Court File No.: CV-22-00688966-00CL

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 THE FLOWR CORPORATION, THE FLOWR CANADA HOLDINGS ULC, THE FLOWR GROUP (OKANAGAN) INC., AND TERRACE GLOBAL INC. (collectively, the "**Applicants**")

FACTUM OF THE APPLICANTS

November 2, 2022

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FACTUM OF THE APPLICANTS

PART I - INTRODUCTION

1. On October 20, 2022, the Applicants in these proceedings, The Flowr Corporation ("**Flowr**"), The Flowr Canada Holdings ULC ("**Flowr Holdings**" or the "**Vendor**"), The Flowr Group (Okanagan) Inc. ("**Flowr Okanagan**" or the "**Company**"), and Terrace Global Inc. ("**Terrace**") (collectively, the "**Applicants**" or the "**Flowr Group**"), made an application to the Ontario Superior Court of Justice (Commercial List) (the "**Court**") for creditor protection under the *Companies Creditors' Arrangement Act,* R.S.C. 1985, c. C-36, as amended (the "**CCAA**").

2. Pursuant to the Order of Justice Cavanagh dated October 20, 2022 (the "**Initial Order**"), *inter alia*, the Court:

(a) declared that the Applicants are companies to which the CCAA applies;

(b) appointed Ernst & Young Inc. as Monitor of the Applicants in these proceedings (in such capacity, the "**Monitor**");

(c) granted a stay of proceedings for an initial stay period up to October 30, 2022 (the "**Stay Period**");

(d) authorized the Applicants to obtain and borrow under a credit facility (the "**DIP Facility**") from 1000343100 Ontario Inc. (the "**DIP Lender**"); and

(e) granted certain priority charges against the property (the "**Property**") of the Applicants (collectively, the "**Priority Charges**").

3. On October 28, 2022, on motion of the Applicants, Justice Cavanagh granted the following Orders:

(a) An Amended and Restated Initial Order (the "**ARIO**"), *inter alia*, extending the Stay Period to January 13, 2022 and increasing the amount of the Priority Charges against the Property; and

(b) An Order (the "**SISP Order**"), *inter alia*, approving a sale and investment solicitation process (the "**SISP**") and authorizing and directing the Monitor to conduct the SISP in accordance with its terms.

4. The SISP Order contemplates the potential for a stalking horse agreement being approved by the Court. In particular, if approved by the Court, a stalking horse agreement would be deemed a Qualified Bid (as defined in the SISP) under the SISP.

5. Under the terms of the Court approved DIP Facility, the DIP Lender has the exclusive option to negotiate a stalking horse agreement with the Applicants (the "**Stalking Horse Bid**").

6. The Applicants, in consultation with the Monitor, have negotiated and entered into a Stalking Horse Purchase Agreement (as defined below) between Flowr Holdings, Flowr Okanagan, and the DIP Lender, as purchaser (the "**Stalking Horse Bidder**" or the "**Purchaser**"), subject to Court approval.

7. Accordingly, the Applicants bring this motion to the Court for an Order substantially in the form attached at Tab 3 of the Motion Record (the "**Stalking Horse Approval Order**"):

(a) authorizing and empowering the Vendor and the Company to enter into the stalking horse purchase agreement dated October 31, 2022 (the "**Stalking Horse Purchase Agreement**") between the Vendor, the Company and the DIP Lender, as Stalking Horse Bidder, *nunc pro tunc*, provided that the approval of any sale and vesting of any Property in and to the Stalking Horse Bidder shall be considered by this Court on a subsequent motion made to this Court if the Stalking Horse Purchase Agreement is the Successful Bid pursuant to the Court-approved SISP;

(b) approving the Break Fee (as defined in the Stalking Horse Purchase Agreement), and, in the event the Stalking Horse Bidder is not the Successful Party under the SISP Order, authorizing and directing the Applicants to pay the Break Fee to the Stalking Horse Bidder in the manner and circumstances described in the Stalking Horse Purchase Agreement; and

(c) confirming that the Stalking Horse Purchase Agreement represents the "Stalking Horse Bid" as defined in and for purposes of the SISP.

8. All capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the SISP Order or the Stalking Horse Purchase Agreement.

PART II - SUMMARY OF FACTS

9. The full facts in support of this motion are set out in the Affidavit of Darren Karasiuk sworn on October 31, 2022 (the "**Second Karasiuk Affidavit**") and the Second Report of the Monitor dated November 2, 2022 (the "**Second Report**").

A. The SISP

10. The key dates under the SISP are as follows:

(a) A November 7, 2022 deadline to publish notice of the SISP and circulate teasers and non-disclosure agreements;

(b) A Bid Deadline of November 25, 2022 to receive binding offers from Potential Bidders participating in the SISP;

(c) An Auction date of December 1, 2022; and

(d) Hearing of the Sale Approval Motion by no later than December 16, 2022, subject to the availability of the Court.[1]

11. The SISP was developed in consultation with the Monitor, taking into account the financial circumstances of the Applicants and the amount of DIP financing available, and will be administered by the Monitor in consultation with the Applicants.[2]

[1] Second Karasiuk Affidavit, at para. 14; SISP Order.
[2] Second Karasiuk Affidavit, at paras. 15-16.

12. Given the financial resources available to the Applicants under the DIP Facility, the SISP contemplates, among other things, that a Qualified Bid must include confirmation that, if the Bid is the Successful Bid and the Flowr Group has cash requirements in excess of the amounts available to them under the DIP Facility to get to a closing of the transaction, then the Bidder will advance funds to the Flowr Group by way of a non-revolving loan facility to allow them to fund their cash requirements in a manner that does not impair the priority of the DIP Facility or otherwise is satisfactory to the DIP Lender.[3]

B. The Stalking Horse Purchase Agreement

13. On October 31, 2022, the Vendor, the Company and the Stalking Horse Bidder entered into the Stalking Horse Purchase Agreement, subject to Court approval.[4]

14. The key terms and features of the Stalking Horse Purchase Agreement are as follows:

(a) The Stalking Horse Purchase Agreement is structured as a purchase of the shares of the Company holding only the Retained Assets (which may, for greater certainty, include certain Transferred Assets from other Applicants) and Assumed Liabilities following a Pre-Closing Reorganization;[5]

(b) It is expected it will maintain the employment of substantially all employees of the Company;[6]

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[3] Second Karasiuk Affidavit, at paras. 17.

[4] Second Karasiuk Affidavit, at para. 20 and Exhibit “A”.

[5] Second Karasiuk Affidavit, at para. 23; Second Report at para. 22.

[6] Second Karasiuk Affidavit, at para. 23.

(c) In the event that the Applicants have cash requirements in excess of those available to them under the DIP Facility once fully drawn, the Stalking Horse Bidder shall advance, as a debtor-in-possession loan facility (the "**Closing DIP Loan**"), such further funding to the Applicants as is reasonably necessary to, among other things, close the transactions contemplated by the Stalking Horse Purchase Agreement;[7]

(d) The purchase price under the Stalking Horse Purchase Agreement is $3,888,888.88 plus the Closing DIP Loan and the Assumed Liabilities, subject to adjustment as provided in the agreement;[8]

(e) The Stalking Horse Bidder shall pay the Purchase Price to the Monitor, for the benefit of the Vendor and ResidualCo, in the form of: (i) a credit bid equivalent to all outstanding amounts under the DIP Facility including any amounts that are owing under the Closing DIP Loan as of the closing of the transaction; (ii) cash consideration for the balance of the Purchase Price, subject to certain adjustments; and (iii) assumptions of the Assumed Liabilities.[9]

(f) In consideration for the Stalking Horse Bidder expending time and money negotiating the Stalking Horse Purchase Agreement, undertaking the necessary due diligence to do so and for it agreeing to act as a stalking horse bidder under the SISP, the Stalking Horse Purchase Agreement contemplates that, subject to approval of the Court, the Stalking Horse Bidder shall be entitled to a break fee in the amount of $185,000

[7] Second Karasiuk Affidavit, at para. 26; Second Report at para. 23.
[8] Second Karasiuk Affidavit, at para. 24.
[9] Second Karasiuk Affidavit, at para. 25; Second Report at para. 23.

(inclusive of HST, if any) (the "**Break Fee**"). The Break Fee shall be payable to the Stalking Horse Bidder in the event that the Stalking Horse Bid is not the Successful Bid under the SISP, following closing of the transaction contemplated by such other Successful Bid.[10]

PART III - STATEMENT OF ISSUES

15. The issues to be determined by this Court on this motion are whether:

    (a) The Stalking Horse Purchase Agreement should be approved?

    (b) The Break Fee should be approved?

PART IV - LAW AND ARGUMENT

A. The Stalking Horse Purchase Agreement Ought to be Approved

16. The Applicants submit that the Stalking Horse Purchase Agreement ought to be approved by the Court as it provides stability to the Applicants' Business and gives confidence to stakeholders including employees, customers and suppliers that a going concern outcome will be achieved through the SISP. Moreover, it provides a baseline purchase price and deal certainty.[11]

17. This Court frequently approves stalking horse agreements as part of a court approved sale process in insolvency proceedings. Justice Brown confirmed that "the use of stalking horse bids to set a baseline for the bidding process, including credit bid stalking horses, has been recognized by Canadian courts as a reasonable and useful element of a sales process.

[10] Second Karasiuk Affidavit, at para. 31; Second Report at para. 23.

[11] Second Karasiuk Affidavit, at paras. 21-22; Second Report at paras. 24-25.

Stalking horse bids have been approved for use in other receivership proceedings, BIA proposals, and CCAA proceedings."[12]

18. In a CCAA case, Justice Pattillo adopted and outlined four factors for the Court to consider in exercising its discretion to authorize a stalking horse process, as follows:

(a) Is the sale transaction warranted at this time?

(b) Will the sale benefit the "economic community"?

(c) Do any of the creditors have a bona fide reason to object to the sale of the business?

(d) Is there a better viable option?[13]

19. While in the context of a *BIA* proposal, Justice Penny in *Danier Leather Inc. (Re)* made the following general findings on the value of stalking horse bids in insolvency proceedings:

> The use of a sale process that includes a stalking horse agreement maximizes value of a business for the benefit of its stakeholders and enhances the fairness of the sale process. Stalking horse agreements are commonly used in insolvency proceedings to facilitate sales of businesses and assets and are intended to establish a baseline price and transactional structure for any superior bids from interested parties… [14]

20. For the following reasons, the Applicants submit that the Court ought to permit the use of a Stalking Horse Bid under the SISP and approve the Stalking Horse Purchase Agreement as the Stalking Horse Bid:

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[12] *CCM Master Qualified Fund v. Blutip Power Technologies*, 2012 ONSC 1750 at para 7 ["***CCM***"].

[13] *Crate Marine Sales Ltd. (Re)*, 2015 ONSC 1062 at para. 14 [*"**Crate Marine**"*], citing *Brainhunter Inc. (Re)*, 2009 CarswellOnt 8207.

[14] *Danier Leather Inc. (Re)*, 2016 ONSC 1044 at para. 20 ["***Danier Leather***"].

(a) The SISP has been approved by the Court and the SISP contemplates the potential of a Stalking Horse Bid being brought forward;

(b) The SISP incorporating the Stalking Horse Purchase Agreement as the Stalking Horse Bid is the most cost-efficient and effective means available to maximize creditor recovery and preserve employment for as many employees as possible. As set out above, it provides certainty to the stakeholders that the Business will emerge from these CCAA Proceedings as a going concern entity and also provides a baseline purchase price;

(c) The sale will benefit the economic community. It is expected that it will maintain the employment of substantially all employees of the Company. The Stalking Horse Purchase Agreement provides confirmation of additional DIP financing by way of the Closing DIP Loan, which provides further certainty that the Applicants will have sufficient funding to get to a closing of the transaction once the DIP Facility is fully drawn, which the Applicants' cash flow currently anticipates will occur by mid-January 2023. Additionally, the Stalking Horse Purchase Agreement acknowledges that a portion of the Purchase Price is intended to fund KERP Entitlements and that to the extent there are any Terminated Employee KERP Payments prior to closing, those amounts would be funded under the Closing DIP Loan;

(d) There is no bona fide reason to object to the sale of the Business. The Monitor has reviewed the financial terms of the Stalking Horse Purchase Agreement and is of the view that they are reasonable in the circumstances and provide a greater value than a liquidation of the Applicants' assets;[15] and

(e) In light of the liquidity crisis faced by the Applicants, the court-approved SISP, and the benefits conferred by the use of a Stalking Horse Bid thereunder, represents the most viable option in the circumstances to secure a sale of the Business and preserve the function of the Business.

B. The Break Fee is Reasonable and Ought to be Approved

21. The Applicants submit that the proposed Break Fee is reasonable in the circumstances and ought to be approved by this Court.

22. The Court has acknowledged that break fees are frequently approved in insolvency proceedings, and that these fees not only reflect the cost to the purchaser of putting together a stalking horse bid, but also the price of stability. Break fees in the range of 3-4% plus expense reimbursements in the range of 2% (combined 5-7%) have been approved by this Court.[16]

23. In this case, the Break Fee equals approximately 4.76% of the Purchase Price. This fee percentage will drop after adding any borrowings under the Closing DIP Loan to the Purchase Price. Moreover, there is no separate expense reimbursement under the Stalking Horse Purchase Agreement.[17]

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[15] Second Report at para. 26.

[16] *Danier Leather* at paras. 41 to 42.

[17] Second Report at para. 27.

24. The Stalking Horse Bidder expended time and money negotiating the Stalking Horse Purchase Agreement, and undertaking the necessary due diligence to do so.

25. The proposed Break Fee is an important component of the Stalking Horse Purchase Agreement and represents the price of stability, certainty and efficiency that the Stalking Horse Purchase Agreement offers to the SISP, to the Business, and to the Applicants' larger economic community.

26. The Monitor has reviewed the quantum of the break fees for stalking horse transactions in CCAA filings over the past three years and is of the view that the Break Fee is within the range of break fees seen in stalking horse transactions of similar nature.[18]

[18] Second Report at para. 27.

ORDER REQUESTED

27. For the reasons set out herein, the Applicants request that this Honourable Court grant the Order approving the Stalking Horse Purchase Agreement, approving the Break Fee and confirming that the Stalking Horse Purchase Agreement represents the "Stalking Horse Bid" for purposes of the SISP.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 2nd day of November, 2022.

Kyla Mahar and Stephanie De Caria

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LIST OF AUTHORITIES

1. *CCM Master Qualified Fund v. Blutip Power Technologies*, 2012 ONSC 1750.

2. *Crate Marine Sales Ltd. (Re)*, 2015 ONSC 1062.

3. *Brainhunter Inc. (Re)*, 2009 CarswellOnt 8207.

4. *Danier Leather Inc. (Re)*, 2016 ONSC 1044.

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