CITATION: Earle v. CannTrust Holdings Inc., 2020 ONSC 579
COURT FILE NO.: CV-19-000625181-00CP
COURT FILE NO.: CV-19-00625351-00CP
DATE: 2020/01/28

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:	
WENDY EARLE, ATIQUR SARKER, DHARAMBIR SINGH, and RON REID	*David Wingfield* and *Dimitri Lascaris* for the Plaintiffs
Plaintiffs	
- and -	
CANNTRUST HOLDINGS INC., ERIC PAUL, PETER ACETO, GREG GUYATT, IAN ABRAMOWITZ, MARK DAWBER, JOHN KADEN, MARK IAN LITWIN, ROBERT MARCOVITCH, MITCHELL J. SANDERS, STAN ABRAMOWITZ, BRAD ROGERS, MICHAEL RAVENSDALE, SHAWNA PAGE, ILLANA PLATT, GRAHAM LEE, KPMG LLC, MERRILL LYNCH CANADA INC., CITIGROUP GLOBAL MARKETS CANADA INC., CREDIT SUISSE SECURITIES (CANADA) INC., RBC DOMINION SECURITIES INC., JEFFERIES SECURITIES, INC., CANACCORD GENUITY CORP., CANNAMED FINANCIAL CORP., and CAJUN CAPITAL CORPORATION	
Defendants	
AND BETWEEN:	
STEPHEN ROSEN	*John Finnigan, Peter Jervis, Douglas Worndl,* and *Paul Guy* for the Plaintiff
Plaintiff	
- and –	
CANNTRUST HOLDINGS INC., PETER ACETO, ERIC PAUL, GREG GUYATT,	

IAN ABRAMOWITZ, MARK LITWIN and KPMG LLP Defendants	)	
Proceedings under the *Class Proceedings Act, 1992*	)	**HEARD**: December 3, 2019

HAINEY, J.

ENDORSEMENT

BACKGROUND

[1] This is a carriage motion pursuant to the *Class Proceedings Act*, 1992 S.O. 1992, c.6, ("CPA") in which I must determine which of two highly experienced teams of legal counsel should represent the interests of proposed class members in a securities misrepresentation class proceeding brought against CannTrust Holdings Inc. ("CannTrust") and other defendants relating to losses suffered by the proposed class members as a result of their investments in CannTrust.

[2] The two competing teams of legal counsel are the following:

(a) The "Consortium" comprised of Henein Hutchison LLP ("Henein"), Strosberg Sasso Sutts LLP ("Strosberg"), A Dimitri Lascaris Law Professional Corporation ("Lascaris PC"), and Kalloghlian Professional Corporation ("Kalloghlian PC") who represent the proposed representative plaintiffs, Patrick Hrusa and Dharambir Singh ("Hrusa/Singh Action") and

(b) The "TGF/RG Team" comprised of Thorton Grout Finnigan LLP ("TGF") and Rochon Genova LLP ("RG") who represent the representative plaintiff, Stephen Rosen ("Rosen Action").

FACTS

[3] CannTrust is in the business of producing and selling cannabis products. Its shares are publicly listed for trading on the Toronto Stock Exchange ("TSX"), the New York Stock Exchange ("NYSE") and other trading venues. As a federally regulated licensed cannabis producer, it operates in a strictly regulated environment governed by various laws, regulations and standards administered in part by Health Canada. Failure to comply with these rules and regulations exposes CannTrust to sanctions and penalties, ranging from fines to the suspension or revocation of its licenses.

[4] Between June 1, 2018 and September 17, 2019, CannTrust, its directors and officers issued securities filings and made public statements representing that it had obtained all the necessary licenses at the facilities it owned, and that it would apply for additional licenses as necessary in the future. It also represented to investors that it met all standards for security, quality assurance, standard operating procedures, and document retention.

[5] These representations were included in a prospectus dated May 1, 2019 ("May Prospectus") pursuant to which US$230 million worth of CannTrust shares were sold to investors.

[6] It is alleged that these representations and statements were false. Unbeknownst to investors, starting on June 1, 2018, CannTrust breached Health Canada regulations by storing cannabis in its manufacturing facility in Vaughan, Ontario ("Vaughan Facility") without the required approval from Health Canada. The Vaughan Facility also failed to meet the required standards for security, quality assurance, standard operating procedures and document retention.

[7] On or around October 1, 2018, CannTrust, with the knowledge and approval of executive management, began producing and selling cannabis made in rooms in its facility in Niagara ("Niagara Facility") that did not have the required licenses. CannTrust employees deceived Health Canada inspectors, going so far as to install fake walls to hide the cannabis being illegally grown in the unlicensed rooms. In addition, CannTrust produced and sold cannabis grown from seeds that were illegally obtained through the black market.

[8] It was not until a series of five key public disclosures issued between July 8 and September 17, 2019, that CannTrust's investors learned the truth about the company's illegal activities. These disclosures are the basis for the allegations in the proposed class proceedings.

(1) On July 8, 2019, CannTrust issued a press release admitting that it had breached Health Canada regulations by growing cannabis in five unlicensed rooms at the Niagara Facility between October 2018 and March 2019.

(2) On July 23, 2019, The Globe and Mail reported that top CannTrust executives, including its chief executive officer, chief financial officer and chairman of the board, knew and directed the illegal growing of cannabis in the unlicensed rooms at the Niagara Facility.

(3) On August 12, 2019, CannTrust issued a press release announcing that Health Canada had discovered noncompliance with Health Canada regulations in another facility in Vaughan dating back to June 2018.

(4) On September 6, 2019, BNN Bloomberg published an article disclosing that senior operating staff working at the Niagara Facility in late 2018 brought cannabis seeds from the black market into production rooms, leading to illicit cannabis flowing into the legal market.

(5) On September 17, 2019, CannTrust issued a press release announcing that it had received a notice of license suspension from Health Canada.

[9] As a result of these disclosures the price of CannTrust's shares dropped 73% from before the July 8th announcement to the September 17th announcement.

[10] The regulatory noncompliance findings had a significant impact on CannTrust's business and operations and its previously-disclosed financial results.

[11] On August 1, 2019, CannTrust announced that it would miss the filing deadline for its Q2 2019 financial statements, because "there was significant uncertainty with respect to the potential impact of pending Health Canada decisions on the valuation of the Company's inventory and biological assets and revenue recognition", and that previously-issued financial statements could require restatement.

[12] On October 24, 2019, CannTrust announced that it would be filing restated financial statements for fiscal 2018 and the first quarter of 2019 "within the next 60 days".

[13] As a result of these developments CannTrust's investors lost millions of dollars of their investments. The proposed class proceedings are an effort to recover those loses for these investors. The primary defendants in the proposed class proceedings are CannTrust, its officers and directors, its auditor, KPMG, and CannTrust's underwriters on its public offering.

LEGAL PRINCIPLES

[14] The CPA gives the court broad jurisdiction to manage class proceedings. Courts are charged with a broad supervisory role in class proceedings from deciding who will have carriage of the proceedings to the approval of settlements in class proceedings. To fulfill this mandate the court must protect class members and their interests. Determining who should represent prospective class members engages this supervisory role at a very high level.

[15] The jurisprudence establishes that the court should grant carriage to the legal team whose proposed class proceeding is better for the proposed class members and best represents and protects their interests, while being fair to the defendants and promoting the prime objectives of class proceedings, access to justice, behaviour modification and judicial economy.

[16] In *Rogers v. Aphria Inc.*, 2019 ONSC 3698, at para. 17, Perell J. set out the following factors that the court should consider in deciding which action should proceed on a carriage motion:

> [17] Courts generally consider a list of overlapping and non-exhaustive factors in determining which action should proceed; including: (1) the Quality of the Proposed Representative Plaintiffs; (2) Funding; (3) Fee and Consortium Agreements; (4) The Quality of Proposed Class Counsel; (5) Disqualifying Conflicts of Interest; (6) Relative Priority of Commencement of the Action; (7) Preparation and Readiness of the Action; (8) Preparation and Performance on Carriage Motion; 9) Case Theory; (10) Scope of Causes of Action; (11) Selection of Defendants; (12) Correlation of Plaintiffs and Defendants; (13) Class Definition; (14) Class Period; (15) Prospect of Success: (Leave and) Certification; (16) Prospect of Success Against the Defendants; and (17) Interrelationship of Class Actions in more than one Jurisdiction.

[17] Almost all of these factors apply to both the Consortium and the TGF/RG Team. They are excellent and experienced legal teams. They have both developed impressive litigation plans with qualified representative plaintiffs and are ready to proceed with their respective actions.

[18] However, the crucial issue in this case is the Consortium's submission that the TGF/RG team has a disqualifying conflict of interest because they cannot pursue the class action against

one of the underwriters, RBC Dominion Securities Inc. ("RBC"), because it is a current client of TGF's.

[19] Ronald Podolny, a member of the TGF/RG Team explained in his affidavit, filed in support of the carriage motion, why the TGF/RG Team decided to name CannTrust's underwriters as defendants in the Rosen Action but could not include RBC as a defendant as follows:

> 66. In the current TGF/RG Claim as filed in August 2019, we did not name the underwriters as defendants, but instead named CannTrust, the Individual Defendants and the auditor KPMG.
>
> 67. The decision not to name the underwriters was informed, in part, by the fact that on August 9, 2019, CannTrust announced that it had been advised by KPMG that it was withdrawing the KPMG Report regarding the FY/2018 Annual Financial Statements as well as KPMG's interim report to the CannTrust Audit Committee dated May 13, 2019 in respect of the CannTrust Q1/2019 Interim Financial Statements and that KPMG's reports "should no longer be relied upon."
>
> 68. This was a strong indication of liability on the part of KPMG in respect of the use of its audit report in the Prospectus.
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> 69. Section 130(8) provides for joint and several liability among section 130(1) defendants. Because we were confident of some finding of liability against KPMG in respect of Prospectus misrepresentation, we considered the addition of the underwriters to be unnecessary.
>
> 70. In addition, we considered the fact that CannTrust appeared to have appropriate licenses in place for all of the Pelham Facility as of April 2019. Therefore, even though there were unlicensed grow rooms in Pelham between October and April, by the time the underwriters did their due diligence in advance of the May 1 Prospectus Offering, the Pelham Facility may have had the appropriate licenses in place.
>
> 71. While this was conjecture, we were comfortable with the decision, given KPMG's exposure to all Prospectus damages and their admission on August 9 that their audit opinion could no longer be relied on. It was a judgment call based on available information.
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> 72. The available information changed almost immediately when, on August 12, 2019, CannTrust announced that Health Canada rated the Vaughan Facility non-compliant for several regulatory infractions, one of which involved poor record keeping.
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> 73. In addition, the news about CannTrust's prospects for long-term survival was getting increasingly grim, suggesting that the bulk of the recovery in this case may be coming from "gatekeepers," like KPMG, CannTrust's D&O insurers and, potentially, the underwriters.

74. We consulted with several highly experienced investment bankers/underwriters, who advised that it appeared to them that a good case could be made that the underwriters were not duly diligent in conjunction with the May 1, 2019 Prospectus Offering. We did not obtain a formal opinion from them, however, their reactions to the facts alleged here gave us comfort that the pleading should be amended to include the underwriters as defendants to the section 130(1) claim.

75. An additional issue then presented itself, and that is that TGF was not able to sue one member of the underwriting syndicate, RBC Dominion Securities ("RBC"), because RBC is a current client of TGF.

76. We made an assessment as to whether the failure to name RBC would materially prejudice the Class, and we determined that it did not. Our reasoning was as follows:

(a) While section 130(8) provides that liability among named defendants under section 130(1) is joint and several, section 130(6) provides that no underwriter may be liable for more than the total public offering price represented by the portion of the distribution underwritten by the underwriter.

(b) Therefore, the most that RBC could be found liable for was the portion of the Underwriting underwritten by it. I understand this portion to be approximately 10% of the approximately US$200 million offering.

(c) Therefore, if there was a finding of Prospectus liability under section 130(1), there would be joint and several liability between KPMG, CannTrust, the individual defendants and the underwriters, however the underwriters could be called upon collectively to contribute 90% of the total, because RBC is not named.

(d) In our judgment, it was highly unlikely that the absence of RBC as a defendant would prejudice the Class.

(e) I am advised by Paul Guy that he informed the two proposed representative plaintiffs of the situation, and they instructed him to name the underwriters, without RBC.

[20] For these reasons, RBC is not named as a defendant in the Rosen Action. However, in the Hrusa/Singh Action, the Consortium names as defendants all six financial institutions (including RBC) that served as underwriters in CannTrust's public offering. These underwriters all signed certificates confirming that the May Prospectus contained full, true and plain disclosure of all material facts relating to CannTrust's shares. The underwriters, or their US affiliates, were collectively paid more than US$12.8 million in underwriting commissions for their role in CannTrust's public offering.

[21] The TGF/RG Team acknowledges that they decided to add the underwriters as defendants because the "bulk of the recovery in this case may be coming from 'gatekeepers' like ... the underwriters". However, they have excluded their client, RBC, as a defendant. RBC is a significant source of possible recovery for the class members and, in my view, should be named as a defendant in the class proceeding.

[22] The Consortium submits as follows at paras. 12 and 13 of its factum:

> [12] Unlike the Consortium, which named all the defendant underwriters to maximize the potential recovery for class members, RG/TGF allowed RBC DS to walk scot-free simply because RBC DS is a client of TGF (a conflict for which RG/TGF should be disqualified). RG/TGF try to explain away this conflict by asserting that the exclusion of RBC DS will not prejudice the potential recovery of class members, but it has articulated no justification whatsoever (other than its desire to remain invested in the litigation) for allowing RBC DS to walk scot-free.
>
> [13] RG/TGF's argument that excluding RBC DS will not reduce access to justice for class members is contingent on a number of assumptions that turn out to be untrue. Specifically, this argument depends on KPMG, CannTrust and the individual defendants being (i) found liable; and (ii) having enough money to satisfy the US$230 million worth of shares sold in the Offering. Neither of these scenarios is inevitable, especially given that RG/TGF's other arguments assume that CannTrust will be insolvent, and the individual defendants will only be able to contribute to the extent of the D&O policy. Moreover, excluding RBC DS would undermine the goal of behaviour modification underpinning the CPA.

[23] I agree with and accept the Consortium's submission. By excluding RBC as a defendant, the TGF/RG Team has chosen to prefer the interests of their client, RBC, over the interests of the class members. They have reduced by 10%, or roughly US$20 million, the maximum recoverable damages against the underwriters. This is not in the proposed class members' best interests.

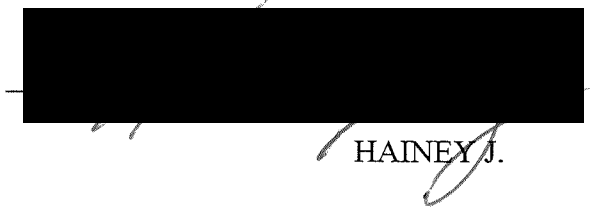
[24] By preferring the interests of their client, RBC, over the class, the TGF/RG Team has reduced the class members' potential recovery before the litigation has even started. In view of my mandate to protect the interests of the proposed class members on this carriage motion, I must ensure that they have legal representation that is not in any way restricted by class counsel's conflicts of interest.

[25] I am satisfied that RBC is a necessary defendant in these proposed class proceedings. It is a possible source of damages of approximately US$20 million and could also be the subject of behaviour modification, one of the objectives of class proceedings. It should not be excluded as a defendant in the proceedings simply because it is a client of TGF's.

CONCLUSION

[26] I have concluded for these reasons that the TGF/RG Team has a disqualifying conflict of interest that makes the team unsuitable to act as class counsel in these proceedings. I therefore grant carriage of these class proceedings to the Consortium.

[27] There shall be no order as to costs.



HAINEY J.

Date: January 28, 2020