

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

B E T W E E N:

EMERALD CASTLE DEVELOPMENTS INC.

Applicant

- and -

FAAN MORTGAGE ADMINISTRATORS INC., in its capacity as the Court-Appointed Trustee
of BUILDING & DEVELOPMENT MORTGAGES CANADA INC. formerly known as
CENTRO MORTGAGE INC., and OLYMPIA TRUST COMPANY

Respondents

APPLICATION UNDER SECTION 37 OF THE *MORTGAGE BROKERAGES, LENDERS AND ADMINISTRATORS ACT*, 2006, S.O. 2006, C. 29; SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990 c. C. 43, and *Rule 14.05(3)(d) of the RULES OF CIVIL PROCEDURE*, R.S.O. 1990, Reg. 194, as amended

RESPONDING FACTUM OF THE INVESTORS

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FACTUM OF THE INVESTORS

PART I - OVERVIEW

1. This Factum is delivered on behalf of 453 individual investors (the “**Investors**”) in connection with an application brought by Emerald Castle Developments Inc. (“**Emerald**”). Emerald is the borrower under a loan agreement pursuant to which it received a syndicated mortgage loan for approximately \$21.2 million from funds raised from the Investors for the development of residential homes (the “**Project**”) on a 48-acre property in Brampton, Ontario (the “**Property**”). The amount currently owed under that loan is approximately \$30 million, excluding costs.¹

¹ Factum of FAAN Mortgage Administrators Inc. (“**FAAN**” or the “**Trustee**”) dated October 8, 2020 (“**FAAN Factum**”) at para. 1.

2. Emerald now asks this Court for declaratory relief which would allow it to pay approximately \$9 million in exchange for a discharge and a release of liability to the Respondent, Building & Mortgages Development Canada Inc. (“**BDMC**”) or the Investors, leaving more than \$20 million that would remain unpaid to the Investors.

3. More than six years after having willingly accepted the funds loaned by the Investors, Emerald is now seeking an outcome that would result in: (a) the Investors receiving only a fraction of their original principal investment instead of their principal, interest and potential profit as they were promised; and (b) Emerald retaining the property that was charged with a mortgage in favour of the Investors, which it claims to be worth [REDACTED] in its current vacant state, and bringing its contemplated development to fruition for its own exclusive profit.

4. This Court should dismiss Emerald’s application because the End of Term Event clause is not enforceable. Emerald’s interpretation of the clause is manifestly unfair and was not adequately disclosed to Investors prior to them making their investment. Alternatively, if the End of Term Event clause is held to be enforceable, the Loan Agreement should be interpreted to allow for only a partial release of the BDMC security and debt in the amount of the payment tendered by Emerald.

PART II - FACTS²

5. There are 453 investors in the loan to Emerald (the “**Loan**”) of which 289 investors, representing \$13.62 million or 64% of the Loan amount, advanced funds from their retirement

² For the purposes of this application, the Investors accept the facts as set out in the FAAN Factum.

accounts.³ Dr. Michael Pizzuto, who has submitted evidence in this proceeding, invested \$500,000 together with his wife, Sharron Pizzuto.⁴

A. Representations Made to Investors in Disclosure Inducing Investment

6. Investors were induced to participate in the Loan by (among other things) the following representations:

- a. the Investors would be provided with notice, appraisals and valuations before Emerald raised funds beyond the initial \$10 million advance;⁵
- b. the Loan was to be secured by a second-ranking mortgage on the Property ranking behind an existing mortgage on the Property in the amount of \$8.15 million;⁶
- c. the loan to value ratio for the investment was represented to be 57% for those who participated in the first \$10 million of advances, such that the Investor's loans were over-secured;⁷
- d. any fees for structuring the mortgage were to be deferred and would become payable upon successful completion of the Project;⁸ and

³ FAAN's Seventeenth Report dated March 27, 2020, Application Record of the Applicant dated October 20, 2020 (the "**Application Record**") Volume III, Tab 7 at para. 29.

⁴ Affidavit of Michael Pizzuto sworn on March 16, 2020 (the "**Pizzuto Affidavit**"), Application Record Volume II, Tab 6 at paras. 19 and 24.

⁵ *Ibid* at para. 8(e) and 32; Exhibit C to the Pizzuto Affidavit, Application Record Volume II, Tab 6 at p. 2.

⁶ *Ibid* at para. 8(a) and (c); *Ibid*.

⁷ *Ibid* at para. 8(d); *Ibid*.

⁸ *Ibid* at para. 9; *Ibid*.

- e. the Investors stood to receive median rates of return based on 13.79% annually for a total return of approximately 55% if completed in 4 years, or an annual 8% return excluding any profit participation.⁹

i. Representations Regarding Further Borrowings under the Loan

7. Investors were informed that they would be provided with notice before Emerald raised funds beyond the initial \$10 million advance, and that they would be provided with appraisals showing increases in the value of the Property to justify the additional borrowings. The disclosure to Investors stated that “from time to time the loan amount will increase upon the completion of certain development and construction milestones on the Property by the Borrower”,¹⁰ and that in connection with all future amounts to be raised under the loan over and above the initial \$10 million, updated valuations/appraisals would be obtained “to substantiate increased property value”.¹¹

8. Contrary to the disclosure that Emerald would achieve certain milestones before raising funds beyond the initial \$10 million advanced, Emerald continued to borrow funds although no such development or construction milestones were ever achieved. By November 2015, Emerald had borrowed an additional \$11.25 million from other Investors despite failing to meet a single milestone.¹² Emerald did not provide any appraisals or other evidence to show that the value of the Property had increased to justify these additional borrowings, nor could it have given that no significant activity took place during this period.¹³

⁹ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 6.

¹⁰ Exhibit F to the Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 19.

¹¹ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 8(e); Exhibit C to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

¹² Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 33.

¹³ Responses to Written Interrogatories for Dr. Michael Pizzuto dated August 7, 2020 (“**Pizzuto Answers**”), Application Record Volume III, Tab 9 at Answer 9.

9. It appears that Emerald also did not comply with other reporting obligations under section 11 of the Loan Agreement, which required Emerald to provide, among other things: (a) cost consultant reports with each advance; (b) quarterly reports as to the status of all zoning and planning approvals and detailed annual reports; (c) monthly status reports; (d) financial reporting as to loan advances, sales reports, project expense reports; and (e) advice as to any material deviations to the Project Budget.¹⁴

ii. Representations Regarding Mortgage Priority

10. Investors were informed that the Loan was to be secured by a second-ranking mortgage on the Property ranking behind an existing mortgage on the Property in the amount of \$8.15 million.¹⁵ Investors were told that they would benefit from a charge against the Property securing the full principal amount of the Loan and all accrued interest ranking in priority to any of the claims, fees and other amounts now alleged by Emerald to reduce the amount payable in exchange for a discharge of the BDMC mortgage.¹⁶

11. Contrary to this disclosure, and unbeknownst to Investors, Emerald placed a mortgage on the Property in the amount of \$22 million in favour of “Emerald’s owners to secure their equity in the project”.¹⁷ This was not disclosed to Investors.¹⁸ Emerald takes the position that this mortgage ranks *pari passu* with the second-ranking charge in favour of BDMC, thereby effectively depriving the Investors of the benefit of most of the value of the collateral for the Loan.¹⁹

¹⁴ Exhibit H to the Pizzuto Affidavit, Application Record Volume II, Tab 6; Transcript of Cross-Examination of Desi Auciello dated July 8, 2020 (“**Auciello Cross**”), Application Record Volume III, Tab 12 at p. 49-50, q. 205-212.

¹⁵ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 8(a) and (c).

¹⁶ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

¹⁷ Factum of Emerald Castle Developments Inc. dated September 24, 2020 (the “**Applicant’s Factum**”) at para. 3.

¹⁸ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

¹⁹ Applicant’s Factum at para. 3.

12. Investors were not informed that their mortgage would have to compete for priority with a mortgage in favour of the owners of the Property.²⁰

13. In addition, Investors were told that their investment would be safe even if the Project failed:

“WHAT IF THE DEVELOPER OR DEVELOPMENT FAILS? A default would occur if the developer cannot pay back the funds by the maturity date of the contract. Centro Mortgage Inc., in advance, would work with the developer to find a solution that could include:

- A payment to investors in exchange for an extension
- An institutional refinance to buy out the Fortress Investors

If these cannot be achieved, then the process would commence to sell the property to recover the investor monies. This is a significant advantage to being secured via syndicate mortgage; recovery of your investment will take priority over all unsecured debts, monies owed by the corporation and even construction liens.²¹”

14. Investors were not made aware of any possibility that their investment was in jeopardy until after FAAN was appointed as Trustee by the Court.²²

iii. Representations Regarding Loan to Value Ratio

15. The Pizzutos advanced their \$500,000 in November 2014 in reliance on, among other things, a represented loan to value ratio of 57%.²³ This representation included three components: Emerald’s borrowing of \$10 million from Investors, the \$8.15 million first mortgage held by an unrelated third party, and an appraised value of \$32 million on an “as-is” and undeveloped basis as at July 4, 2014.

²⁰ Pizzuto Answer, Application Record Volume III, Tab 9 at Answer 9.

²¹ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 10(g).

²² *Ibid* at para. 49.

²³ *Ibid* at para. 8(d); Exhibit C to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

16. As previously explained, Emerald's initial borrowing of \$10 million was increased to \$21.2 million over just eleven months after the initial advance was made²⁴, although no development or construction milestones were achieved and without evidence of an increase in the value of the Property to justify these additional borrowings.

17. Emerald now takes the position that a previously undisclosed mortgage to a related party for \$22 million ranks equally with the BDMC mortgage²⁵, which is entirely inconsistent with the representation that the BDMC mortgage ranked subordinate only to the first-ranking \$8.15 million mortgage.

18. As for the representation of a \$32 million value for the Property, Emerald's evidence on this application is that the \$32 million valuation was not linked to the fair market value of the Property, but rather was just "based on the number [...] acceptable to [Emerald Castle]".²⁶

19. It therefore appears that every component of the representations regarding the loan to value ratio was known by Emerald to be false.

iv. Representations Regarding Payment of Fees

20. A Project Fact Sheet provided to Investors stated that any fees for structuring the mortgage were to be deferred and would become payable "based on the profitability and successful completion of this project".²⁷ Investors were led to believe that any fees would only be collected if the Project was completed and all principal and accrued interest was first returned to Investors.²⁸

²⁴ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 33.

²⁵ Applicant's Factum at para. 3.

²⁶ Auciello Cross, Application Record Volume III, Tab 12 at p. 105, q. 407; p. 106, q. 410-411.

²⁷ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 9; Exhibit C to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

²⁸ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 9.

21. In fact, Emerald has paid \$1.38 million to one of the Emerald owners since the date the loan was initially advanced for “project development work”.²⁹

22. Further, a copy of the Loan Agreement shown to the Pizzutos before they invested stated that total Project Management Fees for the Project would be \$5,950,000.³⁰ This was inconsistent with prior representations made to Dr. Pizzuto, and upon his request, a handwritten change was made to his Loan Agreement after his brokers consulted with a Fortress representative whereby they reduced the fee to \$2,580,000.³¹ Emerald states that it did not have knowledge about this revision and did not agree to it.³²

23. Investors now know that no more than approximately \$1 million of their \$21.2 million was used by Emerald to actually fund the development of the Project.³³ 35% of their \$21.2 million was paid to various parties for fees or commissions, most of which were related to Fortress.³⁴ Of the remaining 65%, \$12 million was paid out by Emerald to its owners as alleged “equity”.³⁵

v. Representations Regarding Expected Returns

24. Marketing material provided to Investors projected median rates of return based on internal pro-forma calculations to be 13.79% annually for a total return of approximately 55% if completed in four years.³⁶ Among other things, Investors were told that borrowers introduced by Fortress “are carefully screened and contribute their own equity and cash also at prescribed intervals”³⁷, that

²⁹ FAAN Factum at para. 4.

³⁰ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 29; Exhibit H to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

³¹ *Ibid.*

³² Auciello Cross, Application Record Volume III, Tab 12 at p. 123-124, q. 463-468.

³³ FAAN Factum at para. 18.

³⁴ *Ibid* at para. 17.

³⁵ *Ibid* at para. 18.

³⁶ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 6; Exhibit A to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

³⁷ *Ibid* at para. 10(f); Exhibit D to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

syndicated mortgages “provide investors with the ability to earn higher return through a deferred lender fee, while still maintaining solid security and collateral on their principal investment”³⁸, and that deferred lender fees could be earned “upon completion of the project”³⁹.

25. Further, the Project was promoted by Emerald and Fortress on the basis that it would contain 258 units, as stated in the Loan Agreement.⁴⁰ Emerald’s website for the Project states that the Project is to consist of approximately 300 units.⁴¹ Investors expected a higher return as a direct result of the number of units that would be sold. [REDACTED]

[REDACTED]

[REDACTED]

26. Each of the representations described in paragraphs 6 to 25 above induced Investors to advance funds. Investors were provided with some (but not all) of the documents pertaining to the Loan, but these complex documents were presented to Investors at the same time they were expected to execute documents to confirm their participation in the syndicated mortgage loan. Investors were not provided with an opportunity to obtain independent legal advice. Instead, Investors were offered a brief telephone consultation with a lawyer hired by Fortress during the appointment to execute their loan participation documents.⁴³

27. At no time prior to the Pizzutos advancing their funds was the End of Term Provision brought to their attention, nor was Emerald’s interpretation of the Loan Agreement explained to

³⁸ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 10(d); Exhibit D to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

³⁹ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 10(e).

⁴⁰ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9; Exhibit H to the Pizzuto Affidavit, Application Record Volume II, Tab 6 at Schedule “B”.

⁴¹ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

⁴² Exhibit G to the Affidavit of Desi Auciello sworn February 26, 2020 (“**Auciello Affidavit**”), Application Record Volume I, Tab 2.

⁴³ Pizzuto Affidavit, Application Record Volume II, Tab 6 at paras. 22-23.

them. When Dr. Pizzuto asked about the Waterfall provision, he was told that the provision was included to define the mechanism by which the cash flow profits realized upon completion of the Project would be distributed.⁴⁴ Investors were not informed that the waterfall provision would be applicable in any other circumstance, including project non-completion or default by Emerald.⁴⁵

B. Emerald Acceded to the Representations Made to the Investors

28. Emerald acceded to the representations made to the Investors. Among other things:

- a. Emerald directly participated in marketing the Project to the Investors; and
- b. Emerald negotiated for itself the right to approve all marketing material used by Fortress/BDMC to raise funds for the Project.

29. Emerald directly participated in marketing the Project to the Investors. Emerald had a dedicated website which included a promotional video by Desi Auciello promoting the attractive features of the Project and the expertise and dedication of Emerald as a developer.⁴⁶ In addition, an officer of Emerald, Ramsay Shaheen, attended a Fortress event at the TIFF Lightbox in September 2014 and spoke about the Castlemore project to prospective Fortress syndicated mortgage investors, including the Pizzutos.⁴⁷

30. Emerald and Fortress negotiated together on all of the details and terms of the various agreements in relation to the Loan before any of the Investors were induced to invest in this

⁴⁴ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 30.

⁴⁵ *Ibid.*

⁴⁶ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 1.

⁴⁷ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 12; Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

Project.⁴⁸ In his affidavit sworn November 11, 2019, Vince Petrozza, one of the Fortress principals, stated:

“Fortress entered into a Development Consultant Agreement (the “**DCA**”) with Emerald dated August 25, 2014. The DCA was a standard form of agreement which Fortress used to set out, amongst other things, its duties as Development Consultant in exchange for compensation in the form of fees and distribution of profits. The business deal behind the DCA was for Fortress to become an equal partner in the Project, but not to become an owner of the lands either directly or indirectly.”⁴⁹

31. In the DCA, Emerald secured for itself the right to pre-approve all marketing and advertising materials issued by Fortress.⁵⁰ The DCA was never provided to the Investors, nor were the terms of the DCA disclosed to Investors.⁵¹

32. Emerald was aware that Fortress would be raising the funds to be advanced under the Loan Agreement from members of the public.⁵² However, after having taken the benefit of the Loan, Emerald is now seeking to distance itself from the marketing materials that induced Investors to invest and which it negotiated to have the right to approve. At best, Emerald chose to not conduct any oversight on Fortress and what it advertised and represented to the Investors.

PART III - LAW AND ARGUMENT

33. For the purpose of this application, the Investors rely on the arguments as set out in FAAN’s Factum.

⁴⁸ Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

⁴⁹ *Ibid.*

⁵⁰ Exhibit C to Auciello Affidavit, Application Record Volume I, Tab 2 at section 8; Pizzuto Answers, Application Record Volume III, Tab 9 at Answer 9.

⁵¹ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 37; *Ibid.*

⁵² Auciello Cross, Application Record Volume III, Tab 12 at p. 93, q. 373-374; *Ibid.*

34. The declaratory relief sought by Emerald would be manifestly unjust to Investors and ought to be rejected based on the principles reaffirmed in the Court of Appeal for Ontario's decision in *MacQuarie Equipment Finance Ltd. v. 2326695 Ontario Ltd. (Durham Drug Store)*.⁵³

35. In *MacQuarie*, enforcing the termination clause would have meant that Durham Drug Store would have to keep paying for equipment even if the other parties defaulted in providing telemedicine services which would render the equipment useless. Similarly, the Investors would not have advanced their savings (including approximately \$13.62 million of registered retirement savings) if they had known that – contrary to the disclosure made to them - they would be precluded from enforcing the BDMC mortgage for the full amount of the Loan.⁵⁴

36. Neither the End of Term Event provision nor the Waterfall provision was brought to the attention of or explained to the Investors before or at the time their loan documentation was executed.⁵⁵ The Investors were not provided with an opportunity to carefully review the documents, nor did they receive independent legal advice.⁵⁶

37. Emerald's interpretations of the End of Term Event and Waterfall clauses are inconsistent with the representations made to Investors in the disclosure and marketing materials provided to them. These interpretations are predicated on Emerald having a *pari passu* mortgage, which is inconsistent with the representations made to Investors that:

- a. the Loan was to be secured by a second-ranking mortgage on the Property ranking behind an existing mortgage on the Property in the amount of \$8.15 million⁵⁷;

⁵³ *MacQuarie Equipment Finance Ltd. v. 2326695 Ontario Ltd. (Durham Drug Store)*, 2020 ONCA 139 (O.N.C.A.) [*MacQuarie*] at para. 33.

⁵⁴ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 43.

⁵⁵ *Ibid* at para. 30 and 45.

⁵⁶ *Ibid* at para. 27.

⁵⁷ *Ibid* at para. 8(c); Exhibit C to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

- b. their advances were over-secured based on the represented loan to value ratios; and
- c. they would receive projected median rates of return of approximately 55%.⁵⁸

38. In considering the unfairness to the Investors, the Court should also take into account other failures by Emerald to abide by the terms of the Loan represented to Investors, including:

- a. The failure to provide evidence of progress on development and/or construction milestones and of property value increases to justify additional borrowings under the Loan⁵⁹; and
- b. the payments of fees and application of the Investors' funds such that no more than approximately \$1 million of the \$21.2 million advanced by Investors was used by Emerald to actually fund the development of the Project⁶⁰.

39. The interpretation of the Loan Agreement advanced by Emerald would deprive the Investors of most of the value of their collateral for the Loan without their knowledge. The Investors would lose more than \$20.7 million on an investment they were assured was over-secured and for which they stood to receive a return of 55%.⁶¹ The effect of Emerald's undisclosed interpretation of the End of Term Event and Waterfall clauses on Investors would be financially catastrophic.

40. On the other hand, Emerald would gain a windfall. Emerald paid \$16.6 million for the Property and received over \$21 million of Investor funds (\$13.81 million on a net basis), of which

⁵⁸ Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 6; Exhibit A to the Pizzuto Affidavit, Application Record Volume II, Tab 6.

⁵⁹ Auciello Cross, Application Record Volume III, Tab 12 at p. 49-50, q. 205-212; Pizzuto Affidavit, Application Record Volume II, Tab 6 at para. 36.

⁶⁰ FAAN Factum at para. 18.

⁶¹ *Ibid* at para 2.

Emerald's owners have already recovered \$12 million personally.⁶² Emerald now seeks to pay approximately \$9 million to discharge a \$30 million debt and keep a property it claims to be worth [REDACTED], with the ability to reap all future profits from the development of the Project.

PART IV - ORDER REQUESTED

41. For the reasons set out above, the Investors respectfully request that this application be dismissed with costs payable on a full indemnity basis.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 13th day of October, 2020.



**CHAITONS LLP,
Court-Appointed Representative Counsel
for Investors**

⁶² FAAN Factum at para. 4.

SCHEDULE “A” – AUTHORITIES

1. *MacQuarie Equipment Finance Ltd. v. 2326695 Ontario Ltd. (Durham Drug Store)*, [2020 ONCA 139](#) (O.N.C.A.).