

12. Since then, and even though Zola is the largest shareholder to have retained counsel and participated in the *CCAA* process, Zola has mostly been excluded from the mediation and settlement discussions with CannTrust and the other Defendants. The coalition of lawyers who became CCAA Representative Counsel refused to allow Zola to directly participate in any settlement discussions or otherwise directly participate in the process. As a result, although the allegations contained in their claim were known to all participants, Zola was never given an opportunity to provide any input on the A&DS.[13]

13. On May 5, 2021, CannTrust, the Zola Plaintiffs and CCAA Representative Counsel entered into a restructuring support agreement, whereby CCAA Representative Counsel was appointed to prosecute Zola's claims and Zola agreed to support the *CCAA Plan*.[14] Under the terms of that agreement, the Zola Plaintiffs reserved all rights challenge a motion to approve an allocation or distribution scheme, such as the motion herein.[15]

C. Zola's Concerns with the A&DS

14. As with settlements in securities class actions,[16] the premise of the proposed A&DS is that during the time that CannTrust was misrepresenting its operations to the public the price of CannTrust shares were artificially inflated. Under the A&DS claimants like Zola, which held shares as of the closing on March 5, 2021,

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[13] Gimelshtein Affidavit at paras 13-15.
[14] Affidavit of Serge Kalloghlian, sworn June 2, 2021 (the "**Kalloghlian Affidavit**") at paras 86-90.
[15] Restructuring and Supporting Agreement, dated May 5, 2021, Exhibit "L" to the Kalloghlian Affidavit, s. 6.
[16] See *Zaniewicz v Zungui Haixi Corporation*, 2013 ONSC 5490 at para 62

have a “Recognized Loss Per Share” of the lessor of: (i) the “Share Inflation” on the date of purchase; or (ii) the purchase price minus $1.70.[17]

15. Since the Zola Plaintiffs purchased three million shares on September 26-28, 2018 and held the vast majority of those shares through March 5, 2021, they are entitled only to the Share Inflation amount as of their dates of purchase, which as discussed, is $1.29/share for the period between June 30, 2018 – September 30, 2018. Had Zola purchased their shares not on Wednesday-Friday of the week of September 24 but on Monday-Wednesday of the week of October 1, their Share Inflation amount (and therefore, their entitlement under the A&DS) almost quadruples to $5.02.[18]

16. The Zola Plaintiffs believe that the $3.73 difference in Share Inflation between Friday, September 28, and Monday, October 1st is arbitrary and unfairly disconnected from the reality of what would have occurred in this case.

17. As Mr. Gimelshtein attests, if CannTrust had begun its illegal growing operation in October, as CannTrust news releases from the time indicate,[19] then the decision to grow illegally would have been made and concrete preparation begun “at a minimum several weeks in advance of the illegal production, and no later than mid-September.”[20]

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[17] Gimelshtein Affidavit at para 17.
[18] Gimelshtein Affidavit at para 17.
[19] CannTrust’s July 8, 2019 News Release “CannTrust Statement Regarding Health Care,” Exhibit “L” to the Kalloghlian Affidavit, which is relied on by the CCAA Representatives, only states that “Growing in unlicensed rooms took place from October 2018 to March 2019.”
[20] Gimelshtein Affidavit at para 20

18. This is due to the complexity and logistics of cannabis production, which require extensive preparations before growing can begin. These complexities include a need to procure numerous “mother” or starter plants and then a cloning process which would take an additional 5-9 days.[21] Furthermore, there was likely an additional “vegetative stage” that would have occurred outside the illegal growing rooms that would have taken an additional 1-4 weeks, depending on the growing technique used.[22]

19. In sum, it would have taken CannTrust a minimum of 1-2 weeks, and “likely more than four weeks” to prepare before they could have begun their illegal growing operation, which means that the decision to commence growing, and therefore when the artificial inflation rate rose, would almost certainly have occurred by mid-September, weeks before the Zola Plaintiffs invested in reliance on false representations.[23]

20. The current A&DS ignores this evidence. Its design relies on factual statements made by CannTrust at a time when it faced potential liability to every shareholder who acquired its shares after the unlicensed conduct was undertaken. The company has not addressed Mr. Gimelshtein’s evidence and there has been no discovery upon which the Company’s statement can be tested. Yet the A&DS designed by the Coalition unfairly places investors like the Zola Plaintiffs in the same Share Inflation category as those who purchased in June of 2018, when there

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[21] Gimelshtein Affidavit at para 21.
[22] *Ibid.*
[23] *Ibid.*

was almost no possibility that cannabis was being cultivated in CannTrust's Niagara Falls facility.

21. The Coalition's decision to rely on CannTrust's statements about the commencement of improper growing rather than the unchallenged evidence of an investor with expertise in the industry does not stand up to scrutiny. It deprives the purchasers of approximately 7 million shares,[24] including the Zola Plaintiffs, of treatment under the A&DS that accords with the evidence. No reason is posited for the arbitrariness of this selection.

PART III - ISSUES AND THE LAW

A. This Court Has Authority to Alter the A&DS

22. The CCAA is a "flexible statute" and this court has "broad jurisdiction to make orders and 'fill in gaps in legislation so as to give effect to the objects of the CCAA."[25]

23. The Zola Plaintiffs ask that this court, pursuant to its broad authority under s. 11 of the *CCAA,* to rectify the significant inequity that results from the current A&DS and extend the period of $5.02 Share Inflation from October 1, 2018 to September 15, 2018. The Zola Plaintiffs say that the allocation provided for by the A&DS should reflect the evidence and case theories available to investors in order to be equitable as between them.

[24] Affidavit of Melissa O'Connor at para 1.
[25] *Labourers Pension Fund of Central and Eastern Canada v Sino-Forest Corporation*, 2013 ONSC 1078 at para 44.

24. In the class action *Zaniewicz v Zungui Haixi Corporation* Perell J. was faced with a single investor complaint about inequitable treatment under a proposed plan of distribution not dissimilar to the A&DS.[26] Perell J. found that such plans should be approved "if in all the circumstances, the plan of distribution is fair, reasonable, and in the best interests of the class."[27]

25. Perell J. carefully considered the complaint of the proposed investor, whose claims had been discounted to zero under the plan, found that their complaint had "considerable merit" and chose to vary the distribution plan to respond to the concerns and ensure fairness between shareholders.[28]

26. It should also be noted that in *Zaniewicz* the discounts applied to the plan of distribution were the subject of a standalone mediation, where various claimant groups were given the opportunity to discuss and provide input into distribution protocol.[29]

27. By contrast, there was no such opportunity here, despite the complexity of the issues and the severity of investor losses. CCAA Representative Counsel excluded Zola from full participation in the mediation process and did not seek their input into the A&DS.[30] This inexplicable failure to consult is an indicator that the current A&DS may not fairly balance investors' interests.

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[26] 2013 ONSC 5490.
[27] *Ibid.* at para 59.
[28] *Ibid.* at paras 84-90.
[29] *Ibid.* at paras 69-80.
[30] Gimelshtein Affidavit at paras 13-15.

B. The Proposed A&DS Treats the Zola Plaintiffs and Others Inequitably

28. As discussed above, the Zola Plaintiffs believe that the current A&DS is not fair and reasonable and should be varied, since the October 1st start date for the increase in artificial inflation ignores the likely reality that CannTrust's illegal behaviour was well underway by that point.

29. The Zola Plaintiffs' position on the timing of CannTrust's production has been consistent. In other words, what is being advanced is not a late in the day tactical theory. The Zola Plaintiffs' Statement of Claim, issued in November, 2019, alleges that "at least as of September 1, 2018, CannTrust had decided to and was taking preparatory steps to illegally cultivate cannabis in the Phase 2 Expansion of the Niagara Facility…"[31]

30. The evidence of Igor Gimelshtein in support of this position is uncontradicted on this motion. CCAA Representative Counsel admits that Zola's position "may well have merit" and that there is a paucity of public information that could "provide further specificity" as to the start date of the illegal cannabis production.[32] This reference to public information is needed because CCAA Representative Counsel has not conducted discovery prior to settling its claims with CannTrust and a number of other parties.

31. Given these acknowledgments and Mr. Gimelshtein's information, this court ought to favour the interests of equity and fairness and align the A&DS with the best

[31] Zola Plaintiffs' Statement of Claim, Exhibit "L" to the Kalloghlian Affidavit at para 81(b).
[32] June 1, 2021 Letter from Serge Kalloglian to Michael G. Robb, Exhibit "O" to the Kalloghlian Affidavit.

available evidence, which indicates that CannTrust's decision to start its illegal operations began sometime in September, and almost certainly no later than mid-September. There is no justification for treating the claims of those who purchased towards the end of September, 2018 in the same manner as those who purchased in June, 2018.

32. It may be true that all cut-off dates contain some level of arbitrariness, but that should not mean that a date that best reflects realities should not be used. This should be particularly the case where there is a significant multifold difference in entitlement between each side of the cut-off.

C. CCAA Representative Counsel's Arguments are Irrelevant

33. In their responding letter and motion materials CCAA Representative Counsel opposes this change, arguing that:

(a) "[w]hile your case theory may well have merit, it is not that the case theory that CCAA Representative Counsel have pleaded, publicized to Securities Claimants, and have advanced through the mediations;"[33] and

(b) Given the size of Zola's holdings, a modification to the A&DS would reduce other Securities Claimants' distributions "negatively in a non-trivial way."[34]

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[33] *Ibid.*
[34] *Ibid.*

34. Neither of these arguments should be relevant to the court's consideration of the A&DS, which should be focused on whether the A&DS rests on an equitable foundation that aligns with the likely facts. On this motion, the Zola Plaintiffs do not challenge, nor does this court need to assess, CCAA Representative Counsel's untested case theory. There is no requirement that plans of distribution perfectly align with pleaded claims, and they often deviate from claims to incorporate subsequent factual developments and information gleaned from the litigation process.[35]

35. If this court finds that the current A&DS treats Zola and other situated investors unfairly, the A&DS should not be saved by the fact that other claimants' distributions would be negatively impacted. The claims of one defrauded investor ought not to be sacrificed for the betterment of other defrauded investors, without sound justification. No such justification has been advanced by CCAA Representative Counsel.

36. In any event, it is simply not the case that the Zola Plaintiffs alone would benefit from the proposed change. Trading data from the period indicates that 7.3 million CannTrust shares traded hands between September 17-September 28, 2018, suggesting that there are many other CannTrust investors who also purchased shares during this period and would benefit from such a change.[36]

[35] *Zaniewicz v Zungui Haixi Corporation*, 2013 ONSC 5490.

[36] Affidavit of Melissa O'Connor at para 1. Given that Zola purchased one million shares directly from the Litwins, no more than 2 million of Zola's share purchases would have factored into this trading volume. See Zola Plaintiffs' Statement of Claim at paras 33-34.

37. Making this variation would ensure that the allocation proposed in the CCAA Plan properly takes into account the conduct that is the basis for Zola's claim and that of other securities claimants.

PART IV - ORDER REQUESTED

38. The Zola Plaintiffs respectively request that this court modify the second row of Table "C" of the A&DS so that the period of $5.02 share inflation begins on September 15, 2018, which is the date that most closely aligns with the available evidence.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 9th day of June, 2021

Alex Dimson

Siskinds LLP and Wright Henry LLP

Lawyers for the Respondents

SCHEDULE "A"
LIST OF AUTHORITIES

Labourers Pension Fund of Central and Eastern Canada v Sino-Forest Corporation, 2013 ONSC 1078
Zaniewicz v Zungui Haixi Corporation, 2013 ONSC 5490

SCHEDULE "B"
RELEVANT STATUTES

Companies' Creditors Arrangement Act, RSC 1985, c C-36, s. 11

General power of court

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

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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