CITATION: Eureka 93 Inc. et. al. (Re), 2020 ONSC 6036
COURT FILE NO.: 33-2618511
DATE: 2020/10/05

COURT OF ONTARIO,
SUPERIOR COURT OF JUSTICE
(IN BANKRUPTCY AND INSOLVENCY)

AND IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF EUREKA 93 INC. OF THE CITY OF OTTAWA IN THE PROVINCE OF ONTARIO

AND IN THE MATTER OF THREE RELATED INTENDED PROPOSALS (LIVEWELL FOODS CANADA INC., ARTIVA INC., AND VITALITY CBD NATURAL HEALTH PRODUCTS INC.)

AND IN THE MATTER OF SECTION 192 OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985, c. C-44, AS AMENDED, AND IN THE MATTER OF A PROPOSED ARRANGEMENT OF 12112744 CANADA LIMITED AND INVOLVING LIVEWELL FOODS CANADA INC. AND ARTIVA INC.

BEFORE: Mr. Justice Calum MacLeod

COUNSEL: Elliot Birnboim & Michael Crampton, for Dominion Capital LLC (noteholders)

Eric Golden for the Proposal Trustee

E. Patrick Shea & Benoit Duchesne, for the debtors

Andrew Lenz for PR, creditor

Barbara VanBunderin, for first mortgagee

HEARD: September 18, 2020

DECISION AND REASONS

[1] This is the latest in a series of hearings focused on the insolvency of Eureka 93 Inc. and its subsidiaries. As outlined in earlier sets of reasons, the matter first came before the court in March of this year as a set of intended proposals.[1]

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[1] See 2020 ONSC 1482, 2020 ONSC 2532, 2020 ONSC 4415 and 2020 ONSC 4703. In addition, there were directions resulting from case conferences and an unreported order for security for costs.

[2] The current motion is an appeal by the noteholders from the Trustee's disallowance of certain claims of the noteholders pursuant to s. 135 (4) of the *BIA*. I am asked by the noteholders to find that Dominion Capital as the representative of the noteholders is the major unsecured creditor in each of the intended proposals.

[3] The proposal of Eureka 93 was already defeated and that corporation is now in bankruptcy. Two other proposals were approved by the creditors but if the appeal is upheld and the votes of Dominion are counted, those proposals would have been defeated. Of particular urgency is the proposal of Artiva Inc. as it is the only entity with an operating business.

[4] That business hangs by a thread. The facility is operating. Crops of cannabis plants are under cultivation. There have been some sales and certain contracts are pending but the DIP financing is now exhausted and the patience of the first mortgagee is finite. If the proposal is approved then an arrangement under the *CBCA* will also be approved and Artiva Inc. may attempt to rehabilitate itself under the proposal process. If the votes of Dominion are counted, the proposals fail and bankruptcy ensues.

[5] There has never been any doubt that the noteholders are owed more than $8.5 million by Eureka 93 Inc. and there has never been any doubt that Eureka pledged assets of its subsidiaries as security. The noteholders hold a debenture registered against the Artiva lands (with a face amount of $48 million). But the pertinent question is whether Artiva owes any unsecured debt to the noteholders. As I will describe, the Trustee has valued the security at $0 and concluded that Artiva Inc. is not indebted to the noteholders so that the noteholders are neither secured nor unsecured creditors in the Artiva proposal.

[6] For the reasons that follow, I generally accept the calculations of the Trustee with one minor exception. I find that Artiva Inc. does have residual indebtedness under the guarantee and the amount of that debt is US$828,000.00 plus interest.

<u>Background</u>

[7] A brief summary of the pertinent facts is necessary. I need not do a deep dive into the history of the matter or the precise nature of debt instruments, reverse takeovers or the corporate structure except to the extent that it bears on the narrow question of who owes the noteholders money and how much is owed.

[8] Eureka 93 Inc. (formerly LiveWell Canada Inc.) was intended to be a vertically integrated North American health sciences company focused on growth and sale of legal cannabis and cannabis and hemp-based products. In the course of its development and expansion between 2014 and 2019 it created or acquired various subsidiaries.

[9] The current insolvency proceedings involve Eureka 93 Inc. itself, ("Eureka" for purposes of these reasons), Livewell Foods Canada Inc. ("Livewell"), Vitality CBD Natural Health Products Inc. ("Vitality") (both direct subsidiaries of Eureka) and Artiva Inc. "Artiva") (a subsidiary of Livewell). All of these are Canadian corporations and the subject of intended proposals under the *Bankruptcy and Insolvency Act.* ("*BIA*"). As noted above, the Eureka proposal has failed and is now a bankruptcy. The Livewell/Artiva proposal and the Vitality proposal have been approved

by the creditors only because the claim of the noteholders to rank as an unsecured creditor in those proposals was disallowed by the Proposal Trustee.

[10] Artiva owns a licenced cannabis production facility which is in essence a greenhouse operation located on farmland in the City of Ottawa. In March of this year the court approved DIP financing so that Artiva could borrow additional funds needed to complete the greenhouses and to begin cannabis production. The Artiva land is subject to the DIP financing and to a first mortgage in favour of Olympia Trust and amongst other encumbrances, it is also subject to a second mortgage or charge in favour of the noteholders.

[11] The noteholders are venture capital companies or lenders based in the United States represented in these proceedings by their collateral agent, Dominion Capital LLC ("Dominion"). In February of 2019 Eureka was in the process of acquiring facilities in New Mexico and Montana. It was at this point that the noteholders first became involved. There is no doubt at all that the noteholders advanced US$3,000,000.00 to Eureka in February of 2019. Those funds were intended to be used to complete the purchase of the New Mexico facility. There is no doubt that Eureka pledged assets of certain of its subsidiaries as collateral. There is also no doubt that the noteholders advanced another US$12,000.000.00 in March of 2019 although it appears that a portion of that (US$3.6 million) was held in escrow and subsequently returned.

[12] The loans to Eureka were structured as security purchases. The noteholders received or were supposed to receive convertible promissory notes and warrants, shares and other debt instruments. They were also to receive security. Notably, they were to receive a first mortgage on the New Mexico facility, a first priority security over the Montana facility, certain guarantees and general security agreements and a charge on Artiva's land.

[13] It is fair to say that the security documents prepared at the time are imperfect and confusing. In some instances, the documents refer to paragraphs or schedules that appear to be missing and in other instances the documents are cross referenced. Despite this, the parties, who are sophisticated commercial parties served by experienced commercial law firms, acted on these documents and formalized them. Each of the documents contains complete agreement provisions indicating that no reliance may be placed on representations or negotiations not reflected in the documents. There is a distinct lack of clarity as to how the February loans and the March loans are interrelated and as I will discuss, there is significant disagreement whether guarantees signed by subsidiaries in February also cover the larger advances to Eureka that occurred in March.

[14] In July of 2019 Eureka was listed on one and then another of the junior Canadian stock exchanges but its financial situation was deteriorating. By the end of 2019 there was an exodus of directors and officers, there was a stop trading and delisting order, and Eureka was in default of significant obligations.

[15] The Montana facility was surrendered to another secured creditor under circumstances which the noteholders regard as highly suspicious and improper and to the detriment of security the noteholders had been promised and thought that they held. The Montana facility is irrelevant to this appeal but it is part of the backstory, a significant driver of conflict between the noteholders and the debtors and a major engine of mistrust.

[16] In December of 2019, Eureka proposed to the noteholders that instead of mortgaging the New Mexico facility to the noteholders, Eureka should simply surrender ownership to Dominion. The proposal was accepted. Dominion became the owner of the New Mexico facility and it wrote down the Eureka debt by US$3,000,000.00 to be applied to the "obligations outstanding under the Notes and other Transaction Documents in accordance with Exhibit B."

[17] It is undisputed that as a consequence of the debt for land New Mexico swap, the parties agreed that the overall debt owed by Eureka to the noteholders was reduced from US$11.4 million to US$8.4 million. Now the noteholders dispute the value of the New Mexico facility and they purport to charge interest and penalties which more than double the debt.

[18] To round out the narrative, whether Eureka 93 owes the noteholders US$8.4 million or CDN$2.5 million or the intermediate number allowed by the Trustee is largely academic. There is no doubt that Dominion on behalf of the noteholders is the largest unsecured creditor of Eureka and voted against the Eureka proposal. As such, there will be new proofs of claim filed in the bankruptcy and a new process for establishing the precise amount of the debt and accrued interest. Although the partial disallowance by the Proposal Trustee was appealed, I agree with the Proposal Trustee that the appeal in the Eureka proposal is now moot. The proposal was defeated.

[19] In the Artiva proposal, it is common ground that the value of Dominion's security is $0 because the land value is less than the amount outstanding on the first mortgage and the DIP financing. This of course was not the situation presented to the court at the time the DIP financing was approved but there is no reason to believe that the new appraisal of the land is overly pessimistic. Since the security is worthless, any claim by the noteholders against Artiva depends on proving that the noteholders are an unsecured creditor. That in turn requires that Artiva is liable for some or all of the Eureka debt. The situation is similar for Vitality except that Vitality has even less in the way of assets.

[20] The critical question is whether the subsidiary corporations that are also making proposals are or are not indebted to the noteholders and the extent of those debts if so. At the time of the February notes, Artiva owned farmland in Ontario. That land is subject to a first mortgage in favour of Olympia Trust. It is undisputed that Artiva signed a guarantee for the $3 million debt of Eureka represented by the February notes and secured the guarantee by a debenture registered as a second mortgage in favour of the noteholders. The nominal amount of the debenture or collateral mortgage was $48 million.

[21] At the time of the March notes, Artiva did not sign a new guarantee. Artiva did pledge its land as security for the Eureka debt and it is common ground that if there is equity in the land owned by Artiva, the noteholders would be secured creditors. As I have previously described, at the time the motion was before me to extend the time for making proposals and to approve the DIP financing, the only evidence of the value of the land was a valuation of $15 million. Unfortunately, a subsequent evaluation in June of this year indicated that the value is now $9 million. The Trustee therefore valued the security at $0.

[22] The noteholders ultimately chose not to challenge the $9 million appraisal or the $0 assessment of the value of the security. As a consequence, the security is worthless (as it ranks behind the DIP financing and the first mortgage). The noteholders therefore filed claims as

unsecured creditors in the Artiva proposal. That claim was disallowed. The Trustee concluded that Artiva Inc. did not owe a debt to the noteholders.

[23] For similar reasons, the Trustee concluded that the other subsidiaries which signed the February Guaranty did not guarantee the March notes. It should be noted that in February, the subsidiaries of Eureka not only signed guarantees but also signed joinders indicating they were debtors under the February security agreement. No such paperwork was completed at the time of the March advance although there were new security agreements signed by Eureka.

[24] There are two logical explanations for the failure to sign guarantees and joinders in March. One explanation is the interpretation put forward by the noteholders that the February guarantees were continuing guarantees for future debts of Eureka and it was unnecessary. The other explanation is that while guarantees were demanded and given for the February advance, they were neither demanded nor given at the time of the March advance and the March investments were secured in a different manner than those in February.

[25] In any event, the position of the noteholders in relation to the proposals in which their proofs of claim were rejected depends upon the court accepting their argument that the correct interpretation of the February security documents is to render the subsidiaries liable for future debts of Eureka. To be more precise, it depends upon the court determining that the decision of the Trustee to reject the proofs of claim is incorrect and unreasonable.

<u>The Standard of Review</u>

[26] There is some debate about whether an appeal under s. 135 (4) should be treated as a true appeal or be considered *de novo* and whether the decision of the Trustee should be reviewed on a standard of correctness or reasonableness. I agree with the analysis of Master Mills sitting as a Registrar in Bankruptcy in *Re Charleston Residential School*.[2] As stated in paragraphs 13 – 18, the *BIA* is intended to operate in an efficient and cost-effective manner. The Trustee as an officer of the court is required by the Act to carefully examine each proof of claim and to act equitably in deciding whether to allow or disallow a claim[3]. There is a positive obligation on the creditor to prove its claim in the first instance and the determination of the Trustee is entitled to considerable deference. While the court has the discretion to consider the matter *de novo* if it is necessary to prevent an injustice, and a Trustee is an administrative official and not a court, this is an appeal and the onus is on the appellant to show that the decision of the Trustee should be disturbed.

[27] In this case, the assessment by the Trustee hinges primarily on the interpretation of debt instruments and security documents rather than investigation of underlying facts so correctness would be the appropriate standard. While the noteholders also allege bias as a ground of appeal, that allegation is essentially a complaint that the Trustee unreasonably accepted the position of the debtor and did not fairly assess the position of the noteholders. Under the circumstances the validity of that allegation depends on whether or not the position of the Trustee is correct in law or a reasonable exercise of the Trustee's authority and power. If the Trustee was incorrect and

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[2] 2010 ONSC 4099

[3] The particular role, duty and status of a Trustee is discussed in many cases. See for example *Farber v. Goldfinger,* 2011 ONSC 2044

unreasonable, that may sustain an allegation of bias but if I find that the Trustee was correct and reasonable, it will be unnecessary to consider bias for purposes of this appeal.

[28] I will just note, that the question of bias relates to the conduct of the Trustee in assessing the proofs of claim. It is not to be conflated with the manner in which Trustee's counsel argued the appeal. I see nothing intrinsically unfair or improper in Trustee's counsel asking or permitting the debtor's counsel to present much of the argument. That Mr. Shea took the lead in argument rather than Mr. Golden, should not lead to the conclusion that the Trustee is improperly aligned with the interests of the debtor and has not properly considered the matter.

Analysis

[29] I agree with the Trustee and I disagree with the noteholders in their interpretation of the February 14th guarantee. That document is a guarantee of the US$3 million which was the obligation owing at that time pursuant to the Securities Purchase Agreement. The description of the Agreement or of the Promissory Notes as including any notes or other securities "issued in in exchange or substitution therefore" and as "amended, supplemented, restated or modified" is fairly standard language dealing with the replacement of commercial paper and relates to the provisions for replacement of securities in the Securities Purchase Agreement. That language does not suggest an open ended guarantee of future debts.

[30] Similarly, the inclusion of language including in the guarantee all "interest, make-whole, redemption and other amounts" refers to interest and penalty attaching to the debt. There is language that protects the right of the noteholders to continue to enforce the principal together with interest and penalties accrued after the insolvency of the principal debtor. It does not refer to future debts. To the contrary, section 8 of the Guaranty makes it clear that it is a limited guarantee and contemplates that the guaranteed obligations may "exceed the amount of the liability of the Guarantor hereunder".

[31] Interpretation of the Guaranty is not assisted by the fact that the obligation is supposed to be set out in what appears to be a non-existent section of the Security Agreement. Nevertheless, the Guaranty has an entire agreement clause and it would take very clear language to include future debts of Eureka that did not exist when the Guaranty was given.

[32] Contractual interpretation in Canada is contextual and the surrounding circumstances are always relevant. The leading case is *Sattva Capital Corp v Creston Moly Corp*.[4] Though *Sattva* affirms that the factual matrix is always relevant and contractual interpretation is not purely a legal exercise, it also sets parameters. In particular, the Supreme Court affirms the continued existence of the parol evidence rule and the irrelevance of the subjective intent of individual contracting parties. The role of surrounding circumstances is confined to informing the interpretation of the document. In paragraph 57 of the decision, the court states as follows:

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[4] 2014 SCC 53, [2014] 2 SCR 633

> [57] While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and Hall, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (Hall, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.

[33] In the face of complete agreement language and in the absence of ambiguity in the document that can only be understood by reference to term sheets, negotiations or industry practice, the surrounding circumstances cannot be used to repair drafting deficiencies or to add terms that are not included. I agree with the Trustee that the guarantee by the subsidiaries does not include language converting what purports to be a limited guarantee into an unlimited guarantee.

[34] It is true that the debenture given by Artiva and registered as a second mortgage contemplates future debt obligations. That is consistent with the face amount of the mortgage being $48 million. But the debenture is not itself a debt. Rather it is security for the lesser of $48 million or the "amount of the obligations". The obligations are the debts owed by Artiva to the "Agent, the Purchasers and the Noteholders" including the obligation arising under the Guarantee. This is an essentially circular reference to debts incurred or assumed by Artiva and does not create unsecured debt. It is a collateral mortgage. There is no independent debt obligation contained within it.

[35] The Securities Purchase Agreement of February 14th to which Eureka and Vitality are signatories but not Artiva, does contemplate future advances. It does so in a number of ways. Firstly, the agreement speaks of an initial closing date and a second closing date. The second closing date only applies if the noteholders (purchasers) elect to purchase the second notes and the second warrants and there are other contingencies and conditions attached to that exercise of rights. Secondly, the purchasers have a right to participate in any further financing and have a right to provide up to 20% of such future financing.

[36] It is entirely unclear whether either of these terms applied to the March investment. The March investment was pursuant to a fresh Securities Purchase Agreement dated March 20, 2019. It did not purport to be pursuant to the February agreement. There was no guarantee signed in March. The subsidiaries, Vitality and Artiva did sign a general security agreement pledging their assets as security for the new debt taken on by Eureka but no new guarantee.

[37] I agree with the Trustee's analysis that Vitality and Artiva gave guarantees for the first US$3 million and gave security for the March investment of US$12 million but did not guarantee the latter amount. It follows that if there is no exigible security, the noteholders only rank as unsecured creditors to the extent that any of the guaranteed amount remains outstanding.

[38] This is not the end of the analysis, however. The Trustee also determined that there was no amount of the US$3 million currently outstanding. He came to this conclusion on the basis of the $3 million credit given for the transfer of the New Mexico facility.

[39] There is no doubt that Dominion accepted the New Mexico facility and wrote down the debt by $3 million. It does not necessarily follow that the $3 million was the February advance and eliminates the debt that was guaranteed. That is because the letter setting out the terms of the agreement identifies the entire debt owing under both the February and March notes as US$11.4 million and writes it down to US$8.4 million in the aggregate. One of the terms of the agreement was that the $3 million would be accepted "as partial payment under the Notes (which may be allocated to all amounts due under the Notes as the Holders may each decide in accordance with and as provided in the Transaction Documents)" So it was open to the noteholders to apply the payments to any note they chose and I do not agree with the Trustee that in the face of this language the noteholders were bound to apply a "first in first out" approach or to retire the oldest debt first.

[40] On the other hand, the noteholders did allocate the debt and set out the allocation in a detailed schedule. The noteholders are bound by that allocation and cannot now reallocate the payments. In the schedule to the agreement, the payments are allocated to outstanding amounts owed to "Nomis", "BPY" and "Dominion" but also to "MMCAP". The only debt to MMCAP was under the March notes whereas the other noteholders had notes from both February and March. I agree with the Trustee that the payments to Nomis, BPY and Dominion would be allocated to the amounts owing under the February notes but it seems clear that the amount owing to MMCAP could not have been.

[41] It follows that there remains US$828,000.00 owing from the original February advance and that amount together with accrued interest should be recognized as an unsecured debt owing to Dominion on behalf of the noteholders by both Vitality and Artiva pursuant to their guarantees.

[42] I understand there is a dispute about interest. This was not fully argued because it applied to the Eureka insolvency. In the case of Vitality and Artiva, there was no calculation of interest because the debt was disallowed. The notes bear interest at 10%. They are described as "10% senior secured notes" although the noteholders claim accelerated interest, additional interest and penalties of 21% or more. For purposes of the proposals, it would be reasonable to recognize simple interest at 10%. This amount can be readily calculated and is clearly within the scope of the guarantee.

[43] For purpose of voting, the debt should be recognized as bearing interest at 10% from the date of the New Mexico write down until the date of filing of the intended proposal.

Summary and Conclusion

[44] There is a distinction between a debt instrument and a security agreement. In this case I generally agree with the findings of the Trustee that Artiva and Vitality were only indebted to the noteholders for the amount covered by their original guarantees although they had granted security over their assets to secure all of the debts incurred by Eureka to the noteholders.

[45] I have found however that the Trustee was in error in allocating all of the New Mexico credit to the first notes and hence to the guaranteed amount. US$828,000.00 of that amount

remains outstanding. For voting purposes, the noteholders are entitled to be recognized as unsecured creditors for that amount plus interest at 10% from December 18, 2019 to the date that the intended proposal was filed.

[46] Apart from that significant variation, the determination of the Trustee is upheld and the appeal is otherwise dismissed.

[47] Success was to some degree divided but I will hear submissions on costs if that is necessary. The noteholders have posted security and that amount is held by their solicitor in trust pending further order. Evidently an order will be necessary if no agreement is reached.

C. MacLeod RSJ Digitally signed by C. MacLeod RSJ
Date: 2020.10.06 09:52:18 -04'00'

Mr. Justice C. MacLeod

Date: October 5, 2020

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DECISION AND REASONS

Mr. Justice C. MacLeod

Released: October 5, 2020