

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

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

(the "Applicant")

MOVING PARTIES' FACTUM

November 19, 2021

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TO: THE SERVICE LIST

FACTUM OF THE MONITOR

PART I - INTRODUCTION

1. On March 22, 2021, the Court granted an initial order (the “Initial Order”) pursuant to the *Companies’ Creditors Arrangement Act*¹ (“CCAA”) granting a stay of proceedings and appointing Schwartz Levitsky Feldman Inc. (“SLF”) as monitor (the “Monitor”) of the Companies (defined below).²
2. After carrying out a court-approved Sales and Investment Solicitation Process (the “SISP”), the Monitor determined that the credit bid from Cobra Ventures Inc. (“Cobra”), the first ranking creditor, represented the highest and best bid for the Companies’ assets.³
3. The Monitor now brings this motion for an Order, among other things:
 - (a) approving the Share Purchase Agreement (the “SPA”) dated November 4, 2021 between Hydrx Farms Ltd. (“HydRx”) and Cobra and the transaction contemplated therein (the “Credit Bid Transaction”);
 - (b) approving the Monitor entering into the SPA, on behalf of HydRx, and authorizing the Monitor to carry out the Credit Bid Transaction on behalf of HydRx;
 - (c) vesting in Cobra all of the common shares of HydRx;

¹ R.S.C. 1985, c. C-36 as amended.

² Fifth Report of the Monitor dated November 12, 2021 (the “Fifth Report”) at Appendix “A”, Tab 2, Motion Record of the Monitor dated November 12, 2021.

³ Fifth Report at para. 37.

- (d) vesting all liabilities that will not be assumed by Cobra (the “Excluded Liabilities”) to 13404994 Canada Inc. (“ResidualCo”);
- (e) removing the Companies from this CCAA proceeding and adding ResidualCo as an Applicant in these proceedings; and
- (f) approving the fees of the Monitor, its’ counsel and the Chief Restructuring Officer.

PART II - SUMMARY OF FACTS

Background

4. HydRx is a private corporation incorporated under the *Canada Business Corporations Act* on April 29, 2014.⁴

5. HydRx has two wholly owned subsidiaries, Scientus Pharma Inc. (Scientus Pharma”) and CannScience Innovations Inc. (collectively, the “Companies”). Neither subsidiary has carried on any active business while owned by HydRx.

6. HydRx is a vertically-integrated biopharmaceutical company with a focus on developing and commercializing pharmaceutical grade cannabinoid derivative products.

7. HydRx was approved by Health Canada as a Controlled Dry Substance Licensed Dealer in October of 2016 and subsequently received a Licensed Product Cultivation License in September of 2017.⁵

⁴ Fifth Report at para. 12.

⁵ Fifth Report at para. 16.

8. HydRx operates out of a 46,000 square foot facility which it owns at 1130 Champlain Court, Whitby, Ontario.⁶

The CCAA

9. On March 22, 2021, Domenic Serafino, as an interested person (the “Serafino Group”), sought and obtained the Initial Order.⁷

10. On March 31, 2021, the Court made the Amended and Restated Initial Order pursuant to which the Court extended the stay of proceedings to May 3, 2021 and granted an administration charge in first ranking priority to a maximum of \$250,000.00 (the “Administration Charge”).⁸

11. On April 30, 2021, the Court approved an Order (the “CRO Appointment and SISP Approval Order”)⁹:

- (a) appointing Macpherson & Associates Inc. as the Chief Restructuring Officer (the “CRO”) of HydRx;
- (b) approving the SISP;
- (c) increasing the Administration Charge to \$400,000;

⁶ Fifth Report at para. 16

⁷ Fifth Report at para. 1.

⁸ Fifth Report at Appendix “B” and para. 3.

⁹ Fifth Report at Appendix “C”.

(d) establishing a process for determining the value of the claim of Cobra Ventures Inc. (“Cobra”), HydRx’s first secured creditor (the “Cobra Claims Process”); and

(e) extending the stay of proceedings to July 30, 2021.

12. On July 26, 2021, the Court approved an Order (the “Expansion of Power Order”)¹⁰:

(a) expanding the powers of the Monitor to allow the Monitor, among other things, to enter into agreements for and on behalf of HydRx and in respect of HydRx’s property; and

(b) extending of the stay of proceedings to October 28, 2021.

13. On October 26, 2021, the Court approved an extension of the stay of proceedings to January 28, 2022.¹¹

Cobra Claims Process

14. The Cobra Claims Process related to the Serafino Group’s motion to determine the quantum of the indebtedness secured by the first ranking debenture (the “Debenture”) and to prevent Cobra from credit-bidding the full quantum of the Debenture.¹²

¹⁰ Fifth Report at Appendix “D”.

¹¹ Fifth Report at para. 6.

¹² Fifth Report at par. 20.

15. Justice Wilton-Siegel heard the motion on June 30, 2021.

16. In an endorsement released on July 12, 2021, Justice Wilton-Siegel determined that the Cobra could credit bid the full amount of the indebtedness owing under the Debenture and that the quantum of such indebtedness was \$14,857,014.00 as at March 31, 2021 (the “Cobra Claims Decision”).¹³

17. On July 14, 2021, the Serafino Group served a Notice of Motion for Leave to Appeal from the Cobra Claims Decision (the “Leave Motion”). At present, the Court of Appeal has not rendered a decision on the Leave Motion.¹⁴

18. The Credit Bid Transaction cannot be completed until the appeal of the Cobra Claims Decision is dealt with by the Court of Appeal.

The SISP

19. As noted above, this Court approved the SISP pursuant to the CRO Appointment and SISP Approval Order dated April 30, 2021. The procedures governing the SISP (the “SISP Procedure”) are attached as Schedule “A” to the CRO Appointment and SISP Approval Order (which order is attached at Appendix “C”).

20. In connection with the SISP, the Monitor prepared a list of potential bidders, published notice of the opportunity in The Globe and Mail and prepared a teaser letter for interested parties (the “Teaser Letter”).¹⁵

¹³ Fifth Report at para. 22.

¹⁴ Fifth Report at para. 23.

¹⁵ Fifth Report at para. 30.

21. Parties who requested a copy of the Teaser Letter were sent a non-disclosure agreement (the “NDA”).

22. In total:

- (a) 127 parties were sent the Teaser Letter;
- (b) 9 NDAs were executed;
- (c) 9 parties were given access to the data room;
- (d) several parties had calls with management, the Monitor or the CRO (or a combination thereof); and
- (e) certain parties visited HydRx’s facility.¹⁶

Review of LOIs

23. Phase 1 of the SISP Procedure contemplated that potentially interested parties were required to deliver non-binding expressions of interest by the Phase 1 Bid Deadline which the Monitor set for July 27, 2021 at 5:00 PM EST.¹⁷

24. The Monitor received six Letters of Intent (an “LOI”) by the Phase 1 Bid Deadline.¹⁸

25. Cobra submitted one of the six LOIs (the “Cobra LOI”). The Cobra LOI provided for a bid for the assets or shares of the Companies by way of a credit bid of the

¹⁶ Fifth Report at para. 31.

¹⁷ Fifth Report at para. 32 and SISP Procedure at para. 22 (Schedule “A” to the CRO Appointment and SISP Approval Order attached at Appendix “C”).

¹⁸ Fifth Report at para. 33. The key terms of the six LOIs are summarized in Confidential Appendix “1” to the Fifth Report.

outstanding Cobra indebtedness (the “Cobra Debt”). As determined in the Cobra Claims Decision, the Cobra Debt was \$14,857,014.00 as at March 31, 2021, plus continuing interest since that date.¹⁹

26. After considering all of the LOIs, the Monitor, in consultation with the CRO, determined that:

- (a) the Cobra LOI represented the highest and best bid; and
- (b) none of the other offers was in an amount sufficient to repay the Cobra Debt (as determined by the court in the Cobra Claims Process).²⁰

27. Therefore, in accordance with the SISP Procedure (and, in particular, paragraph 29 thereof), the Monitor decided not to proceed with Phase 2 of the SISP and, instead, began working, together with the CRO and counsel, to structure and document the Credit Bid Transaction with Cobra.²¹

The Credit Bid Transaction

28. Pursuant to the Credit Bid Transaction, Cobra will assume all of the Cobra Debt and pay cash equal to the “Priority Payables” (being the amount owing under the Administration Charge).²²

¹⁹ Fifth Report at paras. 34-35.

²⁰ Fifth Report at para. 37.

²¹ Fifth Report at para. 38 and SISP Procedure at para. 29 (Schedule “A” to the CRO Appointment and SISP Approval Order attached at Appendix “C”).

²² Fifth Report at para. 49.

29. The Credit Bid Transaction will be effected by the issuance of a “reverse vesting order” pursuant to which the Companies’ liabilities (other than the Debenture) will be transferred to ResidualCo.

30. In connection with the Credit Bid Transaction, HydRx will carry out a reorganization whereby Cobra will acquire 100% ownership of the issued and outstanding shares of HydRx through the following steps:

- (a) Share Issuance: In consideration for the Purchase Price (defined below) HydRx shall issue new common shares to Cobra (the “New Shares”);
- (b) Share Consolidation: HydRx’s Articles shall be amended to consolidate the New Shares and the existing common shares (“Existing Shares”);
- (c) Share Cancellation: all Existing Shares will be reduced to fractional amounts and cancelled; and
- (d) Equity Interests Extinguished: all existing equity interests, including the Existing Shares, will be extinguished, such that the only remaining issued and outstanding shares will be the post-consolidation shares held by Cobra.²³

31. As a result of the foregoing, Cobra will own all of the equity of HydRx following the completion of the Credit Bid Transaction. The Existing Shares will be cancelled.²⁴

²³ Fifth Report at para. 43.

²⁴ Fifth Report at para. 44.

32. The closing of the Credit Bid Transaction will be ten business days after the later of:²⁵

- (a) the date that the Approval and Vesting Order is obtained from the Court;
and
- (b) the date on which the motion for leave to appeal the Cobra Decision is dismissed or, if leave is granted, the date on which the appeal is dismissed or abandoned.

Releases

33. The Approval and Vesting Order provides for a full and final release of the Companies' current and former officers and directors other than any claim:²⁶

- (a) not permitted to be released pursuant to section 5.1(2) of the CCAA;
- (b) against the directors and officers for breach of trust arising from acts or omissions occurring before the date of the Initial Order;
- (c) that may be made against any applicable insurance policy of the Companies prior to the date of the Initial Order; and
- (d) against Domenic Serafino in connection with the indemnity that he gave to HydRx and the Monitor and the fees of Minden Gross LLP.

²⁵ Fifth Report at para. 53.

²⁶ Fifth Report at paras. 55-56.

PART III - STATEMENT OF ISSUES, LAW & AUTHORITIES

34. The issues to be considered on this motion are whether:

- (a) this Court should approve the Credit Bid Transaction;
- (b) this Court should grant the Approval and Vesting Order; and
- (c) the Court should seal the Confidential Appendix.

The Transaction Satisfies the Requirements for Court Approval of a Sale Transaction

Applicable Legal Principles

35. Prior to the enactment of Section 36 of the CCAA, this Court relied upon the decision of the Ontario Court of Appeal in *Royal Bank v. Soundair Corp.*, to determine whether a sale transaction ought to be approved. The Ontario Court of Appeal articulated the following principles governing sale approval applications by receivers (which principles have been held to apply to the consideration of whether to approve a sale in the CCAA):

- (a) whether there has been a sufficient effort made to get the best price, and the receiver has not acted improvidently;
- (b) the interests of all the parties;
- (c) the efficacy and integrity of the process by which offers are obtained; and
- (d) whether there has been unfairness in the working out of the process.²⁷

²⁷ [Royal Bank v. Soundair Corp., 1991 CarswellOnt 205](#) at para 20 (CA) [**Soundair**].

36. Absent a violation of the *Soundair* principles, the Court should uphold the business judgment of the court official and the parties supporting it with respect to the results of a sales process.

37. Following the *Soundair* decision, section 36(6) of the CCAA was enacted, which grants the Court express statutory jurisdiction to authorize and approve the sale or disposition of assets outside of the ordinary course of business. In *Re Canwest*, Pepall J. noted that the *Soundair* factors largely overlap with the factors that were introduced by Section 36(6).²⁸

38. The six non-exhaustive factors that a Court must consider on a sale approval motion made pursuant to section 36 of the CCAA are as follows:

- (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
- (b) whether the monitor approved the process leading to the proposed sale or distribution;
- (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
- (d) the extent to which creditors were consulted;

²⁸ [*Re Canwest Publishing Inc.* \(2010\), 68 CBR \(5th\) 233 \(Ont. S.C.J.\)](#).

- (e) the effects of the proposed sale or distribution on the creditors and other interested parties; and
- (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

The Credit Bid Transaction Should be Approved

39. The Monitor submits that in applying the *Soundair* and s.36(3) factors here, the Credit Bid Transaction should be approved and the Approval and Vesting Order should be granted:

- (a) **The SISP was Reasonable and Transparent:** the Monitor carried out the court-approved SISP which generated the Cobra LOI and culminated in the SPA. The possibility of Cobra submitting a credit bid was expressly contemplated in the SISP;
- (b) **The SPA Provides Greater Consideration than any other Bid:** the Credit Bid Transaction documented in the SPA provides far greater consideration than any of the other bids received pursuant to the SISP. In fact, none of the other bids in Phase 1 of the SISP was in an amount sufficient to even repay the Cobra Debt (whereas the purchaser price under SPA is for the entirety of the Cobra Debt plus cash to satisfy the entirety of the Administration Charge). As contemplated in the SISP, the Monitor was free to conclude the SISP without proceeding to Phase 2 if none of the bids was sufficient to repay the Cobra Debt;

- (c) **The Consideration is Fair and Reasonable:** the SPA provides, by far, the highest aggregate consideration offered in the SISP and the Monitor believes that, based on the results of the SISP, it is in excess of actual market value of the assets being acquired (as reflected by the bids received in the SISP);
- (d) **The SISP Provided for Meaningful Consultation with Stakeholders:** the principal secured creditor (Cobra) and other key stakeholders (the Serafino Group) were actively involved in negotiating the SISP and in its implementation; and
- (e) **The SPA is in the Best Interests of the Relevant Creditors:** The results of the SISP substantiated that Cobra is the only creditor with a continuing economic interest in the Companies. Cobra, as the purchaser under the Credit Bid Transaction, is of course supportive of the transaction.

The “Reverse Vesting Order”

40. The Credit Bid Transaction will be implemented by way of a "reverse vesting order" whereby Cobra will acquire the shares of HyDRx but all Excluded Liabilities and Excluded Contracts will vest in Residual Co. This reverse vesting will allow Cobra to acquire control of the Companies (and their associated Cannabis Licenses) free and clear of encumbrances.

41. This type of “reverse vesting” transaction has been in numerous CCAA proceedings including, in particular, where the proposed transaction involves the transfer

of licences for the production and sale of cannabis.²⁹ In *Plasco*, for example, the Court approved the transfer of substantially all of the debtors' assets into an acquisition corporation and its liabilities into a "newco" via a settlement agreement. Justice Wilton-Siegel held that:

[t]he Global Settlement contemplates the implementation of a corporate reorganization by which the shares of Plasco will be transferred to an acquisition corporation owned by [the purchasers] and the remaining assets of the applicants will be held by a new corporation, referred to as "New Plasco", which will assume all of the liabilities and obligations of Plasco. I am satisfied that the Court has authority under section 11 of the CCAA to authorize such transactions notwithstanding that the applicants are not proceeding under section 6(2) of the CCAA insofar as it is not contemplated that the applicants will propose a plan of arrangement or compromise.

42. Similarly, Justice Conway approved a reverse vesting order in the CCAA proceedings of *Beleave Inc.* In that case (as well as in the CCAA proceedings of *Wayland Group Corp. et al.* and *Green Relief*), the preservation of valuable cannabis licenses was paramount. Justice Conway stated in her endorsement:

The structure of the transaction is partly by share sale and partly by asset sale. The reason for the structure is to accommodate the licensing requirements of Health Canada. The order is structured as a reverse vesting order, in which excluded liabilities and assets will be transferred to "Residualco", which will then become one of the Applicants in the CCAA proceedings. Reverse vesting orders have been approved by the courts in other cases: see *Re Stornoway Diamond Corporation . . .* and *Re Wayland Group Corp....*

The transaction is the culmination of a stalking horse sales process approved by the court. The motion is unopposed. The Monitor recommends and supports the transaction in its Fourth Report. In particular, the Monitor states that the proposed transaction is economically superior to the estimated liquidation value of the Beleave Group's assets and operations, will allow the Purchaser to maintain operations and use of the Cannabis licenses and will provide for continued employment for a

²⁹ Endorsement of Justice Wilton-Siegel in the matter of [Plasco Energy et al. dated July 16, 2015, Toronto, Court File No. CV-15-10869-00C \(ONSC\)](#); *In the matter of Nemaska Lithium Inc. et al. dated October 15, 2020, District of Montreal, Court File No. 500-11-057716-199 (QCSC)*; Approval and Vesting Order *In the matter of Quest University Canada dated November 16, 2020, Vancouver, Court File No. S-200586 (BCSC)*; and endorsement of Justice McEwen in [FIGR Brands Inc. et al., June 10, 2021, Court File No. CV-21-006553373](#)

majority of the existing employees. In my view, the transaction satisfies s. 36(3) of the CCAA and the Soundair test and should be approved.

43. In *Quest University Canada*, the court made the following comments with respect to reverse vesting orders:

There is no dispute between the parties that this Court has authority to grant the RVO under its general statutory jurisdiction found in s. 11 of the CCAA.....

There is no provision in the CCAA that prohibits an RVO structure. As is usually the case in CCAA matters, the court must ensure that any relief is "appropriate" in the circumstances and that all stakeholders are treated as fairly and reasonably "as the circumstances permit": *Century Services* at para. 70....

As with the sales considered in most of the above RVO cases, including *Nemaska Lithium*, this is the only transaction that has emerged to resolve the financial affairs of Quest. No other options are before the stakeholders and the Court that would suggest another path forward. As was noted by Gouin J. in *Nemaska Lithium* (at para. 12), it is not up to the Court to dictate the terms and conditions that are included in an offer.

Many of the RVO cases cited above involve a sale of an ongoing business with a purchaser. The RVO structure was crafted to allow those businesses to continue through the debtor company, since it was that corporate vehicle who owned the valuable "assets" that could be not transferred.

44. In the present case, the Companies face the same challenges and regulatory concerns as expressed in the above-cited cases, and the reverse vesting structure provides the most expeditious, cost-effective and only available solution to transition and preserve the cannabis licenses.

45. Finally, the Monitor notes that the use of the reverse vesting order is not prejudicial to any stakeholder, and mirrors the economics of a conventional vesting order.

Sealing of the Confidential Appendix

46. In *Sierra Club of Canada v Canada (Minister of Finance)*, the Supreme Court of Canada clarified that courts should exercise their discretion to grant sealing orders where

the order is necessary to prevent a serious risk to an important interest, including a commercial interest; and the salutary effects of the order outweigh its deleterious effects.³⁰

47. The Confidential Appendix contain commercially sensitive information that, if disclosed, could be detrimental to the Companies' ability to market the assets sold pursuant to the Credit Bid Transaction in the event that the transaction does not close. The Monitor is supportive of sealing the Confidential Appendix pending the closing of the transaction.

PART IV - ORDER REQUESTED

48. In light of the foregoing, the Monitor submits that the Court should approve the Credit Bid Transaction, grant the Approval and Vesting Order and seal the Confidential Appendix.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 19th day of November, 2021.



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³⁰ [Sierra Club of Canada v Canada \(Minister of Finance\), 2002 SCC 41](#) at para 53.

SCHEDULE "A"

LIST OF AUTHORITIES

1. [Royal Bank v. Soundair Corp., 1991 CarswellOnt 205](#)
2. [Re Canwest Publishing Inc. \(2010\), 68 CBR \(5th\) 233 \(Ont. S.C.J.\)](#)
3. [Plasco Energy et al. dated July 16, 2015, Toronto, Court File No. CV-15-10869-00C \(ONSC\)](#)
4. [Nemaska Lithium Inc. et al. dated October 15, 2020, District of Montreal, Court File No. 500-11-057716-199 \(QCSC\)](#)
5. [Quest University Canada dated November 16, 2020, Vancouver, Court File No. S-200586 \(BCSC\)](#)
6. [FIGR Brands Inc. et al., June 10, 2021, Court File No. CV-21-006553373](#)
7. [Sierra Club of Canada v Canada \(Minister of Finance\), 2002 SCC 41](#)

SCHEDULE "B"

TEXT OF STATUTES, REGULATIONS & BY - LAWS *Companies' Creditors Arrangement Act, R.S.C. 1985, c C-36*

Section 36

Restriction on disposition of business assets

(1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

Factors to be considered

- (3) In deciding whether to grant the authorization, the court is to consider, among other things,
- (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
 - (b) whether the monitor approved the process leading to the proposed sale or disposition;
 - (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
 - (d) the extent to which the creditors were consulted;
 - (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
 - (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Assets may be disposed of free and clear

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

Courts of Justice Act, R.S.O. 1990, c. C.43

Section 137

Sealing documents

(2) A court may order that any document filed in a civil proceeding before it be treated as confidential, sealed and not form part of the public record.

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