This is the 1st affidavit of James M. McGuire in this case and was made on January __, 2022.

No. S-2110503
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

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

AND

IN THE MATTER OF OTSO GOLD CORP. OTSO GOLD OY, OTSO GOLD AB, and 2273265 ALBERTA LTD.

PETITIONERS

AFFIDAVIT

I, James M. McGuire, of 425 Lexington Ave, New York, New York, SWEAR THAT:

1. I am a lawyer and a retired Justice, formerly of the 11th Judicial District for the Supreme Court of the State of New York, and the First Judicial Department of New York State's Appellate Division, and as such have personal knowledge of the facts and matters hereinafter deposed to, except where same are stated to be on information and belief, and where so stated I verily believe them to be true.

2. Attached hereto and marked as Exhibit "A" is a copy of my report (the "Report"), including the Exhibits thereto, namely Exhibit "A" thereto (the "Qualifications"), and Exhibit "B" thereto (the "Instruction Letter").

3. As I set out in the Report, I certify that I am aware of my duty to assist the court and is not to be an advocate for any party, I have made the Report in conformity with that duty, and if called on to give oral or written testimony I will give that testimony in conformity with that duty.

4. The Qualifications accurately set out my biography and the facts set out therein are true.

JM

5. As I was in Valatie, New York and counsel was in Vancouver, I was not physically present before the commissioner while swearing this affidavit, but was linked with the commissioner utilizing video technology, and we used the process described in B.C. Supreme Court COVID-19 Notice No. 2 dated March 27, 2020.

SWORN BEFORE ME at Vancouver, British Columbia, and ~~New York~~ Valatie, New York on January __, 2022)

_____)
A Commissioner for taking Oaths for the Province of British Columbia)

_____
JAMES M. MCGUIRE

JM

This is Exhibit "A" to the Affidavit #1 of James M. McGuire sworn January ___, 2022 before me at the City of Vancouver.

_____

A Commissioner for taking Affidavits in and for the Province of British Columbia.

HOLWELL SHUSTER & GOLDBERG LLP

425 Lexington Avenue
New York, New York 10017
Tel: (646) 837-5151
Fax: (646) 837-5150
www.hsgllp.com

James M. McGuire
646-837-5129
jmcguire@hsgllp.com

January 11, 2022

VIA EMAIL

Rebecca M. Morse
Farris LLP
700 W Georgia St #2500
Vancouver, BC V7Y 1B3, Canada

Re: Otso Gold Corporation (Vancouver Registry No. S-2110503)

Dear Ms. Morse:

You have asked me to provide my opinion, as a neutral and independent expert on New York contract law, on specified questions for use in a proceeding involving Otso Gold Corporation, which I understand is captioned in the Vancouver Registry at No. S-2110503. I am keenly aware that my responsibility is to assist the court and not to act as an advocate for any party. I certify that I have written this report and provided my opinion on these questions in conformity with that responsibility. Further, if called upon, I will give testimony in accordance with this duty.

Below, I introduce myself and my background, present the questions asked of me, the bases for my opinions, an overview of the history and the principles that inform the relevant New York law, and my opinions themselves.

I. Background

I am a partner at the law firm of Holwell Shuster & Goldberg LLP in New York City. The primary focus of my practice is complex commercial litigation, which all but invariably entails disputes arising from contractual relationships. I have also served as an arbitrator in four International Chamber of Commerce arbitrations and three American Arbitration Association arbitrations; the disputes in these arbitrations, of course, arose from contractual relationships between the parties.

Before joining Holwell Shuster & Goldberg, I was a partner at Dechert LLP. There, too, the primary focus of my practice was complex commercial litigation. Prior to joining Dechert, I served, from August 2005 to June 2011, as an Associate Justice of the Appellate Division, First Department of the Supreme Court of the State of New York. The Appellate Division is New

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York's intermediate appellate court, sitting between New York's highest court (the Court of Appeals) and New York's principal trial court (the Supreme Court). The Appellate Division is divided into four Departments, each of which hears and determines appeals from orders and judgments entered in specific governmental subdivisions—counties—of New York State. The First Department has jurisdiction over appeals arising from lawsuits commenced in two of New York's sixty-four counties, Bronx County and New York County (Manhattan), the epicenter of complex commercial litigation in New York.

Appeals in the Appellate Division are determined by panels of at least four, but not more than five, Justices. The overwhelming majority of appeals are resolved by memorandum decisions that are issued by the panel, as opposed to "signed opinions"—decisions authored by an individual Justice on behalf of all or a majority of the members of the panel. During my tenure as a Justice of the First Department, I was a member of panels that adjudicated over 2,300 appeals. I estimate that approximately twenty to twenty-five percent of these appeals were commercial contract disputes governed by New York law.

Before my appointment to the bench, I served in a variety of governmental positions, including as a prosecutor in Manhattan and as Chief Counsel to the Governor of New York, and was engaged in the private practice of law at the firms White & Case LLP and Skadden, Arps, Meagher & Flom LLP. At these firms, I worked primarily on complex commercial litigation. I received a B.A. from Fordham University in 1975 and a J.D. from Cornell University Law School in 1980. A copy of my *curriculum vitae* is attached as Exhibit A.

II. Questions

Farris LLP ("Farris") has asked me to render an opinion on the following questions:

1. Do the relevant laws having application in New York State recognize "penalty clauses" in contracts and are such provisions enforceable?
2. What is the legal test for what constitutes a penalty clause and/or what are the hallmarks of a penalty clause under relevant law having application in New York State?
3. Under the relevant law having application in New York State, if a contract contains an unenforceable penalty provision, what are the consequences arising from such clause (and, specifically, if the clause is unenforceable, does it invalidate the entire agreement, or is the offending clause severable such that the balance of the contract remains enforceable)?
4. If a penalty clause renders either the clause or the contract unenforceable, can a party avoid such a determination by seeking to enforce the contractual provision in a different manner than contemplated in the contract such that it does not amount to a penalty?
5. With regard to the agreements between Pandion and the Companies, are there any indicia of a penalty clause, and if so, can you comment on the possible consequences that might arise as a result? For the avoidance of doubt, we are not asking you for your opinion as to whether the agreements between Pandion and the Companies are

enforceable or contain penalty clauses, but are asking if there are any indicia within the agreements that might be interpreted as in the nature of the penalty.

6. Does New York State recognize relief from forfeiture and/or relief from acceleration and, if so, what is the test that courts would apply?
7. As a matter of general law, will New York law permit the admissibility of extrinsic evidence with respect to each or any of:
   a. contractual interpretation questions in cases where the language of the contract is unambiguous;
   b. contractual interpretation questions in the event of ambiguity with respect to the language of the contract; and
   c. the question of whether or not a contractual provision is in the nature of a penalty.
8. As a matter of general law, does New York law recognize the concept that a material variation of a debt between a principal obligor and a creditor without the consent of a guarantor may operate to vitiate or void the guarantee of that obligation?

III. Bases For My Opinions

I have been asked to assume a set of facts. Those factual assumptions ("Factual Assumptions") are set forth in the instruction letter ("Instruction Letter") that I received from Farris, dated January 9, 2022. The Instruction Letter is attached hereto as Exhibit B.

Farris has also provided me with the following documents, which I have reviewed and considered:

A. The Pre-Paid Gold Forward Agreement;

B. The Amendment to the Pre-Paid Gold Forward Agreement;

C. The Maintenance Loan Agreement; and

D. The Consent and Agreement.

Unless otherwise stated, the opinions given herein rely solely on the Factual Assumptions, the documents noted above, and my understanding of, and experience with, New York contract law as a practitioner, arbitrator, and appellate judge. Virtually all of my experience in contract law is with New York contract law.

IV. Opinions

Overview

The Instruction Letter poses various questions relating to New York law's treatment of contractual fixed-damages clauses (a "Fixed-Damages Clause").[1] For the benefit of the Court, as well as to make my opinions as clear as I can, it is important to set forth the bedrock principles of law that underlie New York law's treatment of Fixed-Damages Clauses. New York law on this subject is founded on the common law and is derived from equity jurisprudence. Thus, in a case decided over 130 years ago, the Court of Appeals referred to the "equitable rule which relieves from a penalty and from forfeiture" for breach of contract. *Ward v. Hudson River Bldg. Co.*, 125 N.Y. 230, 234 (1891).[2] In the course of discussing the applicability of the rule to the facts, the Court surveyed decisions in English reports, including a decision by Lord Mansfield. *See id.* at 235 (citing *Lowe v. Peers* (4 Burr. 2228, 2229)).[3]

Freedom of Contract. A first principle of New York contract law is "freedom of contract," one that is "deeply rooted in public policy." *New England Mut. Life. Ins. Co. v. Caruso*, 73 N.Y.2d 74, 81 (1989). "Freedom of contract prevails in an arm's length transaction between sophisticated parties" and "in the absence of countervailing public policy concerns there is no reason to relieve them of the consequences of their bargain." *159 MP Corp. v Redbridge Bedford, LLC*, 33 N.Y.3d 353, 359 (2019) (internal quotation marks and alteration omitted). Accordingly, "when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms." *Goldstein v. AccuScan, Inc.*, 2 N.Y.3d 811, 812 (2004) (internal quotation marks and alteration omitted). New York courts stress the fundamental importance of freedom of contract and its centrality—particularly in the commercial context—to stability and predictability. *See, e.g., 159 MP Corp.*, 33 N.Y.3d at 360 ("[O]ur public policy in favor of freedom of contract

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[1] I use that defined term because New York courts are clear that whatever label may be attached to a Fixed-Damages Clause in a contract—such as liquidated damages, early termination fee, or accelerated debt—the substance, not the label, governs. *See Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 425 (1977) ("In interpreting a provision fixing damages, it is not material whether the parties themselves have chosen to call the provision one for 'liquidated damages', as in this case, or have styled it as a penalty."). This precept is consistent with the grounding of New York's law on Fixed-Damages Clauses in equity jurisprudence. It is, after all, simply another way of articulating the venerable maxim that "[e]quity, . . . looks through mere form to the substance of things." *Zeiser v. Cohn*, 207 N.Y. 407, 419 (1913).

[2] Citations to "N.Y.," "N.Y.2d," or "N.Y.3d" are to decisions of the Court of Appeals; citations to "A.D.," "A.D.2d," or "A.D.3d" are to decisions of the Appellate Division.

[3] Recently, the United States Supreme Court was presented with the question of whether the imposition by the Securities & Exchange Commission of a particular form of disgorgement—the disgorgement of *more* than the net gains of a wrongdoer—was a penalty. The Court exhaustively reviewed decisions by equity courts—and, *inter alia*, the leading treatise, 1 J. Pomeroy, *Equity Jurisprudence* § 101, p. 112 (4th ed. 1918)—and held that it was a penalty. *See Liu v. Securities & Exchange Comm'n*, 140 S.Ct. 1936, 1942–47 (2020). And the Court took note of the "equitable principle that the wrongdoer should not be punished by paying more than a fair compensation to the person wronged." *Id.* at 1943 (internal quotation marks and alteration omitted).

both promotes certainty and predictability and respects the autonomy of commercial parties in ordering their own business arrangements.").

Contracts and Public Policy. Of course, freedom of contract is not absolute. That is, it is subject to competing public policies that will, in certain situations, trump the maxim that contractual provisions are to be enforced in accordance with their plain and unambiguous meaning. As the Court of Appeals explained nearly 100 years ago:

> As a general rule, the validity of a contract is determined by the law of the jurisdiction where made, and if legal there is generally enforceable anywhere. There is, however, a well-established exception to the rule to the effect that a court will not enforce a contract though valid where made if its enforcement is contrary to the policy of the forum.

F. A. Straus & Co. v. Canadian Pac. R. Co., 254 N.Y. 407, 414 (1930). One hornbook example is that New York courts will not enforce or award damages for the breach of contracts that require the commission of illegal conduct. *See McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 469 (1960) ("New York's policy has been frequently and emphatically announced in the decisions [that] '[i]t is the settled law of this State (and probably of every other State) that a party to an illegal contract cannot ask a court of law to help him carry out his illegal object, nor can such a person plead or prove in any court a case in which he, as a basis for his claim, must show forth his illegal purpose.'") (quoting *Stone v. Freeman*, 298 N.Y. 268, 271 (1948)).

Rosado v. Eveready Ins. Co. provides another example. In that case, the Court of Appeals disregarded—indeed, invalidated—a disclaimer of coverage that was based on an unambiguous coverage exclusion in the insurance contact. 34 N.Y.2d 43 (1974). As the Court of Appeals later explained, the disclaimer of coverage was invalidated "as contrary to the public policy underlying our State's legislation requiring compulsory automobile insurance." *Planet Ins. Co. v. Bright Bay Classic Vehicles, Inc.*, 75 N.Y.2d 394, 399 (1990).

Unenforceability of Penalties. Similarly, a provision requiring a "penalty" payment for a contractual breach is unenforceable under New York law because it is void as against public policy. *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n, Inc.*, 24 N.Y.3d 528, 536 (2014) (Damages that "constitute a penalty . . . violate public policy, and are unenforceable.").

Why is enforcing a penalty so contrary to public policy that it overrides the otherwise venerable freedom-of-contract maxim? The Court of Appeals explained why in *Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc.*:

> A clause which provides for an amount plainly disproportionate to real damage is not intended to provide fair compensation but to secure performance by the compulsion of the very disproportion. A promisor would be compelled, out of fear of economic devastation, to continue performance and his promisee, in the event of default, would reap a windfall well above actual harm sustained . . . . [T]o permit parties, in their unbridled discretion, to utilize penalties as damages, would lead to the most terrible oppression in pecuniary dealings.

41 N.Y.2d 420, 424 (1977) (internal quotation marks omitted). Accordingly, "public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority. It is plain that a provision which requires, in the event of contractual breach, the payment of a sum of money grossly disproportionate to the amount of actual damages provides for a penalty and is unenforceable." *Id.* As *Hoag v. McGinnis* explained nearly two centuries ago, although "[t]he fair and just rights of the creditor are worthy of all protection," that protection can extend "no more than the debtor's right to exemption, from what is beyond an honest compensation to his creditor." 1839 WL 3423 (N.Y. Sup. Ct. 1839); *see also Seidlitz v. Auerbach*, 230 N.Y. 167, 173–74 (1920) ("Generally whenever the damages flowing from a breach of a contract can be easily established or where the damages fixed are plainly disproportionate to the injury the stipulated sum will be treated as a penalty. . . . There must be some attempt to proportion these damages to the actual loss. The parties must not lose sight of the principle of compensation.").

This longstanding public policy against the imposition of penalties is now reflected in positive law, including in the statute enacted in virtually all states in America, the Uniform Commercial Code. *See* N.Y. § UCC 2-718(1) ("A term fixing unreasonably large liquidated damages is void as a penalty.").[4]

Equity. As noted above, and as *Truck Rent-A-Ctr.*'s use of the word "forfeiture" in the above quote suggests, the longstanding, unbroken line of precedents establishing that New York courts will not enforce a Fixed-Damages Clause has its roots in equity. "[O]f course, equity abhors forfeitures," and thus "courts will examine the sum reserved under an instrument as liquidated damages to insure that it is not disproportionate to the damages actually arising from the breach or designed to coerce the performance of a party." *Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 577 (1979). Indeed, in refusing to enforce Fixed-Damages Clauses, courts have specifically cited to this equitable doctrine to undergird the penalty determination. *See, e.g., Clean Air Options, LLC v. Humanscale Corp.*, 142 A.D.3d 923, 924 (1st Dep't 2016) ("The late fee, which according to the parties' calculations results in an annual interest rate of 78%, is unreasonable and ***confiscatory*** in nature, and thus unenforceable. Indeed, in opposition to the motion, plaintiffs admitted that the interest at issue was in the form of a penalty.") (internal citations omitted and emphasis added).

Assessing Whether a Fixed-Damages Clause Is a Penalty. The blackletter test is as follows:

> A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced.

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[4] The UCC, of course, is the brainchild of the prominent scholar and professor of jurisprudence (and contract law), Karl Llewellyn.

JMD Holding Corp. v. Cong. Fin. Corp., 4 N.Y.3d 373, 380 (2005) (internal quotation marks omitted).

In other words, a sufficient condition for concluding that a Fixed-Damages Clause is an unenforceable penalty is that the fixed amount is "plainly or grossly disproportionate to the probable loss" or to the actual loss. *Truck Rent-A-Ctr.*, 41 N.Y.2d at 424 ("[A] provision which requires, in the event of a contractual breach, the payment of a sum of money grossly disproportionate to the amount of actual damages provides for a penalty and is unenforceable."). In such a case, it would be of no legal moment whether the quantum of actual loss was "incapable or difficult of precise estimation" at the time of contract formation. *JMD Holding Corp.* 4 N.Y.3d at 380. Similarly, a Fixed-Damages Clause will be deemed a penalty where actual loss could be "readily forecast" at the time of entry into the agreement. *Id.* at 383.[5] This, too, is a sufficient condition for invalidating a Fixed-Damages Clause as a penalty. *Mosler Safe Co. v. Maiden Lane Safe Deposit Co.*, 199 N.Y. 479, 485 (1910) ("It may be observed, generally, that *whenever* the damages flowing from the breach of a contract can be easily established, *or* the damages fixed are, plainly, disproportionate to the injury, the stipulated sum will be treated as a penalty.") (emphasis added).[6]

Under New York law, the party contending that a Fixed-Damages Clause is an unenforceable penalty bears the burden of proof. *See JMD Holding Corp.* 4 N.Y.3d at 380 ("The burden is on the party seeking to avoid liquidated damages . . . to show that the stated liquidated damages are, in fact, a penalty.").

A matter of importance is the point in time at which New York courts determine whether the conditions have been met. The party resisting enforcement of the Fixed-Damages Clause "must demonstrate either that damages flowing from a prospective early termination were readily ascertainable *at the time [the parties] entered into their [contract]*, or that the [damages are] conspicuously disproportionate to these foreseeable losses." *Id.* (emphasis added).

When a contract is one for the payment of money only, assessing whether a Fixed-Damages Clause is an unenforceable penalty is straightforward. For "agreements to pay"—i.e., "contracts

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[5] As used herein, the term "Fixed-Damages Clause" includes provisions that specify a method for determining the amount payable for breach of contract, rather than a particular amount.

[6] Thus, a Fixed-Damages Clause would be invalidated as a penalty when the actual loss can be "readily forecast" at the time of contract even if the fixed amount equals or is less than the amount of actual damages. I am not aware of a decision applying New York law that expressly so states, but that result is implicit in the above-quoted language from *Mosler Safe Co.* Moreover, why it should be invalidated in either situation is clear: There was, *ex ante*, no reason at all for including the Fixed-Damages Clause in the contract. To be sure, where the fixed amount happens to equal the amount of the actual loss, the court might (correctly) hold that the question of whether the Fixed-Damages Clause was a penalty is moot. If the fixed amount is less than the amount of the actual loss, and the Fixed-Damages Clause was not invalidated, that would mean that the New York law on invalid penalty provisions is a one-way ratchet, because it would operate to benefit only the breaching party. And that makes little sense, because the non-breaching party can also be injured by a Fixed-Damages Clause. Contrary to New York law, the non-breaching party would not obtain what it is entitled to—the amount of its actual damages.

for money only"—the "only recoverable damage for breach is interest." *Bi–Econ. Mkt., Inc. v. Harleysville Ins. Co. of N.Y.*, 10 N.Y.3d 187, 193 (2008). Or, as the Court of Appeals stated more than 150 years ago, "[w]here there is a contract to pay money, the damages for its breach are fixed and liquidated by law, and require no liquidation by the parties." *Cotheal v. Talmage*, 9 N.Y. 551, 554 (1854); *see also Scavenger, Inc. v. GT Interactive Software Corp.*, 289 A.D.2d 58, 58–59 (1st Dep't 2001) ("[W]here the breach of contract was a failure to pay money, plaintiff should be limited to a recovery of the contract amounts plus appropriate interest").

A long line of authority provides judges with guidance in such cases: Courts should resolve doubts in *favor* of finding that a Fixed-Damages Clause is an unenforceable penalty. *See City of New York v. Brooklyn & Manhattan Ferry Co.*, 238 N.Y. 52, 56 (1924) ("The tendency of the courts in doubtful cases is to favor the construction which makes the sum payable for breach of contract a penalty[.]"); *Nat'l Telecanvass Assocs., Ltd. v. Smith*, 98 A.D.2d 796, 798 (2d Dep't 1983) ("[W]e are mindful of the admonition that in determining whether a provision in an agreement is to be considered a penalty . . . any reasonable doubt should be resolved in favor of a construction which holds the provision to be a penalty."). As will be evident, courts must make judgments in determining whether a Fixed-Damages Clause is an unenforceable penalty on matters over which, in some cases, reasonable minds could differ. And room for disagreement will be more expansive in determining whether "the amount of actual loss is incapable or difficult of precise estimation" at the time of contract interpretation, *JMD Holding Corp.*, 4 N.Y.3d at 380 (internal quotation marks omitted), and whether "the amount fixed is plainly or grossly disproportionate to the probable loss." *Id.* (internal quotation marks omitted). Thus, this guidance boils down to the idea that, in doubtful cases, the public policy in favor of freedom of contract should yield to the public policy against the imposition of contractual penalties. The Court, however, should be aware that more recently the Court of Appeals has indicated that doubts should be resolved in the opposite direction. *See JMD Holding Corp.*, 4 N.Y.3d at 381. The Court, in this regard, quoted from a decision of a federal appellate court: "The rule (against penalty clauses) hangs on, but is chastened by an emerging presumption against interpreting liquidated damages clauses as penalty clauses.'" *Id.* (quoting X*CO Int'l Inc. v Pacific Scientific Co.*, 369 F.3d 998, 1002–03 (7th Cir. 2004)).

Finally, "[w]hether the [Fixed-Damages Clause] represents an enforceable liquidation of damages or an unenforceable penalty is a question of law, giving due consideration to the nature of the contract and the circumstances." *JDM Holding Corp.*, 4 N.Y.3d at 379; *see also Mosler Safe Co. v. Maiden Lane Safe Deposit Co.*, 199 N.Y. 479, 485 (1910) (the issue of whether a Fixed-Damages Clause is enforceable "is for the court; having regard to the nature of the contract and the circumstances.").

Exemplar Cases. As the Court knows, legal rules can be easily stated and difficult to apply. But New York's law can be illuminated through the lens of several decisions, discussed below.

<u>*City of Rye v. Pub. Serv. Mut. Ins. Co.*, 34 N.Y.2d 470 (1974)</u>:

In this case, real-estate developers, under a plan approved by a City planning commission, had constructed six luxury apartment buildings and were planning to construct six more. To obtain

certificates of occupancy for the six completed buildings, the developers were required to post a bond with the City to ensure completion of the remaining six buildings. *See id.* at 472. By letter agreement, the developers agreed to post a $100,000 bond and to pay $200 per day for each day after April 1, 1971 that the six remaining buildings were not completed, up to the aggregate amount of the bond. *Id.* More than 500 days had passed without the additional buildings having been completed, and the City sought to recover the entire $100,000 amount of the bond. *Id.*

The Court of Appeals, affirming the lower courts, held that the "bond of $100,000 posted by the developers . . . did not reflect a reasonable estimate of probable monetary harm or damages to the city, but a penalty," and thus, could "not be recovered upon." *Id.* The Court's holding that the agreement's Fixed-Damages Clause was an unenforceable penalty turned on a comparison of the amount of the actual or probable harm with the fixed damages ($100,000). The Court, in an opinion written by one of the Court's storied Chief Judges, explained that the harm to the City from delay in constructing the additional six buildings would be "minimal, speculative, or . . . not cognizable" and that "[t]here [was] nothing to show that either the sum of $200 per day or the aggregate amount of the bond bear any reasonable relationship to the pecuniary harm likely to be suffered or in fact suffered." *Id.* at 473.[7]

Trustees of Columbia Univ. in City of New York v. D'Agostino Supermarkets, Inc., 36 N.Y.3d 69 (2020):

In this case, the Trustees of Columbia University entered into a 15-year lease with D'Agostino Supermarkets. *Id.* at 71. Thirteen years into the lease, with D'Agostino facing financial difficulties, the parties entered into a "Surrender Agreement," which terminated the lease in exchange for D'Agostino's surrender of the premises and a series of payments in the aggregate amount of $261,751.73. *Id.* If D'Agostino failed to make the required payments, it would have to pay all future payments that were due under the lease, plus interest and other costs. *Id.* at 72. D'Agostino vacated the premises, and although it made the first two payments (totaling $86,000), it failed to make the four remaining surrender payments. *Id.* Relying on an express provision of the Surrender Agreement, the Trustees sued to recover $1,020,125.15, an amount equal to the sum of the undiscounted sum of all monthly payments due under the terminated lease, interest on that sum, and taxes and costs due under the lease. *Id.*

The Court of Appeals held that the provision of the Surrender Agreement that required D'Agostino, upon a breach of the contract by failing to make one of the surrender payments, to pay the accelerated rent and other amounts, was an "unenforceable penalty because it is plainly disproportionate to the damages for the only contractual breach at issue in this appeal, i.e., overdue payment of the monthly surrender installments." *Id.* at 73. The provision "effectively reinstated [D'Agostino's] future rent liabilities under the terminated lease, . . . plus interest and other prospective taxes and costs due under the lease, even though these damages did not flow from a breach of the surrender agreement." *Id.* at 75. Thus, although the Trustees could "proceed under that [Surrender Agreement] and demand damages for [its] breach,"—including "acceleration of the remaining installment payments"—they could not seek to recover "the more than one million

[7] Notably, the Court made reference to facts extrinsic to the agreement. *See id.* at 474.

dollars plus interest demanded here," an amount that was "grossly disproportionate" to the $175,751.73 unpaid under the surrender agreement. *Id.* at 76. The Court further explained:

> A simple hypothetical further illustrates the penalizing nature of the liquidated damages provision here. According to plaintiff's interpretation of the surrender agreement, if defendant timely made all but the final monthly surrender payment of $15,977.43, defendant's breach would render it liable for $1,020,125.15 plus interest and additional costs. Defendant would be liable for the total amount remaining due under the terminated lease, and defendant would be forced to pay that amount, rather than the final installment, without having had the benefit of the premises which it had surrendered to plaintiff. There is but one way to refer to this outcome: an unenforceable penalty.

Id. at 77. Those damages were "7½ times what [the Trustees] would have received, if [D'Agostino's] had fully complied with the surrender agreement. [The Trustees] cannot enforce a [terminated] lease under the guise of damages for a breach of a separate contract." *Id.* at 75.[8]

With this background, I will now turn to the questions posed in the Instruction Letter.

1. **<u>Question One</u>: Do the relevant laws having application in New York State recognize "penalty clauses" in contracts and are such provisions enforceable?**

As is clear from the foregoing, the answer to this question is that penalty clauses are unenforceable. The "rule is now well established," *Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 425 (1977): If "the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced." *Id.*; *see also Wirth & Hamid Fair Booking v. Wirth*, 265 N.Y. 214, 223 (1934) (The Fixed-Damages Clause "constitute[s] the compensation which, the parties have agreed, must be paid in satisfaction of the loss or injury which will follow from a breach of contract. They must bear reasonable proportion to the actual loss. Otherwise an agreement to pay a fixed sum upon a breach of contract[] is an agreement to pay a penalty, . . . and is unenforceable.").

2. **<u>Question Two</u>: What is the legal test for what constitutes a penalty clause and/or what are the hallmarks of a penalty clause under relevant law having application in New York State?**

As discussed above, the standard under New York law is indisputably the following:

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[8] A Fixed-Damages Clause also is an unenforceable penalty when it applies indiscriminately to both minor and major breaches. *Fifty States Mgmt. Corp.*, 46 N.Y.2d at 577 (If there is "acceleration as a result of a breach of any of [the contract's] terms, however trivial or inconsequential, such a provision is likely to be considered an unconscionable penalty and will not be enforced."). *Trustees* can be viewed as a variant of this line of cases. After all, a breach of the Surrender Agreement could occur at any point in time—i.e., when in economic terms, the breach was a major one or a minor one—but the Surrender Agreement required payment of the same sum regardless of when the breach occurred.

> A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced

JMD Holding Corp. v. Cong. Fin. Corp., 4 N.Y.3d 373, 380 (2005). This standard requires that two questions be answered, albeit not necessarily in the following order. First, is the amount of the actual damages "incapable or difficult of precise estimation" at the time of contract formation? *Id.* Second, does the amount payable under the Fixed-Damages Clause bear a reasonable relation to the probable loss, as estimated at the time of contract formation, or would it be plainly or grossly disproportionate to the probable loss? *Truck Rent-A-Ctr.*, 41 N.Y.2d at 425. (If "the amount fixed is plainly or grossly disproportionate to the probable loss," then "the provision calls for a penalty and will not be enforced.").

One hallmark of an unenforceable penalty clause is that the amount of damages fixed is plainly or grossly disproportionate to the amount of harm suffered (or the probable harm to be suffered) at the time of contract formation. *Id.*

Another hallmark of an unenforceable Fixed-Damages Clause is that it requires the breaching party pay to more than the amount of the actual damages of the non-breaching party. *Seidlitz*, 230 N.Y. at 173–74 ("Generally whenever the damages flowing from a breach of a contract can be easily established or where the damages fixed are plainly disproportionate to the injury, the stipulated sum will be treated as a penalty.").

3. **<u>Question Three</u>: Under the relevant law having application in New York State, if a contract contains an unenforceable penalty provision, what are the consequences arising from such clause (and, specifically, if the clause is unenforceable, does it invalidate the entire agreement, or is the offending clause severable such that the balance of the contract remains enforceable)?**

The answer to this question is not in doubt. If a contract contains an unenforceable Fixed-Damages Clause, the court will *not* invalidate the entire contract. Rather, as the Court of Appeals has explained, "[i]f the clause is rejected as being a penalty, the recovery is limited to actual damages proven." *JMD Holding Corp.*, 4 N.Y.3d at 380. A sea of authority in New York so holds, and I am aware of no New York case holding (or suggesting) otherwise. Indeed, the rule could hardly be otherwise, and the rule apparently—and unsurprisingly—stands throughout the United States. The *JMD Holding Corp.* case cited a widely respected treatise on contract law generally in the United States. *See id.* That treatise explains—and the Court of Appeals quotes the passage in its opinion in *JMD*—that where "a provision is an unenforceable penalty, 'the rest of the agreement stands, and the injured party is remitted to the conventional damage remedy for breach of that agreement, just as if the provision had not been included.'" *Id.* (quoting 3 Farnsworth, *Contracts* § 12.18, at 304 (3d ed)).

4. **Question Four: If a penalty clause renders either the clause or the contract unenforceable, can a party avoid such a determination by seeking to enforce the contractual provision in a different manner than contemplated in the contract such that it does not amount to a penalty?**

No, and this answer is also uncontroversial. A party cannot avoid the legal effect of an unenforceable Fixed-Damages Clause (the award of actual damages and no more) by seeking to recover some lesser sum that is not provided for in the contract. Indeed, that a party cannot so avoid the legal effect of an unenforceable Fixed-Damages Clause is implicit in the incontrovertible rule that "[i]f the clause is rejected as being a penalty, the recovery is limited to actual damages proven." *JDM Holding Corp.*, 4 N.Y.3d at 380. This rule, moreover, is a long-settled one. As the Court of Appeals epigrammatically put it over a century ago: "Either the liability for the liquidated damages exists, or it does not. It cannot half exist and half be waived." *Mosler Safe Co.*, 199 NY at 487.

I note, moreover, that this rule is commanded by a foundational principle of contract law: "[C]ourt[s] will not rewrite the terms of an agreement under the guise of interpretation." *85th St. Rest. Corp. v. Sanders*, 194 A.D.2d 324, 326 (1st Dep't 1993). Rather, as the Court of Appeals has stated, "we have repeatedly applied the familiar and eminently sensible proposition of law that, when parties set down their agreement in a clear, complete document, their writing should be enforced according to its terms." *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475 (2004) (alterations and quotation marks omitted).[9] In addition, a contrary rule would have no limiting principle to determine the extent to which a party can recover more than its actual damages but less than the amount stated in an unenforceable Fixed-Damages Clause. Just as the liability for liquidated damages cannot "half exist and half be waived," *Mosler Safe Co.*, 199 NY at 487, it cannot two-thirds or one-third exist and two-thirds or one-third be waived. I note, too, what the obvious effect would be of a contrary rule. That is, the law would incentivize aggressive efforts to exact more than the amount of damages to which a party would otherwise be entitled, and commercial stability and predictability would be undermined.

5. **Question Five: With regard to the agreements between Pandion and the Companies, are there any indicia of a penalty clause, and if so, can you comment on the possible consequences that might arise as a result? For the avoidance of doubt, we are not asking you for your opinion as to whether the agreements between Pandion and the Companies are enforceable or contain penalty clauses, but are asking if there are any indicia within the agreements that might be interpreted as in the nature of the penalty.**

Yes, in that the Consent Agreement—which is the operative agreement upon which Pandion seeks to recover damages—contains several such indicia that a court applying New York law would examine. For the reasons stated below, I need not and do not offer an opinion on whether any of the other agreements also contain such indicia.

[9] Of course, as noted above, they will not be enforced if doing so would contravene public policy.

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First, based on the Factual Assumptions provided to me, and under the PPF Agreement, the Amendment, and the Maintenance Loan Agreement, Pandion advanced the Companies the following sums of money:

a. $20.6 million under the PPF Agreement.

b. $7 million under the Amendment; and

c. $5,849,030 under the Maintenance Loan Agreement. With accrued interest, this total becomes $ 7,439,395.

Thus, the total amount advanced is $35,039,395. According to the Factual Assumptions and the agreements, Pandion expected to recover on these loans through various payment mechanisms, including by receiving gold at a discount to then-prevailing market prices (a discount of $500 per ounce of gold).

However, on October 7, 2019 the parties entered into the Consent Agreement, which monetizes the various repayment mechanisms—such as the Pre-Paid Gold Amount, and the Upside Right—into a single $23 million loan, to be repaid by the Companies in two $11.5 million installments. *See* 4th Whereas Clause (page 1 of Consent Agreement). The Consent Agreement further makes clear that making these two $11.5 million payments would satisfy the Companies' prior obligations incurred under the PPF Agreement, the Amendment, and the Maintenance Agreement. That is inherent in the definition of the term "Deferred Payment Amounts" in Section 1.2 of the Consent Agreement. It states: '"Deferred Payment Amounts' means the two, equal installment payments of $11,500,000 due on or prior to each of the eighteen-month anniversary of the Deferment Effective Date and the twenty-four month anniversary of the Deferment Effective Date, *which shall satisfy all amounts owing under the PPF Agreement and the Maintenance Loan Agreement subject to the terms and conditions of this Agreement*." (emphasis added).

This provision is decisive. In *Trustees*, as here, the later-in-time agreement settled or otherwise re-financed prior-existing debt. And as the Court explained, "when the lease was in effect, plaintiff could have exercised its rights as the landowner and proceeded against defendant for violating the leasehold terms. Instead, plaintiff negotiated with defendant to terminate the lease in exchange for a set amount of money and surrender of the premises. That contract freed plaintiff from its lessor obligations." *Trustees of Columbia Univ.*, 36 N.Y.3d at 76. The above-quoted language from the Consent Agreement requires the same conclusion here.

Moreover, the language from Section 2.1 is also critical. That Section, titled, in part, "Recharacterization of Obligations," states in subsection (1) that the prior debt (under the PFF Agreement, the Amendment, and the Maintenance Loan Agreement) is "recharacterized and consolidated under this [Consent] Agreement to a [sic] $23,000,000 payable of the [Companies] owing to [Pandion]." Consent Agreement, § 2.1(1). Additionally, consider that subsection (2) of Section 2.1 states that "any payments due" under the PPF Agreement and Maintenance Loan Agreement are "deferred" until the Deferment Termination Date, which is defined, by cross-

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reference, to Section 5.1, which lists various ways under which the Companies could default under the Consent Agreement.

The negative import of this language in subsection (2), when read together with the definition of "Deferred Payment Amounts," is unmistakable: if the Deferment Termination Date never occurs—because the two $11.5 million payments are made—then "any payments due" under the PPF Agreement and Maintenance Loan Agreement are permanently "deferred." Accordingly, subsection (2) reinforces the conclusion that, under the Consent Agreement, the obligation of the Companies to make payments under the PPF Agreement and the Maintenance Loan Agreements are extinguished *if* the Companies make the two $11.5 million payments required under the Consent Agreement.

Second, applying New York law, a court would further take note that the second sentence of Section 2.1 (contained within § 2.1(2) of the Consent Agreement) says that if the Companies fail to make one of the two $11.5 million installment payments, then "[t]he deferment and consolidation granted pursuant to this Section 2.1 shall automatically terminate on the Deferment Termination Date and the Deferred Payment Amounts, together with all other amounts due on such date under this Agreement and the Transaction Documents, shall be immediately due and payable on such date."

This sentence of Section 2.1 is the Fixed-Damages Clause. If the Companies were to default on the Consent Agreement, *see* § 5.1(a), then not only would the Deferred Payment Amounts ($23 million total) come due, but the Pre-Paid Gold Amount and the Upside Right (under the PPF Agreement and Amendment), as well as the Maintenance Loan Amounts, would all become due and owing. This Fixed-Damages Clause is indistinguishable from the one in *Trustees*. As the Court observed, "[t]he damages provision effectively reinstated defendant's [future debt] . . . to the tune of $1,020,125.15." 36 N.Y.3d at 75.

Third, a court would compare (1) the "probable loss," or "amount of actual loss" with (2) the amount liquidated, i.e., the "provision fixing damages." *Truck Rent-A-Ctr.*, 41 N.Y.2d at 424. If the delta between those two numbers is "plainly or grossly disproportionate," then the provision fixing the damages will be deemed a penalty and will not be enforced. *See id.* at 425.

The court would thus look to the Fixed-Damages Clause, to compare the above "probable loss" of $23 million to the amount of damages that the Fixed-Damages Clause dictates. According to the Factual Assumptions, and adding in the Deferred Payment Amounts (which the Consent Agreement expressly says must be repaid as well, *see* § 2.1(2)), the sum is $117,665,401. The delta between these two amounts is $94,665,401 (exclusive of interest). The latter amount is thus over 5 times the amount due under the Consent Agreement. In assessing this delta, a court would surely conclude that a payment of over $117 million is "grossly disproportionate to the amount past due, plus interest." *Trustees of Columbia Univ.*, 36 N.Y.3d at 76.

Fourth, the Surrender Agreement in *Trustees* did not solely involve the payment of money. Rather, D'Agostino's also was required to surrender the premises. But under the Consent Agreement, the only obligation is the payment of money. Thus, the previously discussed line of authority would apply. *See, e.g.*, *Cotheal*, 9 N.Y. at 554 ("Where there is a contract to pay money,

the damages for its breach are fixed and liquidated by law, and require no liquidation by the parties.").[10]

In sum, the Fixed-Damages Clause of the Consent Agreement is an unenforceable penalty provision under New York law. While I am not being asked to opine on whether it is an unenforceable penalty provisions, I believe my obligation to the Court requires that I do. And because it is an unenforceable penalty provision, there is no need to delve into the other agreements to determine whether they contain indicia of a penalty provision.

6. <u>Question Six</u>: Does New York State recognize relief from forfeiture and/or relief from acceleration and, if so, what is the test that courts would apply?

Yes. New York Courts will decline to enforce provisions that accelerate debt if such an acceleration would constitute an unenforceable penalty. *See 172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n, Inc.*, 24 N.Y.3d 528, 536 (2014) ("[A]n acceleration clause is subject to judicial scrutiny based on a challenge that it is nothing more than a means by which to exact a penalty.").

The *Trustees* case is one example. All future payments that were due under the lease would be accelerated and become immediately due and owing if D'Agostino failed to make the required payments under the Surrender Agreement. For reasons already discussed, the Court of Appeals found this accelerating provision to be an unenforceable penalty.

Another example is provided by the Court of Appeals' decision in *172 Van Duzer Realty Corp.* There, the breaching parties maintained that the landowner's acceleration of prospective rent was disproportionate to the landowner's actual damages where the landowner terminated the lease and relet the premises after the premises were vacated. Without deciding whether the amount sought was a penalty, the Court of Appeals held that the defendants were entitled to a hearing to present evidence that the undiscounted accelerated rent was disproportionate to the landowner's actual losses, and thus constituted an unenforceable penalty. *See* 24 N.Y.3d at 536–37.

[10] Notably, a court might also consider that after entry into the Consent Agreement, the Contract Quantity of Gold and the Upside Right were no longer treated by Otso Gold Corporation as debt obligations, in contradistinction to the treatment of those two items by Otso Gold Corporation after entry into the Amendment (when they were both treated as debt obligations)

7. **Question Seven: As a matter of general law, will New York law permit the admissibility of extrinsic evidence with respect to each or any of: (a) contractual interpretation questions in cases where the language of the contract is unambiguous; (b) contractual interpretation questions in the event of ambiguity with respect to the language of the contract; and (c) the question of whether or not a contractual provision is in the nature of a penalty.**

I will address these questions in the order they are stated.

a. Where language of contract is unambiguous

A court will not consider extrinsic evidence where the language of a contract is unambiguous. "A written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Greenfield v. Philles Recs., Inc.*, 98 N.Y.2d 562, 569 (2002). This hoary common-law rule is known as the "parol evidence" rule and it prohibits the use of extrinsic evidence to "add or vary the writing." *Fogelson v. Rackfay Const. Co.*, 300 N.Y. 334, 338 (1950). The purpose of the rule is, in part, to guard against "perjury, infirmity of memory or the death of witnesses." *Id.*

b. Where the language of a contract is ambiguous

A court will consider extrinsic evidence where the language of a contract is ambiguous. "Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous." *Greenfield*, 98 N.Y.2d at 569. A contract is ambiguous only where reasonable minds could come to different conclusions on the meaning of a provision. *See, e.g.*, *Van Wagner Advert. Corp. v. S & M Enterprises*, 67 N.Y.2d 186, 191 (1986) ("In our view, section 1.05 is ambiguous. Reasonable minds could differ as to whether the lease granted a purchaser of the property a right to cancel the lease, or limited that right to successive sellers of the property."). As discussed immediately above, extrinsic evidence is not otherwise admissible, and it may not be used to "create" an ambiguity—rather, only to resolve an ambiguity. *W.W.W. Assocs., Inc. v. Giancontieri*, 77 N.Y.2d 157, 163 (1990).

c. In interpreting a penalty provision

Extrinsic evidence may be used to determine whether a Fixed-Damages Clause is an unenforceable penalty. For example, consider *JMD*. There, the Court of Appeals did look to extrinsic evidence to see whether the party resisting enforcement had met its burden to show that the Fixed-Damages Clause was a penalty, but the Court found the evidence was lacking: "The conclusory affidavit of JMD's president, which relied entirely on the memorandum of law prepared by JMD's attorney, provides no factual basis to support any conclusion that the early termination fee was an unenforceable penalty." 4 N.Y.3d at 385. Moreover, the Court noted that JMD had failed to present other extrinsic evidence. *Id.*

The admissibility of extrinsic evidence to determine whether a Fixed-Damages Clause is unenforceable is not inconsistent or in tension with the parol evidence rule. After all, extrinsic

evidence is relevant only if it sheds light on whether a Fixed-Damages Clause is an unenforceable penalty provision, and it thus does not "add or vary the writing." *Fogelson*, 300 N.Y. at 338. Of course, however, extrinsic evidence will not assist the court whenever it is clear from the four corners of the contract (and related contracts referenced therein) that as a matter of law, the Fixed-Damages Clause is or is not an unenforceable penalty.[11]

8. **Question Eight: As a matter of general law, does New York law recognize the concept that a material variation of a debt between a principal obligor and a creditor without the consent of a guarantor may operate to vitiate or void the guarantee of that obligation?**

Yes. "Because the surety's obligation is distinct, the parties to the underlying contract may not unilaterally augment the surety's liability." *Midland Steel Warehouse Corp. v. Godinger Silver Art Ltd.*, 276 A.D.2d 341, 343 (1st Dep't 2000). As the Court of Appeals has explained, "[a]lteration of the contractual obligation of the principal releases the surety, for the principal is no longer bound to perform the obligation guaranteed by the surety and the surety cannot be held responsible for the failure of the principal to perform any other obligation. The rule is based upon fundamental principles of contract[.]" *Becker v. Faber*, 280 N.Y. 146, 148–49 (1939); *see also Bier Pension Plan Trust v. Estate of Schneierson,* 74 N.Y.2d 312, 315 (1989) (The rationale is that "the creditor and the principal debtor may not alter the surety's undertaking to cover a different obligation without the surety's consent. If they do so the surety is discharged because the parties have substituted a new contract, to which it never agreed, for the original."). In *Becker*, the Court explained that the alteration must be to the detriment of the surety; there the "the surety claim[ed] that unqualified benefit bestowed upon the principal debtor and leniency and consideration shown to the principal debtor discharges the surety. That is not the law of this State." 280 N.Y. at 152.

* * *

I hope the opinions expressed above are of assistance to the Court.

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[11] One wrinkle, albeit not relevant to this opinion, is that extrinsic evidence is admissible even when the Fixed-Damages Clause contains a recitation that ascertaining actual damages is impracticable and extremely difficult, and that the fixed amount is a reasonable estimate of what the actual damages would be. Precisely such a recitation was included in the Fixed-Damages Clause in *JMD Holding Corp.*, *see* 4 N.Y.3d at 379, and the Court of Appeals nonetheless considered extrinsic evidence. The use of extrinsic evidence in such a context does not offend the parol evidence rule, because such a recitation is nothing more than the expression by the parties of a legal opinion on an issue that is the exclusive province of the courts. *See, e.g.*, *Ward*, 125 N.Y. at 234 ("Whether the sum agreed between parties to be paid, in the event of a breach of some agreement, is termed by them a 'penalty' or 'liquidated damages' is not controlling.").

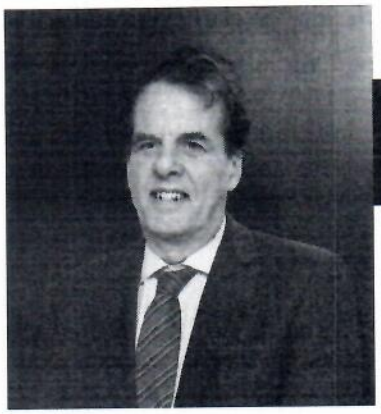
JM

DATED: January 11, 2022
New York, New York

By: _____
James M. McGuire

Exhibit A

HOLWELL SHUSTER & GOLDBERG LLP



JAMES M. MCGUIRE

PARTNER

646.837.8532 | jmcguire@hsgllp.com

Justice James M. McGuire (Ret.) represents clients in securities-related and other complex commercial litigation as well as white collar and regulatory matters. All of his work is informed by deep experience in the judicial and executive branches of New York state government, including his previous service as an appellate and trial court judge.

In private practice, Justice McGuire's extensive experience with securities litigation and enforcement matters includes his successful efforts to secure approval of Bank of America's historic $8.5 billion settlement with investors in failed residential mortgage-backed securities. He also has significant experience representing clients in white collar matters, regulatory proceedings, and bankruptcies. His team's work on a precedent-setting cross-border restructuring—the first case in which federal courts articulated standards applicable to global businesses filing for Chapter 15 bankruptcy—earned distinction in the *Financial Times*'s Top U.S. Innovative Law Firms competition.

Justice McGuire has argued appeals before the New York State Court of Appeals and other appellate courts. His current appellate practice includes representing two major insurers in their appeal, along with other insurers in excess of $250 million in a coverage dispute arising from an SEC disgorgement payment made by the insured financial institutions, and representing the issuer and guarantors of a $150 million debt issuance in an action brought by dissident holder of a small minority of the debt.

He has served as an arbitrator in four ICC arbitrations and three AAA arbitrations. He also has acted as mediator in cases before the United States District Court for the Southern District of New York.

His extensive government service includes, most recently, his tenure as an associate justice in the First Judicial Department of New York State's Appellate Division and, before that, as a justice in the 11th Judicial District for the Supreme Court of the State of New York.

Justice McGuire also previously served as New York Gov. George E. Pataki's chief counsel, a role in which he advised the governor on all legal issues affecting the state, including those arising from the 9/11 terrorist attacks. Earlier, he served as First Assistant Counsel to the Governor, where his responsibilities included advising on criminal justice legislation.

Before joining Holwell Shuster & Goldberg, Justice McGuire served as a partner with Dechert LLP. He also previously practiced at White & Case LLP and Skadden, Arps, Meagher & Flom LLP.

NOTABLE CASES

- Lender entities of major financial institution on a successful appeal of an order that would have permitted debtor, contrary to forum selection clause, to litigate the validity of a $120 million loan in its chosen forum.
- The Bank of New York Mellon, as trustee of residential mortgage-backed securitization trusts, in litigation successfully securing approval of a $8.5 billion settlement with Bank of America Corp. in connection with 530 RMBS trusts.
- An ad hoc group of creditors in connection with the highly contested cross-border restructuring of approximately $1.6 billion in defaulted senior notes issued by Mexico's largest glass manufacturer, Vitro S.A.B. de C.V.
- A New York real estate investor in connection with a complex commercial dispute concerning the control of several national nursing-home companies and related fiduciary duty claims against the operating companies' owners.
- Then-Gov. George Pataki in landmark litigation between the governor and legislature over their respective constitutional roles in the budget process.
- The New York County District Attorney's Office, for which he argued and supervised appeals before state and federal appellate courts as Deputy Chief Counsel of the Appeals Bureau.

GOVERNMENT SERVICE

- Associate Justice of the Appellate Division, First Judicial Department (Aug. 2005 – Jun. 2011)
- Justice of the Supreme Court for the State of New York, Eleventh Judicial District (Jan. 2005 – Aug. 2005)
- Chief Counsel to Governor George Pataki, New York State (Oct. 1997 – Mar. 2003)
- First Assistant Counsel to Governor George Pataki, New York State (Jan. 1995 – Oct. 1997)
- Deputy Chief Counsel of Appeals Bureau & Senior Counsel of the Rackets Bureau, New York County District Attorney's Office (Aug. 1989 – Jan. 1995)
- Deputy Chief Counsel, New York State Commission On Government Integrity (Aug. 1987 – Aug. 1989)
- Assistant District Attorney, New York County District Attorney's Office (Aug. 1980 – Aug. 1985)

EDUCATION

- Cornell University Law School (J.D., *cum laude*, 1980)
- Fordham University (B.A., *magna cum laude*, 1975)

BAR AND COURT ADMISSIONS

- New York
- U.S. Court of Appeals, Second Circuit
- U.S. District Court, Eastern District of New York
- U.S. District Court, Southern District of New York

Exhibit B

Reply Attention of: Rebecca Morse
Direct Dial Number: 604 661 1712
Email Address: rmorse@farris.com

FARRIS

File No: 44737-0001-0000

January 9, 2022

BY EMAIL

Holwell Shuster & Goldberg LLP
425 Lexington Avenue
New York, New York 10017

Attention: James McGuire/Brian Goldman

Dear Sirs:

Re: Re: Otso Gold Corp. (Vancouver Registry No. S-2110503) (the "CCAA Proceeding")

We are counsel for Otso Gold Corp., Otso Gold Ab, and Otso Gold Oy (the "Companies"), which are Petitioners in the CCAA Proceeding. Among the matters at issue in the CCAA is the quantum of debt owing from some or all of the Companies to their secured creditor, Pandion Mine Finance Limited and PFL Raahe Holdings LP (together, "Pandion").

We would like you to provide a written expert report for use in the CCAA Proceeding relating to certain contractual issues related to the agreements between the Companies and Pandion.

Form of Report

In respect of your report, there are a variety of technical rules that should be followed in order for it to be admissible at a trial of this matter. We will work with you as needed during your drafting process to ensure that the technical requirements are met. For present purposes, we ask that you plan to include the following in your report:

- Your name, address, and present employment;
- A brief description of your professional qualifications, as well as your relevant work experience and education. In addition, you should include a current version of your C.V. as an attachment to your report;
- A description of the issues on which your opinion is being sought. In particular, I ask that you please respond to the questions set out below in this letter; and
- Your opinion in respect of each question, together with an explanation of the reasons for your opinion. This should include:
    - A description of the facts on which your opinion is based;
    - A description of any investigation conducted by you that led you to form your opinion;

- A description of any research conducted by you that leg you to form your opinion; and
- A list of any document that you have reviewed that led you to form your opinion.

Your role in this engagement is to act as a neutral and independent expert to assist the court, and not as an advocate for any party, including our clients. Please include in your written report a statement certifying that you are aware that your responsibility is to assist the court and not act as an advocate for any party and that you have written your report and provided your opinion in conformity with that responsibility.

Questions for your Opinion

1. Do the relevant laws having application in New York State recognize "penalty clauses" in contracts and are such provisions enforceable?

2. What is the legal test for what constitutes a penalty clause and/or what are the hallmarks of a penalty clause under relevant law having application in New York State?

3. Under the relevant law having application in New York State, if a contract contains an unenforceable penalty provision, what are the consequences arising from such clause (and, specifically, if the clause is unenforceable, does it invalidate the entire agreement, or is the offending clause severable such that the balance of the contract remains enforceable)?

4. If a penalty clause renders either the clause or the contract unenforceable, can a party avoid such a determination by seeking to enforce the contractual provision in a different manner than contemplated in the contract such that it does not amount to a penalty?

5. With regard to the agreements between Pandion and the Companies, are there any indicia of a penalty clause, and if so, can you comment on the possible consequences that might arise as a result? For the avoidance of doubt, we are not asking you for your opinion as to whether the agreements between Pandion and the Companies are enforceable or contain penalty clauses, but are asking if there are any indicia within the agreements that might be interpreted as in the nature of the penalty.

6. Does New York State recognize relief from forfeiture and/or relief from acceleration and, if so, what is the test that courts would apply?

7. As a matter of general law, will New York law permit the admissibility of extrinsic evidence with respect to each or any of:

   a. contractual interpretation questions in cases where the language of the contract is unambiguous;

   b. contractual interpretation questions in the event of ambiguity with respect to the language of the contract; and

   c. the question of whether or not a contractual provision is in the nature of a penalty.

8. As a matter of general law, does New York law recognize the concept that a material variation of a debt between a principal obligor and a creditor without the consent of a guarantor may operate to vitiate or void the guarantee of that obligation?

Factual Assumptions

For the purpose of your opinion, please assume the following facts are true:

1. All references to funds below are in USD, unless otherwise noted.

2. Pursuant to a Pre-Paid Gold Forward Agreement (the "PPF Agreement") dated November 10, 2017 Pandion advanced a total of $20.6 million (the "Initial Advance") to Otso Gold Corp. (then known as Firesteel Resources Inc.).

3. Pursuant to the PPF Agreement:

    a. Otso Gold Corp. was to provide a fixed amount of gold (the "Contract Quantity of Gold") on a monthly basis, commencing 18 months from the date of the PPF Agreement;

    b. The Initial Advance would be repaid by a way of deliveries of the Contract Quantity of Gold, and by giving Pandion a discount of $500/oz from the prevailing market price;

    c. In the event any amounts were not paid when due, interest would accrue at LIBOR +2%, compounding annually;

    d. Pandion received an upside participation right (the "Upside Right"), pursuant to which Otso Gold Corp. agreed to pay Pandion, for the later of 68 months or the last month in which Otso was required to deliver the Contract Quantity of Gold, the product of:

        i. 50% of the amount of gold required to be sold in that month for the duration of the Gold Delivery Period; and

        ii. The difference between the prevailing market price at the time of the payment (the "Settlement Price") and the Base Spot Price which, at the time of the PPF Agreement, was $1,234.50/oz;

    e. If the price of gold dropped below $160/oz, then:

        i. Pandion could purchase an additional 10 oz of gold each delivery period; and

        ii. The parties would agree on a reduced price for the gold delivery

        (the "Minimum Price Adjustment");

    f. Pandion had the right to convert 24,000 oz of the Contract Quantity of Gold to equity in Otso Gold Corp. (the "Conversion Right");

g. Otso Gold Corp. had the right to terminate the agreement, and, on doing so would be required to pay the following (collectively, the "PPF Early Termination Amount"):

   i. The amount of undelivered amount of the Contract Quantity of Gold times $500/oz, minus any Minimum Price Adjustment (the "Pre-Paid Gold Amount");

   ii. The full value of any Conversion Right exercised by Pandion;

   iii. The full value of the Upside Right for its entire term net of any payments made thereunder, calculated using the Settlement Price as of the date of Early Termination;

h. Upon the occurrence of an event of default, Pandion could demand repayment of the Early Termination Amount;

4. The Early Termination Amount does not contain a present value calculation for any of its component amounts;

5. In October, 2018 the parties amended the PPF Agreement (the "Amendment"). Pursuant to the Amendment:

   a. Pandion advanced a further $7 million, for a total amount advanced pursuant to the PPF Agreement of $27.6 million;

   b. Pandion received a fee of $1.5 million (the "Buyer Fee");

   c. The Contract Quantity of Gold was increased by approximately 23,155 oz;

   d. The Conversion Right was removed;

   e. Pandion received a non-dilution right, requiring Otso Gold Corp. to issue shares after any equity raise to maintain Pandion's share ownership at 19.9%;

   f. The Base Spot Price was fixed at $1,200/oz; and

   g. Pandion received a Net Smelter Royalty Agreement (the "NSR") entitling it to a 2.5% royalty;

6. Beginning with its fiscal 2018 audited financial statements and ending with the management prepared quarterly financial statements for the quarter ended July 31, 2019, Otso Gold Corp. recorded the obligations pursuant to the PPF Agreement as a derivative liability at fair value. At each period end, the derivative liability was re-measured at fair value with any associated increase or decrease to the derivative liability recorded as a gain or loss on the Statement of Operations (income statement). As the derivative liability increased during the pre-production phase of the Laiva Mine, Otso Gold Corp. generated losses, which resulted in negative shareholders' equity (a deficit).

7. Pandion and the Companies also entered into a Maintenance Loan Agreement (the "Maintenance Loan Agreement"). Pursuant to the Maintenance Loan Agreement:

    a. Pandion agreed to advance up to $350,000/month; and

    b. The amounts advanced were repayable upon demand;

8. Pandion calculates that the present amount owing is $7,439,395 (the "Maintenance Loan Amounts"), consisting of the following:

    a. $5,849,030 in advances; and

    b. $1,590,365 in accrued interest;

9. Pursuant to a Consent and Agreement dated October 7, 2019 (the "Consent Agreement") as subsequently amended, the Companies and Pandion agreed:

    a. That the amounts owing under the PPF Agreement and the Maintenance Loan Agreement could be repaid in full by an initial payment of $1.56 million, followed by two payments of $11.5 million (the "Deferred Payment Amounts");

    b. On the failure of the Companies to repay the Deferred Payment Amounts by December 7, 2021 or on the initiation by the Companies of any insolvency proceeding (an "Early Termination Event"), then:

        i. The full Deferred Payment Amounts are immediately due and payable; and

        ii. The full amounts owing pursuant to the Maintenance Loan Agreement and the PPF Agreement, including the Early Termination Amount (the latter including the Pre-Paid Gold Amount and the Upside Right) are immediately due and payable.

10. Beginning with the management prepared quarterly financial statements for the quarter ended October 31, 2019, Otso Gold Corp. recorded the obligations from the Amended PPF Agreement as two distinct liabilities:

    a. A loan including any accrued interest to date as a non-current liability. At each quarter end the loan was fair valued.

    b. A royalty provision with both a current and non-current liability portion. At each quarter end this royalty provision was fair valued.

11. The management prepared quarterly financial statements for the quarter ended October 31, 2019 stated that upon the restructuring of the PPF Agreement pursuant to the Consent Agreement the pre-existing gold forward derivative liability should be updated to fair value prior to derecognition and the fair value of the royalty provision and the Pandion debt compared to that value with the resulting gain recorded in the Statement of Operations (income statement). The resulting gain

recorded on the Statement of Operations (in the amount of $52.0 million) resulted in positive shareholders' equity.

12. The Companies did not pay the Deferred Payment Amounts on December 7, 2021 and filed for insolvency protection on December 3, 2021;

13. Pandion now asserts that the Maintenance Loan Amounts, the Pre-Paid Gold Amount, and the Upside Right are immediately due and payable, and that the amounts of each are the following:

    a. $1,500,000 in respect of the Buyer Fee;

    b. $7,439,395 in respect of the Maintenance Loan Amounts;

    c. $46,557,550 in respect of the Pre-Paid Gold Amount; and

    d. $39,168,456 in respect of the Upside Right.

14. The Royalty Agreement remains in force, and Pandion remains a shareholder of Otso Gold Corp.

Documents

We have delivered to you:

1. The PPF Agreement;

2. The Amendment;

3. The Maintenance Loan;

4. The Consent Agreement; and

5. Pandion's calculation of its indebtedness.

If there are any further documents you require for your review, please let us know.

Scheduling and Other Matters

This evidence is required for use in a Court hearing to take place January 14, 2022. That means that your report will need to be served by 4pm (Pacific time) January 11, 2022. We request your opinion in draft by January 10, 2022 in order to prepare an execute an affidavit by the deadline.

Yours truly,

FARRIS LLP

Per:

FOR Rebecca M. Morse*
*Denotes a Professional Law Corporation

RMM/TLG