CITATION: Trees Corporation, 2024 ONSC 30
COURT FILE NO.: CV-23-00711935
DATE: 2024-01-08

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: 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 AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TREES CORPORATION, ONTARIO CANNABIS HOLDINGS CORP., MIRACULO INC., 2707461 ONTARIO LTD., OCH ONTARIO CONSULTING CORP., AND 11819496 CANADA INC.

Applicants

BEFORE: Chief Justice Geoffrey B. Morawetz

COUNSEL: *Robert Thornton, Derek Harland and Rushi Chakrabarti* for the Applicants

Maya Poliak, for CJ Marketing and Arthur Minh Tri Nguyen-Cao

William Skelly, for 606093 Saskatchewan Ltd., Minerva Investments Ltd., Echo Capital Growth Corporation, and PMH Investco Ltd.

David Bish, for Ernst & Young Inc., the Proposed Monitor

Daniel Richer and Dylan Chochla, for One Plant Retail Corp., Proposed DIP Lender

HEARD and DETERMINED: January 2, 2024

REASONS: January 8, 2024

ENDORSEMENT

[1] On January 2, 2004, a revised form of ARIO was granted with reasons to follow. These are the reasons.

[2] On December 22, 2023, the Applicants sought and obtained relief under the *Companies' Creditors Arrangement Act* ("CCAA") pursuant to the Initial Order.

[3] The Initial Order, among other things:

(a) appointed Ernst & Young Inc. ("E&Y") as Monitor of the Applicants;

(b) granted an initial stay in favour of the Applicants and their Directors and Officers ("D&O's") up to January 2, 2024;

(c) authorized the borrowing by the Applicants of up to $60,000 from the DIP Lender at the interest rate of 15% per annum; and

(d) granted the Administration Charge in the amount of $450,000 and the D&O Charge in the amount of $251,000, with $100,000 of the Administration Charge being given super-priority status and the balance of the Administration Charge and the D&O Charge being ranked subsequent to the security interests of 606093 Saskatchewan Ltd., Minerva Investments Ltd., Echo Capital Growth Corporation, PMH Investco. Ltd., Tweed Inc. ("Tweed"), CJ Marketing Ltd. and Arthur Minh Tri Nguyen-Cao (collectively, the "Secured Creditors ").

[4] On this comeback hearing the Applicants are seeking an Amended and Restated Initial Order (the "ARIO") granting among other things:

(a) an extension of the Stay Period until and including February 29, 2024;

(b) approving the execution by the Applicants of a debtor-in-possession term sheet (the "DIP Term Sheet "), dated December 21, 2023, with One Plant Retail Corp. (the "DIP Lender" or "One Plant"), pursuant to which the DIP Lender has agreed to advance to the Applicants a total of up to $800,000 (the "DIP Facility") on the terms of the Revised DIP (as defined below), which will be made available to the Applicants during these CCAA proceedings;

(c) authorizing the Applicants to take no further steps or incur further expenses in relation to the Securities Filings and declare that none of the D&Os, employees, and other representatives of the Applicants or the Monitor shall have any personal liability for any failure by the Applicants to make the Securities Filing;

(d) postponing the requirement for any future annual general meeting ("AGM") of the shareholders of Trees during the CCAA Proceedings, and extending the time limit to call and hold such annual general meeting of shareholders until after the conclusion of the CCAA Proceedings; and

(e) granting and increasing the amounts of the following Court-ordered priority charges (collectively, the "Charges) against the Property (ordered in priority):

(i) the Administration Charge the amount of $100,000, with a subsequent Administration Charge that ranks behind the Secured Creditors in the amount of $400,000;

(ii) the DIP Lender's Charge in the amount of $1,100,000; and

(iii) the D&O Charge in the amount of $100,000, with a Subsequent D&O Charge (the "Subsequent D&O Charge ") that ranks behind the Secured Creditors and Subsequent Administration Charge respectively, in the amount of $383,000.

[5] The Applicants take the position that the relief is necessary to finance the ongoing operations of the Applicants and the restructuring activities, during the CCAA proceedings, including the development and implementation of a Sale and Investment Solicitation Process ("SISP"). It is the intention of the Applicants to seek court approval of SISP as soon as possible.

[6] In addition to the foregoing, another issue arising from the Initial Order which remains outstanding, is whether E&Y should continue as Monitor.

[7] The requested relief is supported by the Monitor and the DIP Lender.

[8] The facts are set out in the initial affidavit of Jeffrey Holmgren sworn December 21, 2023 (the "Initial Affidavit") and the second affidavit of Mr. Holmgren sworn December 29, 2023 (the "Second Holmgren Affidavit"). Additional information is set out in the Pre-filing Report of E&Y and the First Report of E&Y.

[9] At the outset, counsel to the Applicants indicated that the relief with respect to Securities Filings and the AGM was being deferred, as the regulatory body for the Applicants is the Alberta Securities Commission (the "ASC") and not the Ontario Securities Commission. The ASC has yet to be served.

[10] During the initial CCAA hearing, the Secured Creditors (except Tweed) objected to certain relief sought by the Applicants. In response, the Applicants reserved approval of the DIP Term Sheet to this comeback hearing and agreed to have the D&O Charge and the Subsequent Administration Charge (as defined in the Initial Order) rank subsequent to the security interests of the Secured Creditors . Additionally, the DIP Lender's Charge was limited to a maximum of $60,000. The objections of these Secured Creditors have now been resolved.

[11] The Applicants stated that their financial difficulties were exacerbated by their existing secured loan obligations. The Applicants state that the *prima facie* first-ranking secured debt of Trees, as well as the *prima facie* Second Ranking Secured Debt of OCH, is in respect of loans made by former insiders of these companies, including a previous observer of the board of directors of Trees and to founders of OCH. The Applicants state that these loans are significant contributing factors to the non-viability of the Applicants moving forward without the relief offered by the CCAA. Furthermore, the Applicants state that historically, there has been considerable tension between the Applicants and these creditors because of these loans.

[12] The Applicants also state that, in the case of Trees, the holders of the Trees Secured Debentures (606093 Saskatchewan Ltd., Minerva Investments Ltd., Echo Capital Growth Corporation, PMH Investco Ltd.) are connected to Matt Hill, who was an observer on the board of directors of Trees and exercised significant influence over decisions made by the board. The Trees Secured Debentures contained an option to convert the debt into equity at a discounted rate once the company became public. The Trees Secured Debentures were issued at a time when Trees was implementing a strategy to go public (which Matt Hill initially supported). The high interest rate attributed to the Trees Secured Debentures was intended to be a short-term incentive to investors to make such investment and it was understood that the Trees Secured Debentures would be converted into equity once the option was crystallized.

[13] The Applicants also state that the high interest rate on the Trees Secured Debentures created an untenable situation as the accrued interest on these loans greatly exceeds the underlying principal amount and continues to grow at a significantly beyond-market and near-usurious rate. The transaction giving rise to the Trees Secured Debentures occurred in 2021.

[14] On December 29, 2023, the secured debt of Tweed was assigned to the current DIP Lender, One Plant (the "Tweed Assignment"). Furthermore, Tweed was party to subordination agreements with CJ Marketing Ltd. and Arthur Minh Tri Nguyen-Cao (the "Subordination Agreements"). The Subordination Agreements allow Tweed to assign the debt to a third-party – in this case One Plant – without notice and the third party may rely on the Subordination Agreement as if it were initially a party thereto.

[15] In order to fund the operations of the Applicants during the CCAA proceedings, the Applicants seek to utilize DIP Financing. Initially there were two parties who were prepared to provide DIP Financing. The Applicants received an offer from the Secured Creditors (except for Tweed) for 1181798 B.C. Ltd. ("118 B.C.") to provide a DIP Facility. This was in addition to the proposal provided by the existing DIP Lender. In response to the 118 B.C. DIP, the Monitor requested both 118 B.C. and the existing DIP Lender to make their best offer to provide the DIP Facility by 11:00 a.m. on December 29, 2023.

[16] On December 29, 2023, the Applicants received a DIP proposal from the existing DIP Lender that provided the DIP Facility on the same terms as the DIP Term Sheet except: (i) the commitment fee of $50,000 was no longer required, and (ii) there would be no interest assessed on the DIP Facility (the "Revised DIP ").

[17] In the Applicants' view, the Revised DIP is in the best interests of the Applicants and is economically superior to the 118 B.C. DIP.

[18] Pursuant to the DIP Term Sheet, the DIP Facility must be repaid in full by the date that is the earliest of:

(a) the Maturity Date of February 29, 2024;

(b) the closing of a transaction;

(c) any Order made by the Court replacing E&Y as Monitor;

(d) the date on which the CCAA proceedings are terminated; and

(e) the occurrence of an Event of Default (as defined in the DIP Term Sheet).

[19] The Applicants seek to approve the execution of the DIP Term Sheet and increase the maximum amount that they can borrow under the DIP Term Sheet to $800,000 and increase the amount of the DIP Lender's Charge to $1.1 million.

[20] The updated Cash Flow Forecast ("Cash Flow Forecast") indicates that the Applicants will not have sufficient liquidity to fund operations through the requested Stay Period without the use of the DIP Facility.

[21] In its Factum, the Applicants set out the issues in respect of the relief being sought, namely whether:

(a) the Stay Period should be extended to and including February 29, 2024;

(b) the DIP Term Sheet should be approved, pursuant to which the Applicants should be permitted to draw up to $800,000, and court approval should be given to grant an increase to the DIP Lender's Charge up to $1,100,000;

(c) approval should be given to increase the priorities and amounts, as applicable, of the Charges against the Property.

[22] As noted above, in addition to the foregoing, this hearing was also to address the issue of whether E&Y should continue as Monitor.

[23] The basis for the extension of the Stay Period is set out at paragraphs 43 – 48 of the Applicants' Factum. I am satisfied that the Applicants have acted and are continuing to act in good faith and with due diligence such that the request to extend the Stay Period to February 29, 2024 is reasonable in the circumstances and the extension is granted. In arriving at this conclusion, I have taken into account that with access to the DIP Facility, the Applicants will have sufficient liquidity during the extension of the Stay Period.

[24] The basis for the approval of the DIP Term Sheet and the DIP Lender's Charge is set out at paragraphs 49 – 60 of the Factum. I accept the submissions set out by the Applicants. I am satisfied that the necessary tests for approval of the DIP Term Sheet and the DIP Lender's Charge have been satisfied and the relief is appropriate in the circumstances and is granted.

[25] The basis for the approval of the priority and increase to court ordered Charges is set out at paragraphs 66 – 73 of the Factum. I am satisfied that the relief is appropriate in the circumstances and is granted.

[26] The remaining issue to be considered is whether E&Y should continue as Monitor. On this comeback hearing, this issue is to be considered afresh.

[27] The appointment of the monitor requires a consideration of the provisions of section 11.7 of the CCAA, which provides:

> 11.7(1) When an order is made on the initial application in respect of a debtor company, the court shall at the same time appoint a person to monitor the business and financial affairs of the company. The person so appointed must be a trustee, within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*.
>
> (2) Except with the permission of the court and on any conditions that the court may impose, no trustee may be appointed as monitor in relation to a company
>
> (a) if the trustee is or, at any time during the two preceding years, was
>
> ...

(iii) the auditor, accountant or legal counsel, or a partner or an employee of the auditor, accountant or legal counsel, of the company, or

...

(3) On application by a creditor of the company, the court may, if it considers it appropriate in the circumstances, replace the monitor by appointing another trustee, within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*, to monitor the business and financial affairs of the company.

[28] E&Y consented to act as monitor subject to court approval. E&Y is a related party to Ernst and Young LLP. Ernst & Young LLP was the auditor for the Applicants for the audited financial statements dated December 31, 2021. Ernst & Young LLP resigned as auditor on May 10, 2022, which date is within the restricted period described in ss.11.7(2)(a) of the CCAA.

[29] The Applicants submit that permission should be granted by the court for E&Y to continue as Monitor for the following reasons:

(a) E&Y has assisted the Applicants to the CCAA Proceedings and is familiar with the Applicants' assets and business;

(b) E&Y has acquired extensive and in-depth existing knowledge and understanding of the Applicants' cannabis business, the cannabis sector and the cannabis retail sector;

(c) to prevent E&Y to act as Monitor would only increase the professional costs, to the detriment of the Applicants' restructuring process and its stakeholders; and

(d) given the financial constraints, there is a need to proceed expeditiously with the restructuring on a cost-effective basis.

[30] In its Pre-filing Report, E&Y states that it is qualified to act as monitor. E&Y notes that, while it meets the requirements of ss. 11.7(1) of the CCAA, it is subject to one of the restrictions set out in ss. 11.7(2) of the CCAA, in that Ernst & Young LLP, an affiliate of E&Y, previously acted as Tweeds' auditor in the two-year period prior to the CCAA application.

[31] E&Y has confirmed that:

(a) Ernst & Young LLP no longer acts as auditor to any of the Applicants and has not acted as such in over 19 months;

(b) None of the members of E&Y working or expected to work on the Monitor engagement had any involvement in the prior audit work;

(c) E&Y and Ernst & Young LLP have put in place measures to ensure confidentiality and to prevent any disclosure of information between their respective representatives;

(d) E&Y is not aware of any conflict of interest or loss of independence arising from Trees' prior relationship with Ernst & Young LLP as its auditor, and it does not believe that the former audit role creates any real or perceived reasonable apprehension of bias or impartiality on the part of E&Y as Proposed Monitor; and

(e) E&Y consents to act as Monitor of these proceedings.

[32] E&Y submitted a Factum in support of its position. E&Y emphasizes the following points:

(i) The CCAA does not prohibit a person from acting as monitor where it was formerly the auditor of an applicant. Rather, it permits this to occur but subjects it to express judicial scrutiny to ensure that it is appropriate where the audit engagement was recent. Section 11.7(2) reflects that there will be times and circumstances in which a former auditor can and should be permitted to act as monitor, and nothing in that section indicates that it should only occur sparingly or in exceptional circumstances; rather, simply that this scenario calls for additional judicial scrutiny;

(ii) the objective of section 11.7(2) is not to bar former auditors from acting as monitors but rather to ensure the integrity of the insolvency process is maintained in that circumstance and to bar former auditors from acting only where doing so threatens that integrity;

(iii) there are numerous instances in which former auditors or affiliates of former auditors have been permitted to act as monitors in CCAA proceedings;

(iv) the final period that E&Y LLP audited was for the year ended December 31, 2021, and the Applicants do not reference or rely on the audited financial statements from that period in the CCAA proceedings. There is no reasonable basis to expect that E&Y LLP's previous role will give rise to a reasonable apprehension of bias;

(v) E&Y is the best-positioned firm to act as monitor due to, among other reasons, its work to date on this engagement and its extensive subject matter expertise in the cannabis sector.

[33] E&Y submits that: (i) the overriding objective section 11.7(2) of the CCAA is the preservation of the integrity of the insolvency process; that is, to provide public confidence that the insolvency system is impartial; (ii) the overriding duty of the monitor engaged by its appointment is to act with professional neutrality, and to scrupulously avoid placing itself in a position a potential or actual conflict of interest; and (iii) as a result of the two foregoing considerations, a key consideration for the court in determining whether to permit a former auditor

to act as monitor is whether the facts of the case before it raise a reasonable apprehension of bias or conflict of interest, either real or perceived.

[34] E&Y submits that the courts to date have been willing to approve with "little fanfare" the appointment of a monitor that was an auditor or an affiliate of an auditor that acted in the two preceding years. Reference was made to *Re Divaltex Inc. et al.*, Court File No. 200–11–028987–231 (Sup. Ct. Q. (Commercial Division)), December 14, 2023; *Re Kaisen Energy Corp.*, Court File No. 2101–14684 (Ct. Q.B. Alta.) December 20, 2021; *Re The Aldo Group Inc. et al.*, Court File No. 500–11–058644–200 (Sup. Ct. Q. (Commercial Division)) May 6, 2020; *Re Ernest Enterprises (MTL) Ltd./Les Enterprises Ernest (MTL) Ltée*, Court File No. 500–11–058761–202 (Sup. Ct. Q. (Commercial Division)) Club (September 14, 2020; *Lutheran Church – Canada, Re*, 2016 ABQB 419 (*Lutheran*); *Fonderie Poitres Ltée, Re*, 2009 QCCS 547; *Hickman Equipment (1985) Ltd., Re* (2002), 34 C.B.R. (4th) 203 (NFLD) (*Hickman*).

[35] I note that in virtually all of these cases, there was no or very limited analysis or commentary with respect to the current version of section 11.7(2).

[36] In *Lutheran*, consulting services had been provided by a related entity to the monitor, but no audit function had been provided for sixteen years. Accordingly, the ss. 11.7(2) restrictions were not engaged. In addition, the application to replace the monitor was brought after the time when the last two plans of arrangement had been approved by the requisite double majority of creditors. Romaine J. (at 102) stated she was of the view that the application was strategic.

[37] *Hickman* was decided pursuant to a predecessor version of ss.11.7(2) which provided:

> (2) Except as may be otherwise directed by the court, the auditor of the company may be appointed as the monitor.

[38] In addition, (at 49) Hall J. stated that no creditor actually took the step of formally asking the court to remove the monitor.

[39] In my view, both *Lutheran* and *Hickman* are of no real assistance to the Applicants or E&Y.

[40] Despite the very able argument of Mr. Bish on behalf of E&Y, I am unable to conclude that it is appropriate to appoint E&Y as Monitor in these circumstances.

[41] I do not question the integrity or the professionalism of E&Y to act as Monitor in these proceedings. However, I do take a different approach to the application of ss. 11.7(2) of the CCAA.

[42] In my view, the starting point is to acknowledge that the current ss. 11.7(2), which came into effect in 2009, is more restrictive than the previous version.

[43] The predecessor version provided that the auditor of the company may be appointed as the monitor.

[44] The current version no longer expresses this position in positive language. Rather, except with permission of the court, the appointment of an auditor or former auditor within two years, cannot be made.

[45] The current statutory provision requires the court to override the negative wording in ss. 11.7(2) – or to put it another way – the auditor or former auditor within the two preceding years is not to be appointed as monitor, except with permission of the court. This is the general rule. Mr. Bish acknowledged that he did not disagree with this interpretation.

[46] With this starting point, there have to be extenuating circumstances that would justify the appointment or the continuation of the appointment of E&Y as Monitor. The reasons provided by the Applicant do not persuade me that E&Y should continue as Monitor. With respect to the submissions of E&Y, I have also not been persuaded that it is appropriate to continue with the appointment of E&Y as Monitor.

[47] In addressing the points put forth by Mr. Holmgren, I find that at best, the arguments are self-serving.

[48] The Applicants knew or ought to have known of the restrictions set out in ss. 11.7(2) at the time they commenced preparations for these proceedings. Notwithstanding the restriction, a decision was made by the Applicants to proceed with an attempt to appoint E&Y as Monitor. Having made this decision, it is both artificial and contradictory for the Applicants to take the position that E&Y's role in preparing for the CCAA proceedings makes them familiar with the Applicants' assets and business which would be of benefit to the Applicants in the CCAA proceedings. Had the Applicants made a decision to engage another insolvency professional, the alternative professional would have become familiar with the Applicants' assets and business.

[49] With respect to the submission that the proposed Monitor has acquired an extensive and in-depth existing knowledge and understanding of the Applicants' cannabis business, the cannabis sector and the cannabis retail sector, I take judicial notice that, in the last few years, there have been numerous insolvencies of cannabis entities and a number of different insolvency professionals have been involved in these files. As a result, other insolvency firms have developed a fundamental understanding of the cannabis sector and the cannabis retail sector. The field of competent monitors for the cannabis sector is not restricted to E&Y.

[50] With respect to the submission that to prevent E&Y to act as monitor would only increase the professional costs, to the detriment of the Applicants, the restructuring process and its stakeholders, this argument ignores the fact that it was the Applicants who made the decision to proceed in the manner in which they did. It does not assist the Applicants, in my view, to create a factual matrix and then request the court to exercise its discretion to override the ss. 11.7(2) restrictions to appoint the Monitor in these circumstances.

[51] With respect to the arguments that there was a need to proceed expeditiously, this was recognized at the time of the Initial Order was granted and which appointed E&Y as Monitor on December 22, 2023. The appointment of E&Y as a Monitor was made with the understanding that it would be reviewed at the comeback hearing.

[52] Furthermore, I note that it was the Applicants who raised concerns with certain loan transactions which are referenced at [11] to [13]. These transactions were entered into when E&Y LLP was the auditor. I have no information as to whether any concerns will be raised with respect

to these transactions. However, it is, in my view, necessary to avoid any appearance of conflict if it becomes necessary to review these transactions.

[53] With respect to the submission of E&Y, I agree that ss. 11.7(2) does not prohibit a former auditor from acting as monitor. This is a plain reading of the statutory provision. I also accept that E&Y, at this time, is not aware of any real or perceived apprehension of bias or impartiality that is created by the former auditor role.

[54] However, I am not convinced that the representations of E&Y are significant in my assessment of the issue. I can understand that E&Y would like to receive this engagement, but, I my view, business aspirations are not a factor to be taken into account.

[55] In summary, it is a base line requirement that the monitor be independent and not be in a position of real or perceived conflict. This is a pre-requisite for any appointment. However, in assessing whether to exercise my discretion to continue the appointment of E&Y as Monitor, in the face of the ss. 11.7(2) CCAA restriction, I have taken into consideration the following:

(i) Recognizing that s. 11.7(2) which provides that the appointment of an auditor or former auditor is an exception to the rule, are there any extenuating or unique circumstances that would cause the court to exercise its discretion to appoint the former auditor as monitor. In this issue, there are none;

(ii) A factual matrix created by the Applicants that the auditor or former auditor has obtained the knowledge to perform the role should be regarded with extreme caution;

(iii) The extent of service of materials on affected parties has been limited. In view of the holiday season, there may be affected parties who have yet to become aware of these proceedings; and

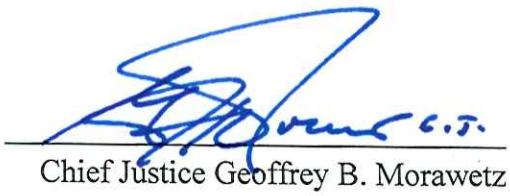
(iv) There are transactions entered into during the ss. 11.7(2) restricted period that may have to be reviewed.

[56] In the result, I have not been persuaded that it is appropriate to exercise my discretion to appoint or continue with the appointment of E&Y as Monitor. In view that this is a comeback hearing, and this issue is being considered afresh, this decision is not being made pursuant to ss.11.7(2) of the CCAA.

[57] I understand that FTI Consulting Canada Inc. ("FTI") has consented to act as monitor. FTI is accordingly appointed as Monitor.

[58] I also note that Mr. Richer, on behalf of the DIP Lender represented that his client agreed to delete the repayment clause referenced in 16(c) to the effect that the DIP Facility must be repaid in the event of an order being issued replacing E&Y as Monitor.

[59] An order reflecting the foregoing has been signed and entered.



Chief Justice Geoffrey B. Morawetz

Date: January 8, 2024