

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

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

**AND IN THE MATTER OF A PLAN OF
COMPROMISE OR ARRANGEMENT WITH RESPECT TO
JTI-MACDONALD CORP.**

**SUPPLEMENTAL TO THE FOURTH REPORT OF THE MONITOR
JUNE 25, 2019**

INTRODUCTION

1. This report (the “**Supplemental Report**”) is supplemental to the Fourth Report of Deloitte Restructuring Inc. in its capacity as Court-appointed monitor (the “**Monitor**”) of JTI-Macdonald Corp. (“**JTIM**” or the “**Applicant**”) dated June 21, 2019 (the “**Fourth Report**”). Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the Fourth Report.
2. The Fourth Report, among other things, was filed in support of JTIM’s motion seeking to extend the Stay Period to December 16, 2019 and to advise the Court on activities of the Monitor and the Applicant since the issuance of the First Report. The Monitor has since reviewed the Responding Motion Record and Factum of the QCAPs served on June 21, 2019 (collectively, the “**QCAPs Motion Materials**”), and provides this Supplemental Report in respect thereof for the assistance of the Court.

3. In the QCAPs Motion Materials, the QCAPs allege that, as a result of the TM Receiver exercising set-off rights against the Deposit to satisfy unpaid royalty payments, JTIM permitted the TM Receiver to circumvent the March 19 Endorsement. The QCAPs are critical that “the Applicant JTIM and its Monitor did not take any action to prevent this breach.” A copy of the March 19 Endorsement and an Unofficial Transcription thereof is attached as Appendix “A”.
4. The QCAPs seek an order directing the TM Receiver to pay any amounts set off by the TM Receiver against the Deposit to JTIM.

PURPOSE

5. The purpose of this Supplemental Report is to provide the Court with the Monitor’s views in connection with the matters raised in the QCAPs Motion Materials.

MONITOR’S VIEWS

6. The Monitor was advised by the TM Receiver that it intended to exercise set-off rights against the Deposit, which the Monitor reported in its Fourth Report. The Monitor did not object to the TM Receiver’s intention to exercise set-off rights having considered, in consultation with its independent legal counsel, the following:

- a) The existence of the Deposit, its purpose and the contractual terms governing the TM Receiver's set-off rights (the "**Amended License Agreement**") were fully disclosed in the application materials of JTIM that commenced the CCAA Proceedings;¹
- b) The Deposit has been held by the TM Receiver since January 2018 and the Monitor was not aware of any basis to compel the return of the Deposit to JTIM, nor had any stakeholder asserted that the Deposit should be repaid to the estate;
- c) The Amended License Agreement provides rights to the TM Receiver to exercise set-off against the Deposit of any outstanding liabilities;
- d) The Monitor understands that CCAA case law in Ontario has concluded that, in light of Section 21 of the CCAA which expressly preserves set-off rights in CCAA proceedings, set-off rights can only be stayed on a "temporal" basis with express language;²
- e) The March 19 Endorsement did not contain any such express language to stay the TM Receiver's set-off rights. In fact, the March 19 Endorsement noted that the Court was advised that "if pre-filing royalties are not paid they will be deducted from a deposit held by TM"; and

¹ Affidavit of Robert McMaster sworn March 8, 2019 at para 29 and Exhibit C.

² See *Re Air Canada*, 2003 CarswellOnt 4016 (Ont. S.C.J. [Commercial List]) and *Tucker v. Aero Inventory (UK) Ltd.* 2009 CarswellOnt 7007 (Ont. S.C.J. [Commercial List]).

- f) The Deposit held by the TM Receiver were not funds to which JTIM had access;
as a result, the set-off if exercised would not result in prejudice to the estate.

All of which is respectfully submitted this 25th day of June, 2019.

**Deloitte Restructuring Inc.,
Solely in its capacity as Court-appointed Monitor
of JTIM and not in its personal capacity**

A handwritten signature in black ink, appearing to read "P. Casey".

Per:
Paul M. Casey, CPA, CA, FCIRP, LIT
Senior Vice-President

APPENDIX “A”

Superior Court of Justice
Commercial List

FILE/DIRECTION/ORDER

Re: JTI Macdonald Corp

Plaintiff(s)

AND

Defendant(s)

Case Management Yes No by Judge: McBwen

Counsel	Telephone No:	Facsimile No:
(see attached)		

- Order Direction for Registrar (No formal order need be taken out)
- Above action transferred to the Commercial List at Toronto (No formal order need be taken out)
- Adjourned to: _____
- Time Table approved (as follows): _____

The Quebec Class Action Plaintiffs ("the Plaintiffs") bring this motion seeking an order suspending the operation of paragraphs 8(c) and 8(d) of the Initial Order of Justice Heiney dated March 8, 2019 (the "Initial Order") thus prohibiting the payments of principal, interest and royalties to JTI-Macdonald TM Corp.

19 March 19

Date

McBwen

Judge's Signature

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pending further Order of the Court.

The Plaintiffs also seek an Order permitting them to oppose or seek a variation of the Initial Order at the comeback hearing scheduled for April 4 and 5, 2019.

The Plaintiffs are supported by HMA for Ontario.

JTI Macdonald Corp (JTIM) opposes the relief sought. It is supported by JT Canada LLC and PWC, as well as the Monitor.

For the reasons below I am prepared to grant the relief sought pending the return of the comeback hearing or further order made by me as the case management judge.

The plaintiffs raise a number of arguments primarily as follows:

- JTIM did not disclose to

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Judges Endorsment Continued

Justice Heiney the negative comments made by Justice Riordan against ITIM and ITI-Macdonald TM Corp ("TM") with respect to their inter-company contracts concerning payments of principal, interest and royalties: see in particular paras: 1095-97, 1101, 1103 and 2141;

- The affidavit of Robert McMaster filed in support of the Application was vague regarding potential adverse tax consequences;
- When ITIM obtained an initial order from Justice Farley in August 2004 these same payments to TM were not requested nor made;
- subsequent to the order of Justice Farley at various times royalty payments and interest were not paid or in the case of interest the

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Judges Endorsment Continued

interest rates reduced;

• ITIM also did not disclose to Justice Harey comments made by Justice Schragar who heard a motion to have ITIM and others post security; see in particular paras 42 and 52.

Based on the foregoing the Plaintiffs submit the Intercompany Royalty and Interest payments that are scheduled to take place before the comeback hearing ought to be suspended. They argue that ITIM had an obligation to put all of the above information before Justice Harey and failed to do so. Based on the above the Plaintiffs claim that there is nothing to suggest that ITIM or TM will be prejudiced if the payments stopTM and that the payments, in any event, are a sham.

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FILE/DIRECTION/ORDER

Judges Endorsment Continued

Last, the Plaintiffs submit that it is unfair to allow JTIM to continue to make the payments in the above circumstances. It is not in keeping with the purpose of the CCAA and payments ought to be suspended pending an opportunity to adjudicate the matter at the comeback hearing.

JTIM vigorously opposes the relief sought primarily submitting as follows:

- The proper materials were before Justice Hume;
- The decision of Justice Mangan in effect "cancels out" the comments made by Justice Riordan;
- The relief sought is designed to inflict pain on a secured creditor;
- There is no request to pay principal and none will be paid absent a

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Judges Endorsment Continued

Further Order of this court;

- if pre-filing royalties are not paid they will be deducted from a deposit held by TM
- royalties going forward must be paid pursuant to the provisions of s.11 of the CCAA;
- with respect to the issue of interest, it is a secured debt and its suspension could lead to an enormous debt later as it will compound - this would adversely affect plaintiffs in all actions;
- there is a repayment agreement in place to satisfy an judgment with a properly capitalized entity - IT International Holding B.V., with respect to interest (not royalties);
- the Monitor approved ITIM's submissions and neither ITIM or for that fact the Monitor sought to TM in any

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FILE/DIRECTION/ORDER

Judges Endorsment Continued

way mislead the Court or provide insufficient information

JUSTICE submits that it is premature to grant the orders sought. I disagree. ✓

While I am not prepared to cast aspersions with respect to the material before Justice Hainey at this time the arguments raised by the Plaintiff persuade me that there should be a pause in the payments pending the return of the comeback hearing.

The comments of Justice Riordan¹ and Schrage raise clear concerns about the legitimacy of the inter-company contracts. Their decisions post-date the decision of Justice Mongean which was released pre-trial.

Further, given the history of

1. Justice Riordan's factual findings were upheld on appeal.

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Judges Endorsment Continued

reduced or lack of payments after the 2004 order of Justice Farley. I am not satisfied at this juncture that the adverse consequences described by Mr McMaster will be borne out. Further, as noted, the relief concerning principal interest and royalty payments was not sought before Justice Farley, nor granted.

In all of the above circumstances, pending the comeback hearing or further order, I agree with the Plaintiff that it is equitable to suspend the payments referred to at Tab DD of Vol 4 of the Application Record; namely the Intercompany Royalty and Interest payments (as well as any principal payments although as noted JTIM is not making these payments).

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Judges Endorsment Continued

There is no real prejudice to
TTIM or TM in allowing this
interim suspension pending the return of
the matter at the comeback hearing.

Based on the submissions I believe
that the only relevant payments the
Plaintiffs seeks ^{to} suspend are noted
at Tab DD above. If further
clarification is required I can be
spoken to as I appreciate that paras.
8 (c) and 8 (d) of Justice Haines
order are somewhat broader in
nature than the above-noted payments.

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**ONTARIO
SUPERIOR COURT OF JUSTICE
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**IN THE MATTER OF THE *COMPANIES' CREDITORS
ARRANGEMENT ACT, R.S.C. 1985, C.C-36 AS AMENDED***

**AND IN THE MATTER OF A PLAN OF COMPROMISE
OR ARRANGEMENT OF JTI-MACDONALD CORP.**

**UNOFFICIAL TRANSCRIBED ENDORSEMENT
OF JUSTICE MCEWEN**

March 19, 2019

The Quebec Class Action Plaintiffs (the "Plaintiffs") bring this motion seeking an order suspending the operation of paragraphs 8(c) and 8(d) of the Initial Order of Justice Hainey dated March 8, 2019 (the "Initial Order") thus prohibiting the payments of principal, interest and royalties to JTI-Macdonald TM Corp. pending further Order of the Court.

The Plaintiffs also seek an Order permitting them to oppose or seek a variation of the Initial Order at the comeback hearing scheduled for April 4 and 5, 2019.

The Plaintiffs are supported by HMQ for Ontario.

JTI-Macdonald Corp. ("JTIM") opposes the relief sought. It is supported by JT Canada LLC and PWC, as well as the Monitor.

For the reasons below I am prepared to grant the relief sought pending the return of the comeback hearing or further order made by me as the case management judge.

The Plaintiffs raise a number of arguments primarily as follows:

- JTIM did not disclose to Justice Hainey the negative comments made by Justice Riordan against JTIM and JTI-Macdonald TM Corp. ("TM") with respect to their inter-company contracts concerning payments of principal, interest and royalties: see in particular paras. 1095-97, 1101, 1103 and 2141;
- the affidavit of Robert McMaster filed in support of the Application was vague regarding potential adverse tax consequences;
- when JTIM obtained an initial order from Justice Farley in August 2004 these same payments to TM were not requested nor made;
- subsequent to the order of Justice Farley at various times royalty payments and interest were not paid or in the case of interest the interest rates reduced;

- JTIM also did not disclose to Justice Hainey comments made by Justice Schragger who heard a motion to have JTIM and others post security: see in particular paras. 42 and 52.

Based on the foregoing the Plaintiffs submit the Intercompany Royalty and Interest payments that are scheduled to take place before the comeback hearing ought to be suspended. They argue that JTIM had an obligation to put all of the above information before Justice Hainey and failed to do so. Based on the above the Plaintiffs claim that there is nothing to suggest that JTIM or TM will be prejudiced if the payments stop and that the payments, in any event, are a sham.

Last, the Plaintiffs submit that it is unfair to allow JTIM to continue to make the payments in the above circumstances. It is not in keeping with the purpose of the CCAA and payments ought to be suspended pending an opportunity to adjudicate the matter at the comeback hearing.

JTIM vigorously opposes the relief sought primarily submitting as follows:

- the proper materials were before Justice Hainey;
- the decision of Justice Mongeon in effect “cancels out” the comments made by Justice Riordan;
- the relief sought is designed to inflict pain on a secured creditor;
- there is no request to pay principal and none will be paid absent a further Order of this court;
- if pre-filing royalties are not paid they will be deducted from a deposit held by TM;
- royalties going forward must be paid pursuant to the provisions of s.11 of the CCAA;
- with respect to the issue of interest, it is a secured debt and its suspension could lead to an enormous debt later as it will compound – this would adversely affect plaintiffs in all actions;
- there is a repayment agreement in place to satisfy any judgment with a properly capitalized entity – JT International Holding B.V., with respect to interest (not royalties);
- the Monitor approved JTIM’s submissions and neither JTIM or for that fact the Monitor sought to, in any way mislead the Court or provide insufficient information.

JTIM therefore submits that it is premature to grant the orders sought.

I disagree.

While I am not prepared to cast aspersions with respect to the materials before Justice Hainey at this time the arguments raised by the Plaintiffs persuade me that there should be a pause in the payments pending the return of the comeback hearing.

The comments of Justice Riordan¹ and Schragger raise clear concerns about the legitimacy of the inter-company contracts. Their decisions post-date the decision of Justice Mongeon which was released pre-trial.

¹ Justice Riordan’s factual findings were upheld on appeal.

Further, given the history of reduced or lack of payments after the 2004 order of Justice Farley I am not satisfied at this juncture that the adverse consequences described by Mr. McMaster will be borne out. Further, as noted, the relief concerning principal, interest and royalty payments was not sought before Justice Farley, nor granted.

In all of the above circumstances, pending the comeback hearing or further order, I agree with the Plaintiffs that it is equitable to suspend the payments referred to at Tab DD of Volume 4 of the Application Record; namely the Intercompany Royalty and interest payments (as well as any principal payments although as noted JTIM is not making these payments).

There is no real prejudice to JTIM or TM in ordering this interim suspension pending the return of the matter at the comeback hearing.

Based on the submissions I believe that the only relevant payments the Plaintiffs seek to suspend are noted at Tab DD above. If further clarification is required I can be spoken to as I appreciate that paras. 8(c) and 8(d) of Justice Hainey's order are somewhat broader in nature than the above-noted payments.

McEwen J.