Court File No. CV-21-00659187-00CL

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, as amended

AND DOMENICO SERAFINO AS A PERSON INTERESTED IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF HYDRX FARMS LTD., CANNSCIENCE INNOVATIONS INC. AND SCIENTUS PHARMA INC.

Applicant (Appellant in Appeal)

NOTICE OF MOTION FOR LEAVE TO APPEAL

TAKE NOTICE THAT THE MOVING PARTY, Domenico Serafino (the **"Appellant"**) as a person interested in the matter pursuant to section 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (**"CCAA"**) will make a motion to a panel of the Court of Appeal for Ontario to be heard on a date to be fixed by the Registrar, which date shall not be before the earlier of the Appellant's reply factum, if any, and the expiry of the time for filing the Appellant's reply factum.

PROPOSED METHOD OF HEARING: The motion is to be heard in writing.

THE MOTION IS FOR:

(a) An Order granting leave to the Appellant to appeal the decision of the Honourable Mr. Justice Wilton-Siegel by endorsements

dated June 30, 2021 and July 12, 2021, of the Superior Court of Justice, Commercial List (collectively, the **"Endorsements"**);

(b) An Order validating the manner of service of this notice of motion and motion materials herein, if necessary;

(c) The costs of this motion, to be fixed by the court; and,

(d) Such further and other relief as this Honourable Court may deem just.

THE GROUNDS FOR THE MOTION ARE:

1. The heart of this proposed appeal is an issue of statutory interpretation of section 120 of the *Canada Business Corporations Act* (**"CBCA"**) which provides, in part, as follows:

> A director of a corporation shall disclose to the corporation, in writing or by requesting to have it entered into the minutes of meetings of directors, the nature and extent of *any interest* that the director has in a *material contract or material transaction*, whether made or proposed, *with the corporation*, if the director is a party to the contract/transaction, if a director or acting in a similar capacity,

of a party to the contract/transaction, or has a *material interest in a party* to the *contract/transaction*. [Emphasis Added]

2. As will be discussed further below, by way of the Endorsements, the Honourable Justice Wilton-Siegel applied a strict reading of the act and held that section 120 of the CBCA is only triggered when the impugned contract or transaction is *directly* with the corporation. His Honour erred in his interpretation of the CBCA. In particular, His Honour:

(a) Failed to read section 120 of the CBCA in its entire context and in its grammatical and ordinary sense harmoniously with the scheme of the CBCA, the object of the CBCA, and the intention of Parliament; and,

(b) Failed to interpret section 120 of the CBCA as being remedial and failed to give it a fair, large and liberal interpretation.

3. Section 120 of the CBCA prohibits a director of a corporation from profiting from a material contract or transaction with that corporation absent full disclosure to the corporation and informed consent from either the independent directors or the shareholders of the corporation.

4. By concluding that section 120 of the CBCA does not apply to a contract of the corporation with a third party that is subsequently assigned to a corporation in respect of which a director of Hydrx has a substantial interest (and which interest is significantly increased after he becomes a director of Hydrx), the Honourable Justice Wilton-Siegel has made a fundamental error in law.

5. The moment a person becomes a director the legal landscape changes. Section 120 of the CBCA is the codification of the well-established common law prohibiting fiduciaries from profiting from estates or corporations to which they have a fiduciary obligation. All contracts carry a risk of loss and a chance of profit. If a fiduciary is a counter-party to a contract (either directly or indirectly) with a corporation to which he or she owes a fiduciary duty, the inevitable pursuit of profit or risk mitigation arising from that contractual interest, conflicts, of necessity, with the obligation of the fiduciary to unreservedly advance and protect the interests of the corporation.

6. A director should not be permitted to do indirectly what he or she would otherwise be statutorily precluded from doing under section 120 of the CBCA. In effect, the learned judge's decision is that a director may freely acquire, for instance, a pre-existing contract with the corporation at an advantageous price or terms and

have no obligation to comply with section 120 of the CBCA in respect of that contract.

7. The fundamental underlying principles of section 120 are equally applicable to (i) contracts entered into directly by the fiduciary with the corporation and (ii) contracts originally entered into by a third party with the corporation and subsequently acquired by a fiduciary on advantageous terms. A director cannot serve two masters under a contract, regardless of the manner in which the director becomes the counter-party to the contract.

8. In addition, in the instant case, it is the most important issue in the CCAA proceedings as it determines the amount owing by Hydrx to its principal secured creditor controlled by its now former director. It is a gating issue to whether a conventional restructuring will occur or whether there will be a sale of the Hydrx assets with the concomitant loss of the existing shareholder equity.

9. The leaned judge further concluded that when a director of a corporation acquires a pre-existing contract on advantageous terms, the corporation cannot suffer a “loss”. If there is a “loss”, it has been suffered by the original counter-party to the contract. The conclusion is that if the corporation suffers no loss, there can be no “profit” to which Section 120 can apply. The essential conclusion is that when a director acquires a pre-existing contract of a corporation, “nothing has

changed" for the corporation. With the greatest of respect, something very fundamental has changed for the corporation in these circumstances. A director is now a counter-party to a material contract of the corporation. That director can actively pursue all benefits of that contract while remaining a director of the corporation and utilizing his/her fiduciary office to further the pursuit of personal profit under that contract with the corporation. This is the very situation that Section 120 and the pre-existing common law is designed to prohibit.

10. There is an additional troubling implication to the learned judge's conclusion that incumbent directors can profit without constraint from pre-existing contracts with the corporation to which they owe their fiduciary obligation. "Notice" and "profit" are parallel concepts in fiduciary fulfillment. The one is the pre-condition of the other. The corollary to the learned judge's ruling that incumbent directors can profit from acquiring pre-existing contracts is that, perforce – such acquisitions can proceed in secret! If an incumbent director is entitled at law to acquire a pre-existing contract and vigorously pursue rights thereunder against the corporation with a view to personal profit, there is nothing to notify the corporation about.

11. In concluding that a director can acquire a controlling interest in a pre-existing material contract of a corporation without complying with section 120, the learned judge has created a new exception to the historic position that fiduciaries cannot, in any circumstance, profit from the estates or corporations to which their fiduciary obligation is owed. The learned judge made a fundamental error in law. This error in law, if allowed to stand, would have implications far beyond bankruptcy and insolvency proceedings as it goes to the very root of the Canadian law of fiduciary obligations of directors. In addition, in the instant case, it is the most important issue in the CCAA proceedings as it defines the amount owing by the corporation to the director under a secured debenture that is material in amount.

Hydrx

12. Hydrx Farms Ltd. (**"Hydrx"**) is a private, vertically integrated cannabis business. Hydrx is a company incorporated under the *Canada Business Corporations Act* (**"CBCA"**).

13. The Appellant is an independent director of Hydrx.

The Aphria Secured Debenture – The "Material Contract"

14. On August 14, 2017, Hydrx reached an agreement with Aphria Ltd. (**"Aphria**") for a subscription agreement which included a senior, secured convertible debenture with a face principal amount of $11.5 million (the **"Aphria**

Secured Debenture"). The Aphria Secured Debenture creates a first charge on all of the assets of Hydrx.

15. At all material times, the Aphria Secured Debenture was a *material contract* of Hydrx, if not the *only* material contract of Hydrx.

16. The Aphria Debenture when into payment default during 2019. At present, with accumulated interest, the amount of debt owing is approximately $15 million.

Cobra Acquires the Material Contract

17. On July 28, 2020, Cobra Ventures Inc. ("**Cobra**"), entered into an agreement with Aphria to take an assignment of the Aphria Secured Debenture for a purchase price of $5 million.

18. Cobra completed the acquisition of the Aphria Secured Debenture on October 1, 2020.

19. On October 1, 2020, Cobra was owned as to 50% by Richard Goldstein ("**Goldstein**") through his company, 2775361 Ontario Inc. (**"277 Ontario"**), and 50% by World Class Extractions Inc. ("**WCE**"), a public company.

20. During the period from July of 2020 through October of 2020, Goldstein and WCE made repeated representations to the Appellant that they

intended to refinance and strengthen the balance sheet of Hydrx by converting the bulk of the indebtedness owing under the Aphria Secured Debenture to common share equity in Hydrx thereby leaving the existing Hydrx shareholders with a continuing 30% equity interest in Hydrx.

21. The principal elements of these representations were set forth in a written summary given to the Appellant in late July of 2020 (the "**July Plan**").

22. On September 6, 2020, all but one of the directors of Hydrx resigned when the D&O insurance carrier refused to extend coverage. The only remaining director of Hydrx was the Appellant, Dominic Serafino ("**Serafino**").

23. On October 23, 2020, Goldstein became a director of Hydrx as did a representative of WCE named Rosy Mondin (**"Mondin"**).

24. During December of 2020, the principals of Cobra had a falling out over how to implement the July Plan.

25. The Cobra corporate divorce was finalized in January of 2021 with Goldstein's company acquiring the 50% interest of WCE in Cobra (the **"Cobra Buyout Transaction"**) that he did not previously own for a purchase price of $2.5 million.

26. Mondin resigned from the board of Hydrx upon completion of the acquisition transaction leaving a "deadlocked" board consisting of Serafino and Goldstein.

The Cobra Buyout Transaction

27. Following the completion of the Cobra Buyout Transaction, Goldstein, through 277 Ontario became a 90% shareholder of Cobra, and, as a consequence, *the predominant indirect owner of the Aphria Secured Debenture.*

28. The net effect of the Cobra Buyout Transaction was that Goldstein acquired through 277 Ontario an aggregate 90% indirect interest in the Aphria Secured Debenture, being an additional 40% increase in such interest after he became a director of Hydrx.

29. The transactions undertaken by Goldstein to acquire and increase his indirect interest in the Aphria Secured Debenture are irrelevant from the standpoint of section 120 of the CBCA applicably until he made the decision to cause Cobra to realize upon the assets of Hydrx and by doing so to profit from his interest.

Steps To Realize on Aphria Secured Debenture

30. Following completion of the Cobra Buyout Transaction, Goldstein took active steps to cause Cobra to realize on the Aphria Secured Debenture.

31. Specifically, on December 22, 2020, he directed Cobra to make demand for payment from Hydrx and to issue the requisite Notice of Intention to Enforce Security. He also took active steps in his capacity as a director of Hydrx to frustrate the ability of Hydrx to protect itself from the realization process. Specifically, after causing Cobra to demand payment from Hydrx and while a director of Hydrx, Goldstein (i) refused to file the requisite renewal application for the Cannabis Excise Tax license which is required for Hydrx to legally sell cannabis product; and (ii) attempted to transfer the Hydrx Health Canada cannabis license to Cobra.

32. At no time from and after his appointment as a director of Hydrx did Goldstein ever comply with section 120 of the CBCA. He gave no disclosure to any of the corporation, the directors or the shareholders of Hydrx of his intention to profit from his indirect contractual relationship with Hydrx through his substantial ownership interest in Cobra (being the owner of the Aphria Secured Debenture) nor did he obtain approval from either the independent board or the shareholders of Hydrx that is the statutory precondition to profit from such relationship.

The CCAA Proceedings

33. The remaining stakeholders of Hydrx were desirous of taking the necessary steps to protect Hydrx from Goldstein's predatory behaviour. However,

given the deadlocked nature of the board, Hydrx was not in a position to make an Application for CCAA protection.

34. Accordingly, in March of 2021, the CCAA proceedings were commenced by the Appellant as an "interested person" under section 11 of the CCAA due to the deadlocked board of directors.

35. On March 22, 2021, the Honourable Justice Hainey granted protection to Hydrx under the CCAA (the **"Initial Order**"). The Initial Order:

(a) Declared the Appellant as a "person interested in the matter" under section 11 of the CCAA;

(b) was granted on a without notice and urgent basis;

(c) a stay of proceedings was granted until and including April 1, 2021 (the **"Stay Period"**).

36. Schwartz Levitsky Feldman Inc. was appointed as monitor under the Initial Order (the **"Monitor**").

37. Subsequent to the granting of the Initial Order, Goldstein was served with the CCAA application materials, including the supporting affidavit which sets out all of the Appellant's allegations against Goldstein.

Amended and Restated Initial Order

38. On March 31, 2021, the Appellant sought and was granted an amended and restated initial Order (the "**Amended and Restated Initial Order"**) extending the Stay Period to and including May 3, 2021 (the **"Extended Stay Period"**).

39. The Extended Stay Period was granted, in part, on the basis that Hydrx had sufficient liquidity to finance operations and the CCAA proceedings.

Further Extension of Stay Period, Court Approved SISP & CRO

40. On April 30, 2021, the Appellant sought and was granted an order extended the Extended Stay Period to and including July 30, 2021 (the **"Further Extended Stay Period"**). The Further Extended Stay Period was granted, in part, on the basis that Hydrx had sufficient liquidity to fund its obligations up to and including the Further Extended Stay Period.

41. On April 30, 2021, the Monitor sought and was granted an order:

(a) Appointing Macpherson & Associates Inc. as the chief restructuring officer of Hydrx (the **"CRO"**). The Monitor sought the appointment of the CRO in part due to the deadlocked Hydrx board of directors;

(b) Approving a sale and investment solicitation process (the **"SISP"**).

The SISP

42. The determination of Cobra's rights in respect of its alleged claim was a gating issue for the purpose of determining rights in the court sanctioned SISP.

43. As part of the court sanctioned SISP, the Monitor sought a process to be followed to determine the amount, if any, owing to Cobra, together with any issues impacting the ability to credit-bid Cobra's claim as part of the SISP. The SISP order provides as follows:

> "Redemption of Secured Debt and Filing of CCAA Plan of Arrangement
>
> 12. Within 29 days of the Cobra Claim Decision becoming final, the Companies shall have the right to redeem the secured debt owing to Cobra As established by the Cobra Claims Decision and any appeals therefrom (the "Cobra Secured Debt").
>
> 13. Upon payment of the Cobra Secured Debt in readily available funds, Cobra shall, at the sole option of the Companies, either discharge its security interest in the Property of the Companies or assign the same to a third party as directed by the Companies. For greater certainty: the form of any assignment of security shall be on an "as is, where is" basis with no recourse to Cobra, and to avoid or reduce a potential residual security interest in favour of Windsor Private Capital Limited Partnership ("Windsor") in the assets of Hydrx, the first funds payable by Hydrx as part of its redemption of the Cobra Secured Debt shall be paid directly to Windsor up to the extent of any indebtedness owing by Cobra to Windsor, in the event that Windsor continues to hold a security interest in the assets of Hydrx at the time of such redemption

payment. The quantum of any such payment to Windsor by Hydrx shall reduce on a dollar for dollar basis any indebtedness owing by Hydrx to Cobra in respect of the Cobra Secured Debt."

No Independent Board or Shareholder Approval of Material Transaction

44. The Aphria Secured Debenture is a *material contract* of Hydrx. The assignment of the Aphria Secured Debenture to Cobra is a material transaction within the scope of section 120 given the substantial equity interest of Goldstein in Cobra. Under subsection 120(7) of the CBCA, Goldstein is prohibited from realizing a profit from a *contract or transaction* with Hydrx as he did not:

(a) Make formal disclosure of his indirect interest in the Aphria Secured Debenture;

(b) He did not obtain approval from the board of directors or shareholders to profit from such interest in the Aphria Secured Debenture.

45. The decision by Goldstein to cause Cobra to realize upon the Aphria Secured Debenture rather than proceeding with the July Plan was designed to solely benefit Goldstein and Cobra at a time when Goldstein had a clear fiduciary and statutory duty to Hydrx.

46. It is immaterial whether Aphria or WCE sold their respective interests in the Aphria Secured Debenture at less than market price or whether these parties suffered a loss. The material question to be addressed is whether a director of Hydrx is entitled to profit from his interest in a corporation that took an assignment of a material contract of Hydrx, namely, the Aphria Secured Debenture. The purpose of section 120 of the CBCA is to impose upon a director a certain statutory pre-conditions to the ability to profit. Such pre-conditions were not met.

The June 30, 2021 Motion

47. By way of motion commenced by Cobra and heard on June 30, 2021, Cobra sought:

(a) An order declaring and confirming that the indebtedness owing by Hydrx to Cobra is in the approximate amount of $15 million;

(b) Cobra is entitled to credit bid up to the full amount of the Cobra secured indebtedness, including in the SISP.

48. The Appellant opposed the relief sought by Cobra on the basis that Goldstein and Cobra ought to be prohibited from profiting from the Aphria Secured Debenture and requiring Goldstein and Cobra to account to Hydrx for any profit or gain realized as a result of Cobra's acquisition of the Aphria Secured Debenture.

49. The Honourable Justice Wilton-Siegel denied the relief sought by the Appellant on the basis that section 120 of the CBCA was not triggered as there was no material contract or transaction directly with Hydrx. By way of endorsement dated June 30, 2021, His Honour endorsed as follows:

> *For written reasons to follow, the order sought by Domenico Serafino as set out in his Factum dated June 29, 2021 in this proceeding at paragraph 97 is denied in its entirety.*

50. By way of endorsement dated July 12, 2021, His Honour released the written reasons which provide, in part, as follows:

> *First, and most importantly, I do not think that it is correct that any transactions involving the Debenture, or the assignment of the Debenture, constitute transactions with HydRx for the purposes of x. 120. Section 120 pertains to contracts or transactions "with the corporation". None of the Rydan Loan Transaction, the Windsor Loan Transaction and the Cobra Buy-Out Transaction constituted such a contract or transaction.* (At paragraph 28 of His Honour's Endorsement); and

> *...Because the transactions by which Goldstein indirectly acquired his 90% interest in the Debenture were between Cobra and Aphria in respect of the Aphria Transaction, and between Goldstein and Chamberland in respect of*

> *the Cobra Buy-Out Transaction, any "profit" that Cobra might make on the redemption of the Debenture was at the expense of Aphria and Chamberland, respectively, who will have sold their interests in the Debenture at less than market price. There is no sense in which any such "profit" will be realized at the expense of Hydrx.* (At paragraph 43 of His Honour's Endorsement)

51. The above conclusions misapprehend the policy intention of section 120. Specifically, section 120 is intended as a statutory safeguard to preclude a director from profiting in respect of any interest such director has in a contract to which the corporation is a party - unless the statutory preconditions of disclosure and approval have been satisfied.

The Proposed Appeal

52. The Appellant seeks leave to appeal the decision of the Honourable Justice Wilton-Siegel. The proposed appeal raises serious issues about the interpretation, purpose and scope of section 120 of the CBCA, including what constitutes *a material contract or transaction with a corporation* under the statute.

53. The Honourable Justice Wilton-Siegel applied a strict reading of section 120 of the CBCA, namely that the *any interest in a material contract or transaction* needs to be a contract or transaction *directly* with the corporation. His Honour erred in this strict reading of the plain language of section 120 of the CBCA.

54. The words under section 120 of the CBCA are to be read in their entire context and in their grammatical and ordinary sense *harmoniously* with the scheme of the CBCA, the object of the CBCA, and the intention of Parliament. The policy behind section 120 of the CBCA is to identify those situations in which a director's ability to consider, fairly and effectively, the corporation's interest may be inhibited by self-interest. In 2001, the section was amended to add the term *transaction* to broaden the coverage of section 120 and clarify the extent of the section's application by requesting identification of interests which extend beyond those resulting from material contracts. The Honourable Justice Wilton-Siegel erred in failing to read section 120 of the CBCA *harmoniously* with the scheme and object of the CBCA and intention of Parliament.

55. Section 64 of the *Legislation Act, 2006*, S.O. 2006, c 21, Sch F, requires that every act shall be interpreted as being remedial and shall be given such fair, large, and liberal interpretation as best ensures the attainment of its objects. The Honourable Justice Wilton-Siegel failed to interpret section 120 as being remedial and failed it give it a fair, large and liberal interpretation.

56. The policy behind section 120 of the CBCA is one of protection for a corporation from the actions of a director who seeks to benefit himself at the expense of the corporation.

57. To accept the position that section 120 of the CBCA is only triggered where the *material contract/transaction* is *directly* with the corporation will only allow any other director to do exactly what Goldstein has done with no consequence: use a separate corporation (Cobra) as a tool to gain an interest in and profit by a material contract (the Aphria Secured Debenture) of a company. That was surely not the intention of Parliament when it enacted section 120 of the CBCA and subsequently expand the statutory scope to include material transactions as well as material contracts.

***Prima Facie* Meritorious**

58. The proposed appeal is *prima facie* meritorious. The Honourable Justice Wilton-Siegel erred in his statutory interpretation of section 120 of the CBCA. Specifically, the learned judge erred by failing to recognize that the provisions of section 120 require a director to disclose any interest in a material contract or transaction such a director has with the corporation whether directly or indirectly by way of a material interest in a counter-party to such a contract or transaction with the corporation of which he is a director.

59. In the case at bar, Goldstein was a director and controlling mind of Cobra when Cobra acquired the most material contract in the corporate history of Hydrx. He was subsequently both a director of Cobra and Hydrx at the time of the

Cobra Buyout Transaction which resulted in Goldstein significantly increasing his ownership interest in Cobra and thereby his indirect interest in the Aphria Secured Debenture. He was a director at the time that the decision was made to abandon the July Plan and simply realized on the Aphria Secured Debenture for personal benefit.

60. When Goldstein made the decision to have Cobra realize upon the assets of Hydrx under the Aphria Secured Debenture for personal profit, the statutory safeguards built into section 120 of the CBCA were triggered. Specifically, in order to profit from a contract or transaction involving Hydrx (in this case as a co-party with Cobra in its capacity as an assignee of Aphria), Goldstein needed to satisfy the statutory pre-conditions of disclosure and consent. He did not.

61. Section 120 provides a statutory precondition to a director from profiting from a material contract. Goldstein neither disclosed his material interest nor obtained the statutorily required consent from the independent board of Hydrx or its shareholders.

62. Section 120 is equally applicable to (i) contracts entered into directly by the fiduciary with the corporation and (ii) contracts originally entered into by a third-party with the corporation and subsequently acquired by a fiduciary on advantageous terms. A director cannot serve two masters under a contract, regardless of the manner in which the director becomes the counter-party to the contract.

63. The concept of "profit" should be given its normal meaning. There is no less "profit" accruing to a director by virtue of the fact that the wording in the pre-existing contract acquired by that director has not changed.

64. The conclusion that if a director acquires a pre-existing contract with the corporation "nothing has changed" is a misperception. Something very fundamental has changed, a director is now a counter-party to a material contract of the corporation. That director can actively pursue all benefits of that contract while remaining a director of the corporation and utilizing his or her fiduciary office to further the pursuit of personal profit under that contract with the corporation. This is entirely inconsistent with the purpose and intent of section 120 and the common law that preceded it.

65. If a director can acquire a pre-existing contract and actively pursue remedies and profit thereunder without any obligation to account to the corporation then there can be no basis for insisting that the director disclose his/her interest in the contract. This concept is entirely foreign to the current and historical regime for fiduciary fulfillment.

66. Goldstein became a director of his own volition. He concluded that it was in his commercial interests to do so. After becoming a director, his rights and obligations as a counter-party to contracts with Hydrx changed irrevocably. He could no longer pursue risk mitigation and profit maximization in respect of that

contract without limitation. Section 120 and the historical regime for fiduciary fulfillment are admittedly a "blunt instrument". It is quite impossible to parse out circumstances in which the law should allow some degree of profitability in contractual relations between fiduciaries and corporations or other estates. As a result, the law has consistently enforced a fundamental rule – no profit under any circumstances.

67. The integrity of the capital markets requires that purchasers of distress debt instruments be able to rely on those instruments in accordance with their terms. The case at hand is based upon an admittedly unusual fact situation, involving as it does the acquisition of a distress debt instrument by a director of the debt issuer. Traditional holders of distress debt instruments universally avoid assuming fiduciary obligations in respect of the underlying debtor for the simple reason that doing so would restrict the pursuit of remedies and profit under the debt instrument. Requiring directors to comply with the rules applicable to all fiduciaries and all contracts (including debt instruments) will have no impact on the trade in distress instruments in the capital markets generally.

68. In concluding that a director can acquire a controlling interest in a pre-existing material contract of a corporation without complying with section 120, the learned justice has created a new exception to the historic position that fiduciaries cannot, in any circumstance, profit from the estates or corporations to which their

fiduciary obligation is owed. The learned judge made a fundamental error in law. This error in law, if allowed to stand, would have implications far beyond bankruptcy and insolvency proceedings as it goes to the very root of the Canadian law of fiduciary fulfillment. In addition, in the instant case, it is the most important issue in the CCAA proceedings as it defines the amount owing by the corporation to the director under a secured debenture that is material in amount.

Issues are Significant

69. The proposed appeal raises issues of significance to the practice and business community.

70. The learned judge concluded that Section 120 did not apply to the case at bar. The learned judge's reasoning appears to be that the acquisition of a pre-existing contract (in this case the Aphria Secured Debenture) is not a material contract or material transaction relating to Hydrx because the steps taken to acquire that pre-existing contract did not involve Hydrx. Instead, the steps involve a director of Hydrx and one or more third-parties.

71. The learned judge reaches this conclusion notwithstanding the fact that the true subject matter of the acquisition is the Aphria Secured Debenture. The Aphria Secured Debenture is a material contract of Hydrx within the intended scope

of section 120 of the CBCA. In fact, it is the most material contract of Hydrx in its corporate history.

72. After Cobra acquiring its 100% interest in the Aphria Secured Debenture for a total cost of $5 million, Goldstein was both the mind and management and principal owner of Cobra (and therefore the Aphria Secured Debenture) and a director of Hydrx. His cost of acquisition of the Aphria Secured Debenture is $5 million. The face value of the Aphria Secured Debenture is approximately $15 million. His potential profit from the Aphria Secured Debenture is a straightforward calculation - $10 million. As the indirect owner of the Aphria Secured Debenture he is entirely focused on mitigating the risk of loss and maximizing the chance of profit from the ownership of the Aphria Debenture. The pursuit of that undertaking is entirely adverse in interest to Hydrx. At the same time, he is a director of Hydrx and charged with the responsibility of putting Hydrx's interest ahead of all others. This is precisely the position of fundamental conflict that Section 120 and the preceding body of common law is designed to eliminate. One cannot serve two masters in a contractual relationship no matter how that relationship arose.

73. The implication of the learned judge's ruling creates fertile ground for mischief. Every pre-existing service agreement, supply agreement, joint venture agreement, co-tenancy agreement, lease agreement, debt instrument etc. etc. entered

into by a corporation with an arm's length third-party can now be acquired by incumbent directors of the corporation through intermediary corporations, possibly at advantageous prices or on advantageous terms. Those directors can then pursue risk mitigation and profit maximization under a contract with the corporation while still being a director and bound to place the corporation's interests above all others.

74. In the ordinary course of business, such mischief may be addressed by recourse to the other areas of statutory redress under the CBCA, such as a claim in oppression. However, when dealing with a secured debt instrument, and the remedies available to a creditor thereunder, the ability of the debtor corporation to defend itself against a conflicted miscreant director is limited and the practical reality is any recourse to an oppression or other claim may ultimately provide some recovery for stakeholders but it will not protect the corporation.

75. Goldstein acquired 50% of his interest in the Aphria Secured Debenture on October 1, 2020. He became a director of Hydrx on October 23, 2020. Subsection 120 (2) (d) specifically applies to this situation. A director who has an interest in a material contract of the corporation (in this case the Aphria Debenture) prior to becoming a director and who then becomes a director is required to comply with Section 120 in respect of that contract.

76. Goldstein, through Cobra, acquired the remaining 50% of his interest in the Aphria Secured Debenture, from WCE, in January 2021. This acquisition of an interest in a material contract of Hydrx should clearly fall within Section 120.

77. The obligations under Section 120 are applicable only to directors of a corporation. All other third parties are unrestrained in their contractual dealings with corporations and may pursue profit from those contracts without limitation.

78. Both Goldstein and Mondin requested appointment as directors of Hydrx. Regardless of their reasons for becoming directors of Hydrx, once they accepted the appointment as directors their rights and obligations as counter-parties to contracts with Hydrx change irrevocably. They could no longer pursue risk mitigation and profit maximization in respect of that contract without limitation.

79. Once the July Plan was abandoned and Goldstein, through Cobra, acquired the 100% interest in the Aphria Secured Debenture, Goldstein remained constrained by his obligations as a director. Goldstein had no obligation to impose a loss upon himself as the counter-party to the Aphria Secured Debenture. However, he is constrained in his ability to "profit" as a counter-party to that contract by long established common law as codified in the provisions of Section 120.

80. Under Section 120, once Goldstein abandoned the July Plan and proceeded to maximize his personal profit from the Aphria Debenture by simply realizing on the instrument and retaining the net proceeds above $5 million, he was obliged to strictly comply with the provisions of Section 120 which require:

(a) Formal written notice of the "nature and extent of the interest in" the Aphria Secured Debenture – which "nature and extent" would have included disclosure of the intent to realize on the instrument and retain the "profit" for his personal benefit; and

(b) Seeking express consent from the independent directors or the shareholders of Hydrx allowing him to retain any profit from such realization for his personal advantage.

Goldstein did neither. He took no steps whatever to comply with Section 120.

81. Goldstein, as a counter-party to a material contract (the Aphria Secured Debenture) with a corporation in which he is a director (Hydrx) cannot profit from his interest in that material contract without full compliance with Section 120.

82. Goldstein's motives or intentions in becoming a director of Hydrx are not relevant to the determination of his rights and obligations as a counter-party to a material contract of Hydrx. He gave up his right to unrestrained pursuit of profit with respect to that contract that is otherwise available to third-parties, once he accepted his appointment as a director of Hydrx.

83. The fact that the material contract was a pre-existing contract of Hydrx and that Goldstein acquired the contract from a third-party does not relieve him of his most fundamental fiduciary obligation. He cannot profit from being a counter-party to a material contract with Hydrx while being a director. To rule otherwise would undermine the entire framework controlling fiduciary conflicts of interest and create multiple pathways for abuse.

84. The Appellant requests leave to appeal the order of the learned judge be granted to allow this issue of fundamental importance to be heard by the Court of Appeal.

No Undue Delay or Hindrance

85. The proposed appeal will not unduly hinder the progress of the proceedings. In fact, the SISP order contemplates Cobra claims process and the proposed appeal will not hinder the restructuring.

86. The CCAA orders including the granting the Stay Period, Extended Stay Period, and Further Extended Stay Period have allowed Hydrx to commence and continue re-start operations.

87. Each of the stay periods were granted on the basis that Hydrx had sufficient liquidity to fund its obligations and costs of the CCAA proceedings.

88. As it currently stands, Hydrx is forecast to have sufficient liquidity to fund its obligations and the costs of the CCAA proceedings through the end of the Further Extended Stay Period.

89. It is anticipated that an extension of the Further Extended Stay Period will be sought to implement either a conventional restructuring under the CCAA as desired by the Appellant or a sale under the SISP.

90. Rule 61.03.1 of the *Rules of Civil Procedure*.

91. Section 6(1)(b) of the *Courts of Justice Act*, R.S.O. 1990, c.C.43.

92. Section 120 of the *Canada Business Corporations Act*.

93. Such further and other grounds as the lawyers may advise.

THE FOLLOWING DOCUMENTARY EVIDENCE will be used at the hearing of the Motion: (List the affidavits or other documentary evidence to be relied on)

(a) Affidavits of Domenico Serafino.

(b) Affidavits of Richard Goldstein.

(c) Transcript.

(d) Endorsement of the Honourable Justice Wilton-Siegel dated June 30, 2021.

(e) Endorsement of the Honourable Justice Wilton-Siegel dated July 12, 2021;

(f) Such further and other evidence as the lawyers may advise and this Honourable Court may permit.

July 14, 2021

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IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED

AND DOMENICO SERAFINO AS A PERSON INTERESTED IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF HYDRX FARMS LTD., CANNSCIENCE INNOVATIONS INC. AND SCIENTUS PHARMA INC.

Court File No. CV-21-00659187-00CL

COURT OF APPEAL FOR ONTARIO

Proceeding commenced at TORONTO

NOTICE OF MOTION
FOR LEAVE TO APPEAL

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