Court File No.

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 2675970 ONTARIO INC., 2733181 ONTARIO INC., 2385816 ALBERTA LTD., 2161907 ALBERTA LTD., 2733182 ONTARIO INC., 2737503 ONTARIO INC., 2826475 ONTARIO INC., 14284585 CANADA INC., 2197130 ALBERTA LTD., 2699078 ONTARIO INC., 2708540 ONTARIO CORPORATION, 2734082 ONTARIO INC., TS WELLINGTON INC., 2742591 ONTARIO INC., 2796279 ONTARIO INC., 10006215 MANITOBA LTD., AND 80694 NEWFOUNDLAND & LABRADOR INC.

FACTUM OF THE APPLICANTS
(CCAA INITIAL ORDER)

August 27, 2024

RECONSTRUCT LLP
Richmond-Adelaide Centre
120 Adelaide Street West
Suite 2500
Toronto, ON M5H 1T1

Caitlin Fell LSO No. 60091H
Tel: 416.613.8282
Email: cfell@reconllp.com

Sharon Kour LSO No. 58328D
Tel: 416.613.8288
Email: skour@reconllp.com

Jessica Wuthmann LSO No. 72442W
Tel: 416.613.8288
Email: jwuthmann@reconllp.com

Fax: 416.613.8290

Lawyers for the Applicants

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PART I – INTRODUCTION

1. 2675970 Ontario Inc., 2733181 Ontario Inc., 2385816 Alberta Ltd., 2161907 Alberta Ltd., 2733182 Ontario Inc., 2737503 Ontario Inc., 2826475 Ontario Inc., 14284585 Canada Inc., 2197130 Alberta Ltd., 2699078 Ontario Inc., 2708540 Ontario Corporation, 2734082 Ontario Inc., TS Wellington Inc., 2742591 Ontario Inc., 2796279 Ontario Inc., 10006215 Manitoba Ltd., and 80694 Newfoundland & Labrador Inc. (the "**Applicants**" or the "**Companies**") bring this application for an initial order (the "**Initial Order**") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**").

2. The Applicants own, operate, and franchise retail dispensaries in Canada selling cannabis products and accessories directly to consumers under the brand name "Tokyo Smoke"; they also maintain an online platform for direct-to-consumer cannabis sales and deliveries (the "**Business**"). The Applicants have 61 corporate retail locations and 29 franchised retail locations across Canada. The Applicants employ approximately 474 employees, not including those employees employed by franchisees.

3. The Applicants have historically relied on financing to fund their working capital needs, but can no longer sustain their operations without effecting an operational restructuring to streamline operations. The Applicants' insolvency has been brought on by changes in the licensing regime that have devalued cannabis retail licenses and saturated the market, downward price pressures on retail cannabis due to lack of product differentiation between retailers and the grey market, and increased operating costs due to the general inflationary environment. These factors have suppressed revenues and made it challenging for the Applicants to continue to operate the Business without restructuring.

4. The Applicants seek CCAA protection to allow them to effect an operational restructuring that would right-size their operations and allow the Business to continue as viable going

concern. If granted the stay of proceedings and protections of the CCAA, the Applicants intend to, among other things:

(a) maintain operations for the benefit of most of their employees and other stakeholders;

(b) disclaim unfavourable leases and unprofitable franchise agreements;

(c) streamline their remaining operations with a view to generating positive cash flow and achieving long-term viability of the Business; and

(d) conduct a court-approved sale and investment solicitation process ("**SISP**") with a court-approved stalking horse bid in order to maximize realization for their stakeholders.

PART II – FACTS

5. The facts with respect to this application are summarized below but are more fully set out in the Affidavit of Andrew Williams, sworn August 27, 2024 (the "**Williams Affidavit**").

A. THE APPLICANTS

6. The Applicants are affiliated corporate entities. 2675970 Ontario Inc. ("**ParentCo**") is the parent of the other Applicant entities, which are all direct or indirect wholly-owned subsidiaries. ParentCo's sole shareholder is TS Investments Inc., a secured lender to the Applicants and the proposed DIP lender (the "**DIP Lender**").[1]

7. The subsidiaries of ParentCo have various purposes in the larger enterprise:

(a) 2737503 Ontario Inc. holds the leases for the retail operations ("**LeaseCo**");

[1] The Affidavit of Andrew Williams sworn August 27, 2024, Tab 2 of the Applicants' Application Record dated August 27, 2024 ("**Williams Affidavit**") at paras 14-15.

(b) 2161907 Alberta Ltd. holds the licenses and other intellectual property associated with the Tokyo Smoke brand ("**LicenseCo**");

(c) 2733181 Ontario Inc. is the franchisor for the Applicants' franchising business ("**FranchiseCo**").

8. The other Applicants are operating entities holding and operating the Applicants' retail locations (the "**Corporate Stores**"). The Applicants do not directly operate any franchised locations (the "**Franchised Stores**"), all such operations are the responsibility of each franchisee under their respective franchise agreements with FranchiseCo (the "**Franchise Agreements**").

9. In addition to the Applicants, ParentCo has four other subsidiaries which are not insolvent and not Applicants in these CCAA proceedings (the "**Non-Applicant Entities**").[2]

B. THE BUSINESS

10. The Business has three segments: (i) the operation of corporate retail stores; (ii) franchising the Tokyo Smoke brand; and (ii) the Digital Platform (as defined and described below).

(a) Corporate Retail Stores

11. There are 61 brick and mortar retail Corporate Stores owned and operated by the Applicants.[3] Approximately 432 people are employed in the Corporate Stores.[4] Corporate Store

[2] Williams Affidavit at para 21.
[3] Williams Affidavit at para 30.
[4] Williams Affidavit at para 32.

sales accounted for approximately 72.5% of the Applicants' gross revenue for the quarter ended June 2024.[5]

12. The retail space for Corporate Stores provide flagship experience to customers and offer spacious square footage and polished design. Retail space is typically leased in AAA locations with significant capital investment made to upgrade stores with aesthetic signage and design to achieve the premium customer experience that has become associated with the Tokyo Smoke brand.[6]

(b) Franchised Stores

13. There are approximately 29 Tokyo Smoke stores that are operated by franchisees pursuant to the Franchise Agreements between FranchiseCo and the respective franchisee.[7] All Franchise Agreements are executed by FranchiseCo as franchisor. FranchiseCo provides certain start-up assistance and orders inventory for franchisees but is not responsible for the cash management of the franchisee, nor its employees.[8]

14. Pursuant to the Franchise Agreements, a franchisee is permitted to use the Tokyo Smoke system to set up retail outlets under the Tokyo Smoke brand name.[9] Franchisees pay an initial fee to start up the store, royalties based on gross sales generated by the retail store, consulting fees, renewal fees, and contributions to an advertising fund.[10] Franchisees are required to maintain their own permits for cannabis retail, are responsible for hiring their own employees, and are required to pay for inventory from designated suppliers.[11]

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[5] Williams Affidavit at para 32.
[6] Williams Affidavit at para 31.
[7] Williams Affidavit at para 33.
[8] Williams Affidavit at para 36.
[9] Williams Affidavit at para 34.
[10] Williams Affidavit at para 38.
[11] Williams Affidavit at para 38.

15. Franchise-related revenues account for approximately 27.5% of the Applicants' gross revenue for the quarter ended June 2024. Currently, three franchisees are in default of their monetary obligations under the Franchise Agreements, with total arrears of approximately $384,059.[12]

(c) Digital Platform

16. The Applicants maintain a digital platform comprised of mobile applications for customer interaction and e-commerce (the "**Digital Platform**").[13] Among other things, the Digital Platform allows consumers to purchase cannabis products for pick-up and delivery where permitted by regulation.

17. Sales through the Digital Platform accounted for less than 1% of the Applicants' gross revenue for the quarter ended June 2024, not including orders fulfilled through Franchised Stores.[14] It is anticipated that the Digital Platform will remain undisturbed during the pendency of these CCAA proceedings.

(d) Licenses

18. The Applicants are regulated by the *Cannabis Act (Canada)* as well as applicable provincial and municipal legislation.[15] In connection with its Corporate Stores, the Applicants hold retail store authorizations in Ontario, Alberta, Manitoba, Saskatchewan, Newfoundland and Labrador.[16] Franchisees are required to maintain their own permits and licenses in connection with the Franchised Stores.[17]

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[12] Williams Affidavit at para 40.
[13] Williams Affidavit at para 42.
[14] Williams Affidavit at para 45.
[15] Williams Affidavit at para 46.
[16] Williams Affidavit at para 48.
[17] Williams Affidavit at para 49.

(e) Leases

19. The Applicants operate out of leases premises. They also hold 72 leases for Corporate Store locations, 31 of which are executed by LeaseCo as tenant for Corporate Stores that are currently in operation in Ontario.[18] The Applicants monthly rent expenditures amount to approximately $1.5 million.[19] The Applicants' have accrued rental arrears in the amount of $719,880 with respect to Corporate Stores.[20] Approximately 23 of the leases for Corporate Store locations are indemnified by one of the Applicant entities.[21]

20. Approximately seven of the leases executed by the Applicants are for vacant space at locations they have never taken possession of or operated within due to insufficient financing. In 2024, the Applicants shut down approximately seven Corporate Stores and have returned vacant possession of those premises to the respective landlords.[22]

21. LeaseCo is also a tenant under 23 head leases with third party landlords (the "**Head Leases**") for premises that are sublet to franchisees pursuant to subleases between LeaseCo and the franchisee for the operation of Franchised Stores. LeaseCo's obligations under the Head Leases are indemnified by LicenseCo.[23]

(f) Employees

22. The Applicants employ approximately 474 employees, 157 of whom hold full-time positions and 317 who hold part-time or hourly positions.[24] The Applicants have five Corporate Stores in Ontario that are subject to collective bargaining agreements with the United Food and

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[18] Williams Affidavit at para 51.
[19] Williams Affidavit at para 55.
[20] Williams Affidavit at para 55.
[21] Williams Affidavit at para 52.
[22] Williams Affidavit at para 56.
[23] Williams Affidavit at para 53.
[24] Williams Affidavit at para 59.

Commercial Workers Union Locals 175 and 1006A. A total of 37 unionized employees are employed to work at five unionized Corporate Stores.[25]

23. The Applicants are not employers of any employees working at Franchised Stores.[26]

(g) Key Suppliers

24. The Applicants are not producers of cannabis and purchase cannabis products directly from a small number of provincially-approved distributors for retail sale at Corporate Stores.[27] There are very few regulated suppliers of cannabis products in Canada and maintaining supplier relationships is critical for timely and effective supply of inventory. Any interruption in supply from these critical suppliers will have a material adverse effect on the Business.[28]

25. The Business also relies on other providers of key products and services, including online and in-store card, cash, and gift card payment processors; asset protection and security services; suppliers of digital maintenance services for the Digital Platform; insurance; utilities; telecommunications; and delivery routing.[29]

26. In the ordinary course of business, the Applicants use a cash management system to, among other things, collect revenues, including from Corporate Stores, the Digital Platform, and from franchisees, and pay expenses including payroll, taxes, rent, supplies and utilities.[30]

27. The Applicants maintain 51 Canadian-dollar demand-deposit bank accounts with the Bank of Montreal ("**BMO**").[31] Payments on the Digital Platform, as well as credit card and debit card transactions at Corporate Stores are processed by Merrco Payments Inc., an online

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[25] Williams Affidavit at para 60.
[26] Williams Affidavit at para 63.
[27] Williams Affidavit at para 64.
[28] Williams Affidavit at para 67.
[29] Williams Affidavit at para 68.
[30] Williams Affidavit at para 69.

payment platform for regulated businesses.[32]

C. ASSETS AND LIABILITIES OF THE APPLICANTS

28. The book value of the Companies' liabilities exceeds the book value of its assets by approximately $89.1 million.[33] As at June 30, 2024, the Applicants held assets with a book value of approximately $148.2 million and had liabilities with a book value of approximately $237.4 million.[34]

29. The Companies have been operating at a loss and are wholly dependent on financing from related parties and third party lenders to meet their working capital needs. Tokyo Smoke had a net loss of $29.3 million for the fiscal year ended June 30, 2024.[35] Without financing, the Companies are not able to satisfy their obligations as they become due.

(a) Secured Indebtedness to BMO

30. The Companies' primary third-party lender is BMO pursuant to a demand credit agreement dated October 7, 2022 ("**BMO Credit Agreement**") between BMO and ParentCo.[36] The BMO Credit Agreement provides for a revolving credit facility in the maximum principal amount of $40 million, a hedge facility (under which no amounts are owing), and a credit card facility.[37] In total, approximately $38.6 million is owed to BMO.[38]

31. ParentCo's obligations under the BMO Credit Agreement are jointly and severally guaranteed by all of the Applicants as well as the Non-Applicant Entities, and are cross-

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[31] Williams Affidavit at para 70.
[32] Williams Affidavit at paras 72-73.
[33] Williams Affidavit at para 83.
[34] Williams Affidavit at paras 81-82.
[35] Williams Affidavit at para 80.
[36] Williams Affidavit at para 86.
[37] Williams Affidavit at para 86.
[38] Williams Affidavit at para 87.

collateralized and secured against the Applicants' and Non-Applicant Entities' assets.[39] ParentCo's obligations under the BMO Credit Agreement are also guaranteed by TS Investments and another related entity, DAK Capital Inc., up to a maximum of $40 million.[40] The indebtedness owed to BMO is secured by a general security agreement and has been registered in the relevant personal property security registries.[41]

32. The Companies have consulted with BMO in respect of this CCAA application and understand that BMO supports the relief sought by the Applicants on the basis that the Applicants do not intend to compromise or otherwise affect BMO's security, and that any interim financing charge obtained by the Applicants will be subordinated to BMO's security.

(b) Secured Intercompany Loans

33. The Applicants have also funded their working capital needs through intercompany loans advanced by related entities. As at June 30, 2024, the aggregate outstanding intercompany loans owed to related entities was approximately $64.4 million.[42] The Applicants do not intend to make any payments under any intercompany loan arrangements during the pendency of the CCAA proceedings.

34. The majority of the intercompany funding has been advanced by way of secured advances from TS Investments.[43] TS Investments has advanced approximately $52.5 million to ParentCo pursuant to a grid promissory note dated October 7, 2022.[44]

35. To facilitate the flow of funds to its subsidiaries, ParentCo, has also entered into certain

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[39] Williams Affidavit at para 89.
[40] Williams Affidavit at para 91.
[41] Williams Affidavit at para 88.
[42] Williams Affidavit at para 97.
[43] Williams Affidavit at para 98.
[44] Williams Affidavit at para 103.

intercompany lending arrangements with its subsidiaries including a grid promissory note dated October 7, 2022 between ParentCo as lender and various of the Applicants as borrowers (the "**ParentCo Grid Note**"). Approximately $4.025 million in principal is outstanding under the ParentCo Grid Note.[45]

(c) HST, Payroll and Source Deductions

36. The Applicants remit HST either quarterly or monthly and have accrued approximately $372,000 of HST for the stub period between accrual and remittance in the normal course. Payroll taxes and deductions are remitted bi-weekly. The Applicants have accrued approximately $170,000 in payroll and source deductions for the previous pay period.[46] The Applicants do not owe any accrued corporate taxes.[47]

(d) Unsecured Liabilities

37. As at June 30, 2024, the Company had accounts payable and accrued liabilities of approximately $16.8 million, of which $5 million were trade payables and operating costs accrued in the ordinary course. The majority of the Applicants' trade payables relate to the purchase of cannabis inventory.[48]

38. The Applicants are seeking to pay, with the consent of the proposed monitor Alvarez & Marsal Canada Inc. (the " **Proposed Monitor**" and if appointed in these CCAA proceedings the "**Monitor**"), certain pre-filing amounts to critical suppliers in order to maintain the supply of cannabis inventory for sale to consumers.[49] Because there are few regulated suppliers,

[45] Williams Affidavit at para 109.
[46] Williams Affidavit at para 119.
[47] Williams Affidavit at para 120.
[48] Williams Affidavit at para 115.
[49] Williams Affidavit at para 67.

maintaining existing supplier relationships is critical and any interruption in supply from those critical suppliers would have a material adverse impact on the Business.[50]

39. LicenseCo is a borrower under an unsecured promissory note dated January 17, 2022 with Tweed Franchise Inc. as lender to finance the buildout of stores (the "**Canopy Promissory Note**"). The Canopy Promissory Note matures on April 15, 2025 and a total of $5 million in principal remains outstanding.[51]

(e) Contingent Claims

40. On or around August 15, 2024, Canopy Growth Corporation and two related entities commenced civil proceedings against ParentCo, LicenseCo, FranchiseCo and 14284585 Canada Inc. in connection with the sale of Canopy's Canadian retail cannabis business to ParentCo.[52] The plaintiffs claim, among other things, damages of approximately $5.3 million.[53] At this time, no defenses have been filed, nor have any examinations for discovery been conducted.

41. Several franchisees have delivered notices of recission under their respective Franchise Agreements. In connection with the recission claims, the franchisees have claimed a total of approximately $6 million in compensation under the Franchise Agreements. The recission claims stem from allegations of incomplete statutory disclosure by FranchiseCo.[54] No determination has been made by any Court or arbitral body in respect of the recission claims.

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[50] Williams Affidavit at para 67.
[51] Williams Affidavit at para 117.
[52] Williams Affidavit at para 121.
[53] Williams Affidavit at para 123.
[54] Williams Affidavit at para 124.

D. URGENT NEED FOR RELIEF UNDER THE CCAA

42. The Applicants were one of the first chain retailers to form after legalization of cannabis in Ontario in 2019.[55] The Tokyo Smoke retail model was premised on the existence and growth of a premium cannabis market in Canada in circumstances where access to retail licenses was highly restricted, and retailers would be able to differentiate based on product quality and retail experience.[56] Ontario ultimately moved to an open market system, allowing for an unlimited number of stores authorizations.[57]

43. The number of cannabis retail licenses in Ontario has increased from less than 100 initial licenses to over 1600 licenses. Further, due to the highly regulated nature of cannabis retail, all cannabis retail supply is sourced from the same regulated wholesaler, resulting in little differentiation of product between stores. The cannabis retail regulatory framework and environment has resulted in an oversupply in the market and significant competitive price pressure between retailers.[58]

44. A thriving grey market has also had a significant impact on Tokyo Smoke's revenues. The impact of the cannabis grey market is estimated to be $2 to 4 billion across Canada and disproportionately impacts licensed retailers with legitimate operations.[59] This money is diverted from legitimate operators, reducing revenues and profits, including those of the Applicants.

45. Finally, the COVID-19 pandemic has caused inflationary pressures, increasing the Applicants' operating costs while deteriorating profit margins. Compounded with the change in the licensing regime and oversaturation in the market, the Applicants have not been able to

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[55] Williams Affidavit at para 6.
[56] Williams Affidavit at para 126.
[57] Williams Affidavit at para 133.
[58] Williams Affidavit at para 8.
[59] Williams Affidavit at para 130.

achieve their targeted revenues and are unable to meet their obligations as they become due.[60]

46. If granted, the Applicants intend to take the following key restructuring steps, among others, under the supervision of the Monitor:

(a) closing approximately 21 underperforming Corporate Stores and disclaiming the applicable leases;

(b) disclaiming three Head Leases and two Franchise Agreements pursuant to which franchisees are in default of their obligations; and

(c) undertaking a SISP to canvass the market for sale, investment and recapitalization opportunities for the Business.[61]

47. To facilitate the SISP, the Applicants are negotiating a stalking horse agreement setting out the terms on which the Applicants intend to close a transaction, subject to Court approval, and setting the floor price for the SISP in order to maximize realization.

E. PROPOSED DIP FINANCING

48. Tokyo Smoke, with the assistance of its counsel and the Proposed Monitor, has engaged in discussions with TS Investments regarding the DIP facility ("**DIP Facility**"). The primary purpose of the DIP Facility is to fund the working capital requirements of the Company, including the payment of professional fees incurred during the CCAA proceedings.

49. TS Investments is prepared to provide the DIP Facility to Tokyo Smoke provided that the Court grants it a charge over all of the Applicants' assets (the "**DIP Lender's Charge**") in favour of TS Investments, securing all amounts advanced and all obligations incurred pursuant to the

[60] Williams Affidavit at para 134.
[61] Williams Affidavit at para 140.

DIP term sheet ("**DIP Term Sheet**") that ranks in priority to all other encumbrances save and except for the Administration Charge (defined below) and the BMO debt.

50. The key terms and conditions of the DIP Term Sheet are set out in the Williams Affidavit and include:

(a) a maximum principal loan amount of $8 million, including an initial advance in the principal amount of $3.3 million;

(b) interest accruing at a rate of 13% per annum, compounded and calculated monthly;

(c) a commitment fee equal to 1% of the maximum principal loan amount;

(d) a maturity date of the earlier of (i) December 6, 2024 or such later date as the DIP Lender agrees to in writing, (ii) the implementation of a plan of compromise or arrangement, (iii) the closing of a sale transaction, (iv) the termination of the CCAA proceedings, and (v) the conversion of the CCAA proceeding into a proceeding under the *Bankruptcy and Insolvency Act*; and

(e) advances under the DIP Facility are conditional upon Court approval of the DIP Term Sheet and the granting of a Court-ordered DIP Lender's Charge in favour of the DIP Lender over all of the property of the Applicants, subject only to the Administration Charge (defined below) and the and the existing security held by BMO.[62]

51. With the assistance of the Proposed Monitor, the Applicants have prepared a 13-week cash flow statement for the period ending the week of November 22, 2024 (the "**Cash Flow Projection**").[63] The Cash Flow Projection demonstrates that the Applicants require approximately $2.5 million in interim financing as early as the week ending August 30, 2024 and

[62] Williams Affidavit at para 147.
[63] Williams Affidavit at para 135.

continuing over the following 13-week period. Of the entire amount, approximately $2.5 million is forecasted to be required in the initial 10-day stay period.[64]

PART III – ISSUES

52. The principal issues to be determined by this Honourable Court are:

(a) whether the Applicants are entitled to seek protection under the CCAA and should be granted protection, including a stay of proceedings;

(b) whether the stay of proceedings should be extended to the Non-Applicant Entities;

(c) whether the DIP Term Sheet and DIP Lender's Charge should be approved;

(d) whether the Court should exercise its jurisdiction to grant the Administration Charge and the Director's Charge for the initial period of 10 days until the comeback hearing and as expanded thereafter; and

(e) whether the Applicants should be permitted to pay certain pre-filing obligations with the consent of the Monitor.

PART IV – LAW & ARGUMENT

A. The Applicants are Debtor Corporations to which the CCAA Applies

53. The Applicants are "debtor companies" as that term is defined under the CCAA. Pursuant to section 2 of the CCAA, a "debtor company" is defined as a company that is insolvent within the meaning of the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 (the "**BIA**").[65] The BIA provides that a person is insolvent if it is unable to meet its obligations as they generally become due, has ceased paying current obligations in the ordinary course of

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[64] Williams Affidavit at para 136.
[65] CCAA, S. 2.

business, or whose aggregate property is not at fair valuation sufficient to enable payment of all its obligations due and accruing due.[66]

54. The CCAA applies in respect of a "debtor company" or "affiliated company" where the total claims against the debtor or affiliate exceeds $5 million.[67] Companies that are part of an affiliated group do not need to individually satisfy the definition of insolvency if the group, taken as a whole, is insolvent, and if it is appropriate that all the companies in the group be included as part of the CCAA orders and restructuring proceeding.[68]

55. It is appropriate for all Applicants to be included in these proceedings as "affiliated companies" under the CCAA. Among other things, the Applicants' Business is fully integrated. The Applicants have jointly and severally cross-guaranteed and cross-collateralized their obligations. No effective restructuring could be achieved if creditors were permitted to enforce against any of the Applicants on an individual basis.

56. The Applicants together owe $38.6 million to BMO, $64.7 million under intercompany loans, and $568,307 in arrears on rent in respect of Corporate Stores. In contrast, the Applicants have only approximately $1.369 million of available liquidity on hand. The Applicants do not have the funds to continue paying their normal course obligations without right-sizing the Business and undertaking a restructuring within a CCAA proceeding.

57. Further, the Applicants have historically been funded with debt. Without the continued infusion of capital from related parties and BMO, the Applicants will not be able to continue as a going concern. Interim financing within the CCAA proceeding is needed to allow the restructuring to occur and to allow the Business to continue.

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[66] CCAA, S. 2; BIA, S. 2.
[67] CCAA, S. 3(1).
[68] *First Leaside Wealth Management Inc. (Re)*, 2012 ONSC 1299 at paras. 25-30.

58. Subsection 9(1) of the CCAA provides that an application under the CCAA may be made to the Court that has jurisdiction in the province where the debtor company has its "head office or chief place of business."[69] If the head office of a debtor is in one province or territory and its chief operations are located in another, an application can be made in either jurisdiction.[70]

59. ParentCo's registered head office is located in Toronto, Ontario.[71] The majority of the other Applicants are Ontario corporations with registered head offices in Ontario. While the Applicants conduct operations across multiple provinces, the majority of the Business operations are based in Ontario, where most of the Corporate Stores and Franchised Stores are located. Thus, the Ontario court is the appropriate venue for these CCAA proceedings.

B. The Relief Sought is Reasonably Necessary

60. Pursuant to s. 11.001 of the CCAA, the relief sought on an initial application is limited to what is reasonably necessary to continue the operations in the ordinary course during the initial stay period.[72] The Applicants seek only the relief necessary to maintain the Business during the initial stay period. The Applicants have worked closely with the Proposed Monitor to determine the necessary relief, including to size the proposed charges, and have carefully considered whether the relief is necessary to protect the Applicants' assets and operations, as well as in the interest of its creditors and stakeholders.[73]

61. The Applicants intend to commence their operational restructuring during the initial 10-day stay period by disclaiming unfavourable leases and unprofitable Franchise Agreements and closing underperforming Corporate Stores. The Applicants expect that they will need to

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[69] CCAA, S. 9(1).
[70] *Ibid.*
[71] Williams Affidavit at para 14.
[72] CCAA, S. 11.001; *Lydian International Limited (Re)*, 2019 ONSC 7473 at paras. 22-26.
[73] Williams Affidavit at paras 157 and 163.

terminate certain employees as a consequence of the operational restructuring and store closures.

C. The Applicants Require the Protection of a Stay of Proceedings

62. Under CCAA s. 11.02, a Court may grant on Order staying all proceedings in respect of a debtor company for a period of no more than 10 days if the Court is satisfied that circumstances exist that make the order appropriate.[74]

63. A key purpose of the CCAA is to maintain the *status quo* to allow the debtor company the breathing room to deal with its liquidity issues, consult with stakeholders, and develop a viable restructuring plan with a view to continuing operations for the benefit of all stakeholders. The interests to be considered include those of employees, directors, and even other parties doing business with the insolvent company.[75]

64. The Applicants require the protection of a stay of proceedings to effect an operational restructuring, maintain the profitable segments of the Business, disclaim unfavourable leases and Franchise Agreements, and to negotiate and finalize a stalking horse agreement and SISP to be conducted with the approval of the Court. Without the protection of the CCAA, the Applicants would have to cease operating, which would be detrimental to the Applicants' landlords, franchisees, suppliers, customers, and hundreds of employees.

D. The Stay Should Be Extended to the Non-Applicant Entities

65. This Court has the authority to extend the stay of proceedings to the Non-Applicant Entities pursuant to s. 11 and 11.02(1) of the CCAA, which allow the Court to make an initial order on any terms that it may impose.

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[74] CCAA, S. 11.02(3).
[75] *Century Services Inc. v Canada (Attorney General)*, 2010 SCC 60 at para 60; *Nortel Networks Corporation (Re)*, 2009 CanLII 39492 (ON SC) at para 47.

66. In *Re JTI-Macdonald Corp.*, Justice Hainey set out factors that courts have considered in deciding whether to extend a stay of proceedings to non-applicant third parties:

(a) whether the business and operations of the third party was significantly intertwined and integrated with those of the debtor company;

(b) whether extending the stay to the third party would help maintain stability and value during the CCAA process;

(c) whether declining to extend the stay to the third party would have a negative impact on the debtor company's ability to restructure, potentially jeopardizing the success of the restructuring and the continuance of the debtor company;

(d) whether the economic harm would be far-reaching and significant if the debtor company were prevented from concluding a successful restructuring with its creditors;

(e) whether failure of the restructuring would be even more harmful to customers, suppliers, landlords and other counterparties whose rights would otherwise be stayed under the third party stay;

(f) if the restructuring proceedings were successful, whether the debtor company would continue to operate for the benefit of all of its stakeholders, and its stakeholders would retain all of their remedies in the event of future breaches by the debtor company or breaches that are not related to the released claims; and

(g) the balance of convenience favours extending the stay to the third party.[76]

67. In particular, Courts have extended third party stays of proceedings where the subsidiaries of the CCAA applicants are guarantors of the applicants' obligations, where

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[76] *JTI Macdonald Corp., Re*, 2019 ONSC 1625 at para 15 ["*JTI*"].

the non-applicants are integrated into the applicants' business operations, where the claims against the non-applicants are derivative of the primary liability of the applicants, and where the non-applicant and applicant parties are integrally and closely interrelated.[77]

68. Here, the Non-Applicant Entities are direct subsidiaries of ParentCo and are therefore constitute assets of ParentCo. They hold, among other things, intellectual property used by the Applicants and are guarantors of certain of the Applicants' obligations to BMO and TS Investments. While they are not Applicants under the CCAA and do not need to compromise any claims or effect a restructuring pursuant to the CCAA, it would be disruptive to the CCAA proceeding if any party were to take steps against the Non-Applicant Entities. Therefore, the Applicants seek a third party stay to be extended over the Non-Applicant Entities during the pendency of the CCAA proceeding.

E. THE DIP TERM SHEET AND DIP LENDER'S CHARGE SHOULD BE APPROVED

69. The Applicants are seeking approval of the DIP Facility and a DIP Lender's Charge over the Applicants' assets, property and undertaking in favour of the DIP Lender, to secure amounts borrowed by the Applicants under the terms of the DIP Facility. The proposed DIP Lender's Charge is to rank behind the Administration Charge and the existing security held by BMO, but above all other liens, charges and encumbrances.

70. The Applicants are seeking to secure only the amount to be advanced under the DIP Facility in the initial 10-day stay period in accordance with s. 11.2(5) of the CCAA, which provides that a charge may be granted to secure the amount "reasonably necessary for the

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[77] *MPX International Corporation*, 2022 ONSC 4348 at para 52; *Laurentian University of Sudbury*, 2021 ONSC 659 at para 39.

continued operations of the debtor company in the ordinary course of business" during the initial 10-day stay period.[78]

71. Section 11.2 of the CCAA permits the Court to grant the DIP Facility and the DIP Lender's Charge on notice to those secured creditors that would be affected and in an amount that the Court considers appropriate having regard to the Applicants' cash flow forecast.[79]

72. In determining whether the DIP Lender's Charge is appropriate, the Court is required to consider the following factors under section 11.2(4) of the CCAA:

(a) the period during which the company is expected to be subject to proceedings under the CCAA;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report, if any.[80]

73. The prescribed factors have been met. The DIP Lender's Charge will not rank in priority to the security held by BMO, however BMO has been consulted and is supportive of this

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[78] CCAA, S. 11.2(5).
[79] CCAA, S. 11.2(1).
[80] CCAA, S. 11.2(4).

proceeding. The DIP Lender's Charge is proposed to rank below the proposed Administration Charge and BMO security. All other secured lenders of the Applicants are related entities that have been consulted and do not oppose the DIP Lender's Charge.

74. The Applicants have been reliant on financing from lenders to fund their working capital needs. The Applicants are not able to obtain interim financing without a charge. Without interim financing, the Applicants will be forced to cease operating.

75. The Monitor supports the Applicants' request for approval of the DIP Facility and the DIP Lender's Charge. As held by this Court in *Lydian International Limited (Re)*, the DIP Facility should be approved because it is necessary to enable the Applicants to implement their restructuring plan, the Monitor is supportive of the DIP, and it does not give rise to any material financial prejudice.[81] The DIP is reasonably necessary and appropriate in the circumstances.[82]

F. THE ADMINISTRATION CHARGE AND DIRECTORS' CHARGE SHOULD BE GRANTED

(a) Administration Charge

76. The Applicants request that this Court grant a super-priority administration charge ("**Administration Charge**") up to a maximum of $400,000 for the initial 10-day stay period to secure the fees and disbursements of the Proposed Monitor, its counsel, and the Applicants' counsel. If the Initial Order is granted, the Applicants anticipate seeking increases in the Administration Charge to a maximum amount of $850,000 at the comeback hearing.

77. Section 11.52 of the CCAA gives this Court jurisdiction to grant a priority charge for the fees and expenses of financial, legal and other advisors or experts. The Proposed Monitor, its counsel, and the Applicants' counsel are essential to these CCAA proceedings; without their

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[81] *Lydian International Limited (Re)*, 2020 ONSC 4006 at para 67.
[82] *Ibid.* at para 68.

assistance, the Applicants cannot restructure and their only alternative is liquidation. It is unlikely that these advisors will participate in the CCAA proceedings without the Administration Charge.

78. The success of the Applicants' restructuring is dependent on the involvement of the Monitor and legal counsel. Those roles are not duplicative. While estimating the quantum of an administration charge is "an inexact exercise",[83] the quantum of the Administration Charge has been carefully considered by the Applicants in consultation with the Proposed Monitor and is commensurate with the complexity of the Applicants' business and anticipated restructuring.

(b) Directors' Charge

79. The Applicants propose a super-priority charge in favour of the directors of $2.25 million to secure the Applicants' indemnity of their directors and officers ("**Directors' Charge**"). The Directors' Charge is proposed to rank behind the Administration Charge, BMO's existing security, and the DIP Lender's Charge. The Directors' Charge is intended to encourage directors and officers to continue to occupy their positions during the restructuring and provide reassurance that the company will hold directors harmless for any personal liability they may incur by continuing to act as a director after the insolvency filing.[84]

80. Pursuant to s. 11.51 of the CCAA, the Court is authorized to grant the Directors' Charge in the amount the Court considers appropriate, provided notice is given to the secured creditors who are likely to be affected by it.[85]

81. A successful restructuring of the Applicants will only be possible with the continued participation of its directors, management, and employees. The directors' involvement in these

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[83] *Canwest Global Communications Corp. (Re)*, 2009 CanLII 55114 (ON SC) at para 40.
[84] *Mecachrome International Inc.*, [2009] QCCS 1575, para 58.
[85] CCAA, S. 11.51.

proceedings is conditional upon the granting of the Directors' Charge. The directors of the Applicants have expressed concern about their exposure and are unlikely to remain in office without adequate indemnity.[86] While the Applicants maintain liability insurance for their directors, it is not certain that such policies provide coverage for the liabilities that may be incurred by the directors during the CCAA proceeding and it would be challenging, if not impossible to obtain additional insurance coverage for directors during the CCAA proceeding at reasonable cost.[87]

82. The Proposed Monitor is of the view that the charge is required and is reasonable in the circumstances. Both the Directors' Charge and the Administration Charge are appropriately sized to reflect the Applicants' needs during the initial stay period, and are supported by the Proposed Monitor.

G. Payment of Pre-Filing Obligations with Approval of the Monitor

83. The Initial Order authorizes the Applicant to pay, with the consent of the Monitor amounts owing for essential goods or services supplied to the Applicant prior to the date of the Initial Order, if in the opinion of the Monitor, the payment is necessary and appropriate up to the maximum amount of $330,000 during the initial ten-day stay period.

84. The Court is empowered to grant such relief pursuant to the Court's general jurisdiction under s. 11 of the CCAA. Courts have routinely granted orders allowing CCAA applicants to pay pre-filing amounts to critical suppliers with the consent of the monitor.[88] In doing so, Courts have considered the following criteria: whether the goods and services concerned are integral to the business, the applicants' need for the uninterrupted supply of the goods or services, the monitor's support and willingness to work with the applicants to ensure that payments to suppliers in respect of pre-filing liabilities are appropriate, and the effect on the applicants'

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[86] Williams Affidavit at para 161.
[87] *Jaguar Mining Inc. (Re)*, 2014 ONSC 494 at para 45.
[88] See: *Cinram International Inc. (Re)*, 2012 ONSC 3767 at para 23; *JTI, supra,* at paras 24-25.

ongoing operations and ability to restructure if they were unable to make pre-filing payments to their critical suppliers.[89]

85. The Applicants rely heavily on a small number of suppliers and contractors who provide highly regulated and specialized services and materials. To avoid disruption to the Business, the Applicants seek the flexibility to make pre-filing payments as necessary to maintain the Business and avoid impairing their restructuring efforts. No payments of pre-filing amounts will be made without the consent of the Monitor.

PART V – RELIEF REQUESTED

86. The Applicants therefore request an Order substantially in the form of the draft Initial Order attached as Tab 3 to the Application Record.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 27th DAY OF AUGUST, 2024

/s RECONSTRUCT LLP

RECONSTRUCT LLP
120 Adelaide Street West
Suite 2500
Toronto, ON M5H 1T1

Lawyers for the Applicants

[89] *JTI, supra* at para 24; *Clover Leaf Holdings Company, Re.*, 2019 ONSC 6966 at para 25.

SCHEDULE "A"

List of Authorities

1. *Canwest Global Communications Corp. (Re)*, 2009 CanLII 55114 (ON SC)
2. *Century Services Inc. v Canada (Attorney General)*, 2010 SCC 60
3. *Cinram International Inc. (Re)*, 2012 ONSC 3767
4. *Clover Leaf Holdings Company, Re.*, 2019 ONSC 6966
5. *First Leaside Wealth Management Inc. (Re)*, 2012 ONSC 1299
6. *Jaguar Mining Inc. (Re)*, 2014 ONSC 494
7. *JTI Macdonald Corp., Re*, 2019 ONSC 1625
8. *Laurentian University of Sudbury*, 2021 ONSC 659
9. *Lydian International Limited (Re)*, 2019 ONSC 7473
10. *Lydian International Limited (Re)*, 2020 ONSC 4006
11. *Mecachrome International Inc.*, [2009] QCCS 1575
12. *MPX International Corporation*, 2022 ONSC 4348
13. *Nortel Networks Corporation (Re)*, 2009 CanLII 39492 (ON SC)

SCHEDULE "B"

Statutory Authorities

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended**

Definitions

2(1) In this Act…

company means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province, any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies;
…
debtor company means any company that
(a) is bankrupt or insolvent,

(b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts,

(c) has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, or

(d) is in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent;

Application

3 (1) This Act applies in respect of a debtor company or affiliated debtor companies if the total of claims against the debtor company or affiliated debtor companies, determined in accordance with section 20, is more than $5,000,000 or any other amount that is prescribed.

Affiliated companies

(2) For the purposes of this Act,

> **(a)** companies are affiliated companies if one of them is the subsidiary of the other or both are subsidiaries of the same company or each of them is controlled by the same person; and
> **(b)** two companies affiliated with the same company at the same time are deemed to be affiliated with each other.

Company controlled

(3) For the purposes of this Act, a company is controlled by a person or by two or more companies if

(a) securities of the company to which are attached more than fifty per cent of the votes that may be cast to elect directors of the company are held, other than by way of security only, by or for the benefit of that person or by or for the benefit of those companies; and
(b) the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the company.

Subsidiary

(4) For the purposes of this Act, a company is a subsidiary of another company if

(a) it is controlled by

(i) that other company,

(ii) that other company and one or more companies each of which is controlled by that other company, or

(iii) two or more companies each of which is controlled by that other company; or

(b) it is a subsidiary of a company that is a subsidiary of that other company

Jurisdiction of court to receive applications

9 (1) Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company in Canada is situated, or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

Relief reasonably necessary

11.001 An order made under section 11 at the same time as an order made under subsection 11.02(1) or during the period referred to in an order made under that subsection with respect to an initial application shall be limited to relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.

Stays, etc. — initial application

11.02 (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 10 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Stays, etc. — other than initial application

(2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose:

(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(a);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

Burden of proof on application

(3) The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

Restriction

(4) Orders doing anything referred to in subsection (1) or (2) may only be made under this section

Stays — directors

11.03 (1) An order made under section 11.02 may provide that no person may commence or continue any action against a director of the company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company if directors are under any law liable in their capacity as directors for the payment of those obligations, until a compromise or an arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

Exception

(2) Subsection (1) does not apply in respect of an action against a director on a guarantee given by the director relating to the company's obligations or an action seeking injunctive relief against a director in relation to the company.

Persons deemed to be directors

(3) If all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the company is deemed to be a director for the purposes of this section

Interim financing

11.2 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.

Priority — secured creditors

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Priority — other orders

(3) The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.

Factors to be considered

(4) In deciding whether to make an order, the court is to consider, among other things,

> **(a)** the period during which the company is expected to be subject to proceedings under this Act;
>
> **(b)** how the company's business and financial affairs are to be managed during the proceedings;
>
> **(c)** whether the company's management has the confidence of its major creditors;
>
> **(d)** whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;
>
> **(e)** the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)(b), if any.

Additional factor — initial application

(5) When an application is made under subsection (1) at the same time as an initial application referred to in subsection 11.02(1) or during the period referred to in an order made under that subsection, no order shall be made under subsection (1) unless the court is also satisfied that the terms of the loan are limited to what is reasonably necessary for the continued operations of the debtor company in the ordinary course of business during that period.

Security or charge relating to director's indemnification

11.51 (1) On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Restriction — indemnification insurance

(3) The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

Negligence, misconduct or fault

(4) The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

Court may order security or charge to cover certain costs

11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;

(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

Priority

(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Court to appoint monitor

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*.

Restrictions on who may be monitor

(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

(i) a director, an officer or an employee of the company,

(ii) related to the company or to any director or officer of the company, or

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

(b) if the trustee is

(i) the trustee under a trust indenture issued by the company or any person related to the company, or the holder of a power of attorney under an act constituting a hypothec within the meaning of the *Civil Code of Quebec* that is granted by the company or any person related to the company, or

(ii) related to the trustee, or the holder of a power of attorney, referred to in subparagraph (i).

Court may replace monitor

(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.

***Bankruptcy and Insolvency Act*, R.S.C. , 1985, c. B-3**

Definitions

2 In this Act,

…

insolvent person means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and

- **(a)** who is for any reason unable to meet his obligations as they generally become due,
- **(b)** who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
- **(c)** the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due; (*personne insolvable*)

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 2675970 ONTARIO INC. et al.
Applicants

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at Toronto

FACTUM OF THE APPLICANTS
(CCAA Initial Order)

RECONSTRUCT LLP
Richmond-Adelaide Centre
120 Adelaide Street West, Suite 2500
Toronto, ON M5H 1T1

Caitlin Fell LSO No. 60091H
cfell@reconllp.com
Tel: 416.613.8282

Sharon Kour LSO No. 58328D
skour@reconllp.com
Tel: 416.613.8283

Jessica Wuthmann LSO No. 72442W
jwuthmann@reconllp.com
Tel: 416.613.8288

Fax: 416.613.8290

Lawyers for the Applicants