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

REPLY FACTUM OF THE CCAA REPRESENTATIVES

(Sanction Hearing)
(Returnable June 11, 2021)

June 10, 2021

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To: The Service List

PART I ~ OVERVIEW

1. The CCAA Plan resolves litigation against over 30 defendants in at least 11 separate proceedings commenced in the United States and Canada arising from CannTrust Holdings' noncompliance with federal cannabis laws.[1] The CCAA Plan provides $83 million in recovery to those most harmed in this ordeal (the Securities Claimants) while still allowing the Applicants to emerge from insolvency as a going concern.

2. KPMG is the sole defendant objecting to the CCAA Plan. After causing CannTrust Holdings' collapse and ½ billion dollars of losses to the investing public through its negligent audit, KPMG is now seeking to prevent the company's emergence from insolvency. KPMG makes no secret of the reason it wants this CCAA Plan to fail: so it can avoid facing CannTrust's direct auditor negligence claim against it for the catastrophic damages it caused ("**KPMG Claim**").[2]

3. The claim against KPMG is a simple one. CannTrust's ability to carry out its business depended on complying with the terms of the licences it had received from Health Canada. As part of its audit functions KPMG was required to ensure that CannTrust was complying with the terms of these licences. *There is no evidence that KPMG did this*. Had KPMG performed its services to CannTrust properly and without negligence, CannTrust would not have continued the illegal conduct and entered into the transactions that caused its insolvency.

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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.

[2] Responding Factum of KPMG LLP, dated June 10, 2021 ("**KPMG Factum**") paras 54-55.

4. KPMG's goal on this motion is to use any means possible to prevent the shareholders who have been harmed by KPMG's misconduct from being able to obtain full recovery for their losses. Amongst its kitchen sink attack on the CCAA Plan, it argues that

(a) the assignment of the KPMG Claim is not integral to the bargain struck in the RSA and it can be severed from the CCAA Plan;[3] and

(b) it is unfair for CCAA Representative Counsel to represent the Securities Claimants, as well as the Securities Claimants Trust (the beneficiaries of which are the Securities Claimants)[4]

5. The court should reject KPMG's objections because:

(a) there is no basis to question CCAA Representative Counsel's sworn evidence that they ascribed significant value to the KPMG Claim and that assignment of it to the Securities Claimant Trust was a fundamental deal term of the RSA;

(b) no conflict arises from counsel acting for both the Securities Claimants and the Securities Claimant Trust, because the Securities Claimants are the exclusive beneficiaries of the trust;

(c) issues relating to the applicability of the arbitration clause or documentary production do not need to be addressed now and will be dealt with during the course of the litigation following the implementation of the CCAA Plan; and

[3] KPMG Factum paras 21-24.
[4] KPMG Factum paras 57-60.

(d) acceding to KPMG's objections would be contrary to public policy because it enables it to veto CannTrust's restructuring efforts in order to avoid its liabilities to the investing public.

PART II ~ REPLY SUBMISSIONS

A. Assignment of the KPMG Claim is a fundamental deal term and integral to the CCAA Plan

6. There is no basis in the record to question CCAA Representative Counsel's sworn evidence regarding the value and importance of the KPMG Claim.

7. The entire basis for KPMG's allegation is its theory that because CannTrust itself did not sue KPMG, then the KPMG Claim must not have value.[5]

8. This submission ought to be rejected. CannTrust's choice not to prosecute the KPMG Claim has no bearing on the claim's value or CCAA Representative Counsel's assessment of it. CannTrust's motivations when it entered insolvency proceedings was to end litigation against it and re-emerge as a going concern. Firing and suing its auditor was not consistent with those plans. CCAA Representative Counsel has different motivations, which are to maximize litigation recovery for the benefit of the Securities Claimants.

9. KPMG itself admits in its factum that the KPMG Claim would give the Securities Claimants a litigation advantage they do not currently have. Most significantly, the KPMG Claim is not restricted by the liability limits imposed on the direct shareholder claims, thereby greatly increasing the recovery from proving KPMG's negligence.[6] That is precisely why the Securities

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[5] KPMG Factum paras 23-24.
[6] KPMG Factum paras 54-55.

Claimants bargained for and obtained CannTrust's claims against KPMG as part of the compromise and settlement of the Securities Claimants' claims against CannTrust.

10. KPMG's assertion that CannTrust's internal investigation absolved it of liability has no evidentiary foundation.[7] Nowhere does CannTrust say that it conducted an investigation into KPMG's conduct.[8] And there is certainly no suggestion that CannTrust conducted an inquiry into whether KPMG's audit complied with PCAOB standards, and found that KPMG did not breach the standard of care.

11. The court should reject KPMG's request to draw an adverse inference against Mr. Kalloghlian for declining to produce documents and answer questions protected by the Mediation Order's confidentiality protocol.[9] KPMG's counsel requested production of "all communications, including any documents exchanged, with CannTrust or its advisers, during the course of the negotiations of the RSA that relate to 'CannTrust's potential claim against KPMG'". These documents fall squarely within the paragraph 11(d) of the Mediation Order:

> *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*.

12. CCAA Representative Counsel has no discretion in the face of that court order to produce such documents. It was wholly inappropriate for KPMG's counsel to attempt to elicit information from Mr. Kalloghlian that was squarely within the parameters of the mediation process in which

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[7] KPMG Factum para 24.
[8] Transcript of Cross-examination of Serge Kalloghlian taken June 7, 2021 ("**Kalloghlian Transcript**"), Q 73, 80, p 18, 20, Transcript Brief, Tab 1.
[9] KPMG Factum para 24.

KPMG had been participating with the Securities Claimants. There is therefore no basis to draw an adverse inference against Mr. Kalloghlian regarding the importance and value of the KPMG Claim.

13. For the reasons above, the court should reject KPMG's submission that the KPMG Claim is not an integral part of the CCAA Plan.

B. No Conflict or Prejudice From Securities Claimants' Counsel acting as Trustee

14. KPMG argues that there is somehow a conflict for counsel to act for the Securities Claimants and the Securities Claimants' Trust concurrently. It is difficult to understand how such a conflict could occur, since the Securities Claimants are the beneficiaries of the trust.

15. The cases cited by KPMG where an independent counsel was appointed to manage parallel litigation are distinguishable because the beneficiaries of the two sets of litigation were different and had conflicting interests.[10] In *Vaeth*, counsel commenced a class action and individual action against the same defendants on behalf of different plaintiffs. The court held that there was a conflict of interest between the two sets of plaintiffs "about the sequence of any settlement if there are genuine or imposed solvency limits on the settlement proceeds."[11] The dispute between the litigation trust and the class action plaintiffs in *Sino Forest*[12] arose because the beneficiaries of the litigation trust were different from the class action plaintiffs (apart from a minor overlap).[13]

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[10] KPMG Factum at para 59;
[11] *Vaeth v North American Palladium Ltd*, 2016 ONSC 5015 at [68], Reply Book of Authorities of the CCAA Representatives ("**Reply BOA**") Tab 1.
[12] *Labourers' Pension Fund of Central and Eastern Canada (Trustees of) v Sino-Forest Corp*, 2015 ONSC 4004, Reply BOA Tab 2.
[13] Excerpt of Plan of Compromise and Reorganization of Sino Forest Corporation, Article 4.11 (a), Reply Factum of the CCAA Representatives, Appendix A; Excerpt of Sino-Forest Litigation Trust Agreement, Reply Factum of the CCAA Representatives, Appendix B.

16. Here, the beneficiaries of the Securities Claimant Trust are the Securities Claimants. KPMG has not given any example of a conflict that could occur in this situation, where interests are perfectly aligned, because there are none.

17. KPMG's purported concerns about how counsel to the Securities Claimants Trust will be compensated should be assuaged given that the court will continue its supervisory jurisdiction in the continuing litigation.

18. Paragraphs 60 to 61 of the Factum of the CCAA Representatives explains several reasons why it would be against the Securities Claimants' best interests to appoint a separate trustee (and hence counsel) to manage the Securities Claimants Trust. In addition to those reasons, doing so would be inconsistent with Justice Hainey's prior orders (i) granting carriage of the Canadian class action to Canadian CCAA Representative Counsel; and (ii) appointing CCAA Representative Counsel to represent the interests of the Securities Claimants.

19. KPMG's argument in this regard should be seen for what it is: an attempt by KPMG to remove from the Securities Claimants the counsel they have chosen, and who KPMG does not want to face in litigation against it.

C. Procedural and Litigation Issues Will be Determined Later

20. KPMG expresses concern that assignment of the KPMG Claim to the Securities Claimant Trust will deny it the right to confidential arbitration, or may give the Securities Claimants procedural advantages. These are matters of procedure about future litigation that are not relevant to this sanction motion, and which the court can address during the course of the litigation against KPMG.

D. Acceding to KPMG's Objections Is Contary to Public Policy

21. There is a public policy dimension to the CCAA process. Accordingly, it is well-accepted that courts exercising the broad remedial powers inherent in the CCAA sometimes must weigh the broader public interest as a factor in determining whether to allow a particular action, such as the sanction order in this case.[14]

22. On this point, the Court of Appeal in *Metcalfe & Mansfield Alternative Investments II Corp*[15] accepted that:

> *[T]he Act was designed to serve a "broad constituency of investors, creditors and employees". Because of that "broad constituency" the court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest.*

23. The public interest is a strong factor in this restructuring because the restructuring occurs against the backdrop of shareholder losses and claims under the civil liability provisions of the *Securities Act*, which is remedial legislation with the twin goals of (a) facilitating and enhancing access to justice for investors, and (b) deterring corporate misconduct and negligence.[16] The restructuring also engages the public's interest in ensuring that auditors of public companies competently discharge their gatekeeping duties to assist the collectivity of shareholders in their task of overseeing management.[17]

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[14] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at [60], Reply BOA Tab 3, ("…courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed.").
[15] *Metcalfe & Mansfield Alternative Investments II Corp, (Re)*, 2008 ONCA 587 at [52], Reply BOA Tab 4, leave to appeal to SCC refused, 32765 (19 September 2008).
[16] *Green v Canadian Imperial Bank of Commerce*, 2014 ONCA 90 at [36], Reply BOA Tab 5.
[17] *Deloitte & Touche v Livent Inc (Receiver of)*, 2017 SCC 63 at [60], Reply BOA Tab 6.

24. It would be contrary to the public interest to deny the persons harmed by KPMG's misconduct the ability to fully recover the losses caused by that misconduct by preventing the assignment to them of the KPMG Claim, and to preference the private goals of KPMG to scupper CannTrust's restructuring efforts to help it avoid its liabilities to the investing public.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

CCAA Representative Counsel

SCHEDULE "A"
LIST OF AUTHORITIES

1. *Vaeth v North American Palladium Ltd.*, 2016 ONSC 5015
2. *Labourers' Pension Fund of Central and Eastern Canada (Trustees of) v Sino-Forest Corp*, 2015 ONSC 4004
3. *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60
4. *Metcalfe & Mansfield Alternative Investments II Corp, (Re)*, 2008 ONCA 587, leave to appeal to SCC refused, 32765 (19 September 2008).
5. *Green v Canadian Imperial Bank of Commerce*, 2014 ONCA 90
6. *Deloitte & Touche v Livent Inc (Receiver of)*, 2017 SCC 63

APPENDIX A

Excerpt of Plan of Compromise and Reorganization of Sino-Forest Corporation

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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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

APPLICANT

PLAN OF COMPROMISE AND REORGANIZATION

pursuant to the *Companies' Creditors Arrangement Act*
and the *Canada Business Corporations Act*
concerning, affecting and involving

SINO-FOREST CORPORATION

December 3, 2012

then be deemed to be assigned by Newco to Newco II pursuant to section 6.4(x) hereof. The obligations of SFC to the applicable Subsidiaries and Greenheart in respect of all Subsidiary Intercompany Claims (other than those set-off pursuant to section 6.4(l) hereof) shall be assumed by Newco on the Plan Implementation Date pursuant to 6.4(m) hereof, and then shall be assumed by Newco II pursuant to section 6.4(x) hereof. Notwithstanding anything to the contrary herein, Newco II shall be liable to the applicable Subsidiaries and Greenheart for such Subsidiary Intercompany Claims and SFC shall be released from such Subsidiary Intercompany Claims from and after the Plan Implementation Date, and the applicable Subsidiaries and Greenheart shall be liable to Newco II for such SFC Intercompany Claims from and after the Plan Implementation Date. For greater certainty, nothing in this Plan affects any rights or claims as between any of the Subsidiaries, Greenheart and Greenheart's direct and indirect subsidiaries.

4.11 Entitlement to Litigation Trust Interests

(a) The Litigation Trust Interests to be created in accordance with this Plan and the Litigation Trust shall be allocated as follows:

(i) the Affected Creditors shall be collectively entitled to 75% of such Litigation Trust Interests; and

(ii) the Noteholder Class Action Claimants shall be collectively entitled to 25% of such Litigation Trust Interests,

which allocations shall occur at the times and in the manner set forth in section 6.4 hereof and shall be recorded by the Litigation Trustee in its registry of Litigation Trust Interests.

(b) Notwithstanding anything to the contrary in section 4.11(a) hereof, if any of the Noteholder Class Action Claims against any of the Third Party Defendants are finally resolved (whether by final judgment, settlement or any other binding means of resolution) within two years of the Plan Implementation Date, then the Litigation Trust Interests to which the applicable Noteholder Class Action Claimants would otherwise have been entitled in respect of such Noteholder Class Action Claims pursuant to section 4.11(a)(ii) hereof (based on the amount of such resolved Noteholder Class Action Claims in proportion to all Noteholder Class Action Claims in existence as of the Claims Bar Date) shall be fully, finally, irrevocably and forever cancelled.

4.12 Litigation Trust Claims

(a) At any time prior to the Plan Implementation Date, SFC and the Initial Consenting Noteholders may agree to exclude one or more Causes of Action from the Litigation Trust Claims and/or to specify that any Causes of Action against a specified Person will not constitute Litigation Trust Claims ("**Excluded Litigation Trust Claims**"), in which case, any such Causes of Action shall not be transferred to the Litigation Trust on the Plan Implementation Date. Any such Excluded Litigation Trust Claims shall be fully, finally, irrevocably and forever compromised, released, discharged, cancelled and barred on the Plan

APPENDIX B

Excerpt of Sino-Forest Litigation Trust Agreement

SINO-FOREST LITIGATION TRUST AGREEMENT

In this Agreement, "**Litigation Trust Assets**" means the Litigation Trust Claims, the Litigation Funding Amount, and any other assets acquired by the Litigation Trust on or after the Effective Date pursuant to this Agreement or the Plan.

The Litigation Trust is established for the sole purpose of liquidating and distributing the Litigation Trust Assets pursuant to the Plan and this Agreement with no objective to continue or engage in the conduct of a trade or business.

The Litigation Trust is established for (i) the benefit of the Affected Creditors with Proven Claims and the Noteholder Class Action Claimants entitled to receive Litigation Trust Interests under the Plan (individually, a "**Litigation Trust Beneficiary**" and collectively, the "**Litigation Trust Beneficiaries**") and (ii) the pursuit of all Litigation Trust Claims.

The Litigation Trustee is duly appointed pursuant to the Plan, the Plan Sanction Order and Section 1.2(b) of this Agreement.

Unless the context otherwise requires, capitalized terms used in this Agreement and not otherwise defined herein shall have the meanings ascribed to them in the Plan. Schedule A to this Agreement sets forth an index of terms that are defined in this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the promises and the mutual covenants and agreements contained herein and in the Plan, SFC and the Litigation Trustee intending to be legally bound, agree as follows:

ARTICLE 1
ESTABLISHMENT OF THE LITIGATION TRUST

1.1 Settling the Litigation Trust and Funding Expenses of the Litigation Trust

SFC hereby settles the Litigation Trust with the sum of twenty ($20.00) Canadian dollars (serial number: BIR6584805) (the "**Settlement Funds**"), the receipt of which is hereby acknowledged by the Litigation Trustee, and loans the Litigation Funding Amount to the Litigation Trustee, by way of the form of promissory note appended hereto at Schedule B, which is executed as of the date of this Agreement, to finance the operations of the Litigation Trust. The Litigation Trust Claims Transferors (as defined below) have no other funding obligations with respect to the Litigation Trust.

1.2 Establishment of Litigation Trust and Appointment of the Litigation Trustee

(a) Pursuant to the Plan, the Plan Sanction Order and this Agreement, the Litigation Trust is hereby established on the date and at the time set out in section 6.4 of the Plan, and shall be known as the "**SFC Litigation Trust**" on behalf of and for the benefit of the Litigation Trust Beneficiaries.

(b) The Litigation Trustee hereby accepts its appointment as trustee of the Litigation Trust as of the Plan Implementation Date (the "**Effective Date**") and agrees to accept and hold the Settlement Funds and the Litigation Trust Assets in trust for

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(Sanction Hearing)
(Returnable 11 June 21)

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